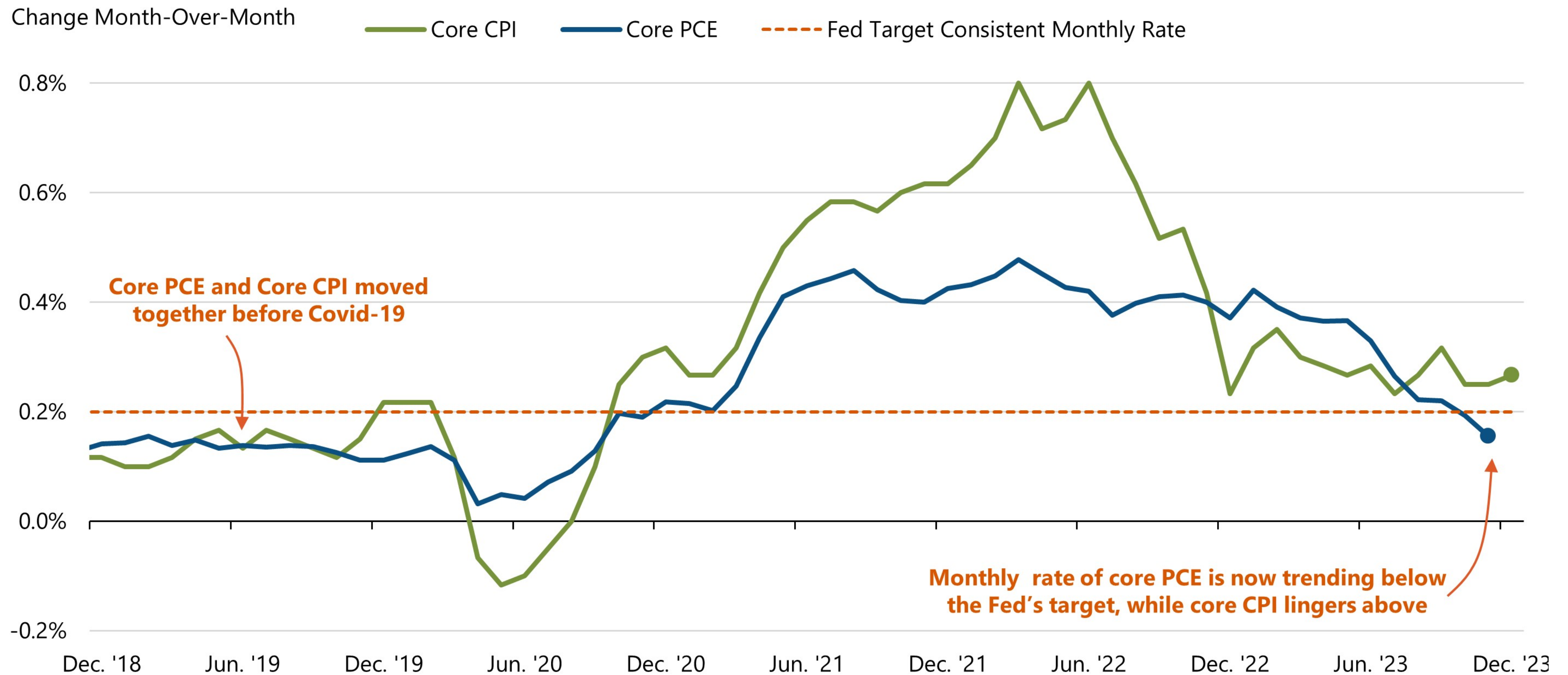


Wedge Worries

Monthly Change In Core CPI* Versus Core PCE⁺, 6-Month Moving Average

For The Week Ending 01/12/2024



Source: Bureau of Labor Statistics, Bureau of Economic Analysis

*Consumer Price Index (CPI), ⁺Personal Consumption Expenditures (PCE)

As enthusiasm for rate cuts continued to move markets this week, December's Consumer Price Index (CPI) showed price pressure remained sticky during the month, with the core (excluding food and energy) index rising 0.3% for the month and 3.9% for the year. The 6-month average monthly rate of core CPI (one way to gauge underlying price trends) is 0.27%. Compare that to the Fed's preferred inflation gauge, the core PCE, which has averaged a much softer 0.15% over the same period. What explains the "wedge"? One significant factor is the weight of shelter in CPI (~35%) versus PCE (~24%). Shelter prices rose 6.2% over the last year, contributing to a larger rise in core CPI than core PCE. So, should the Fed and investors ignore core CPI and cling to core PCE? We're reluctant to endorse this view since both gauges moved together pre-Covid. Further, even if we exclude shelter, CPI core services ex-shelter still rose 0.32% month-to-month on a six-month average. While core inflation may continue to cool in 2024, watch the wedge and be realistic about the path.