



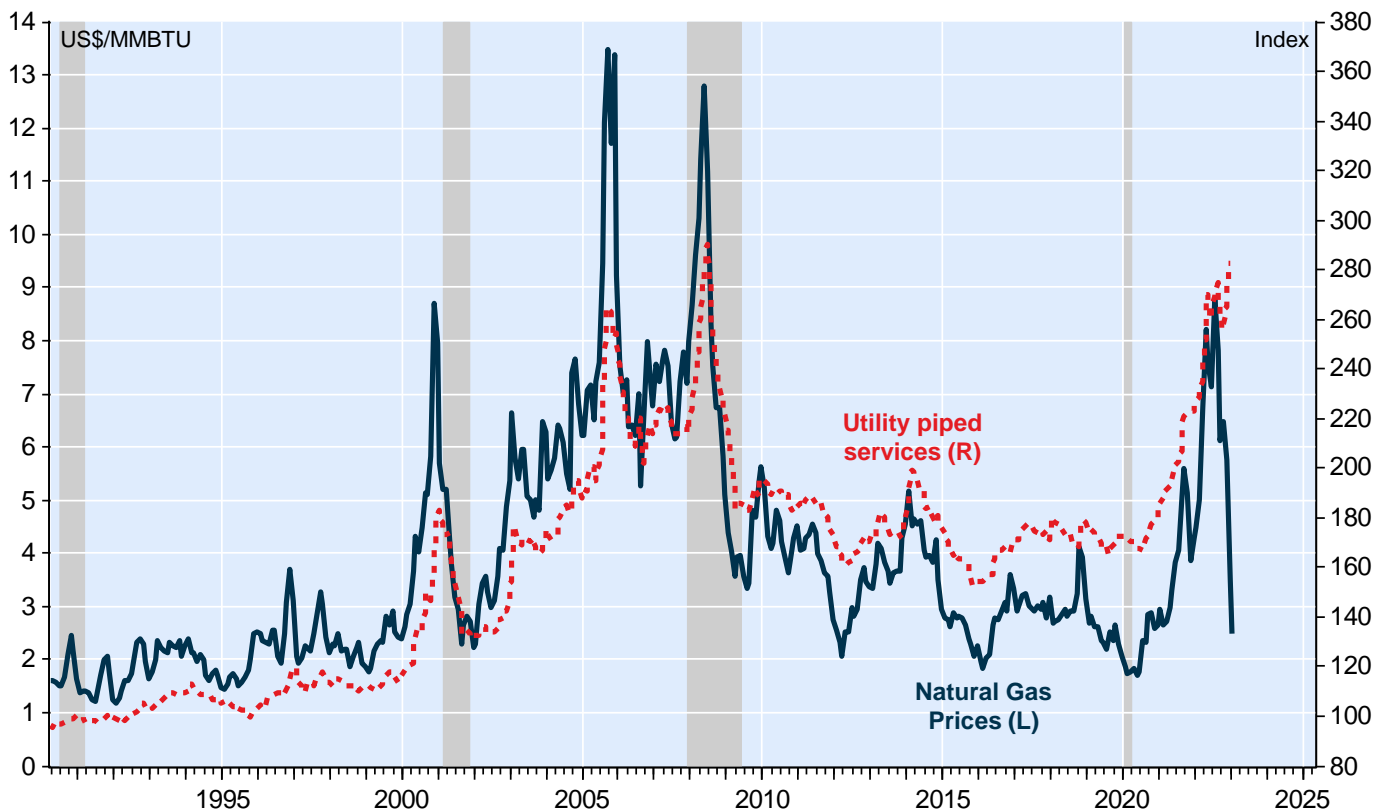
U.S. Watch

By Jocelyn Paquet

Three days after its release, January's CPI report continues to make headlines in the United States, with the narrative surrounding the news actually getting more and more negative as time goes by, with some pundits describing this week's data as troubling or claiming altogether that disinflation has stalled. To be fair, the latest inflation numbers could hardly be described as encouraging, but we still believe that the prevailing pessimism is somewhat exaggerated. On a twelve-month basis, inflation was indeed higher than expected in January but, as has been the case for several months, headline numbers painted an incomplete picture of the situation. A big chunk of the monthly increase in prices was due to a +0.7% gain in the shelter component which did not reflect the current situation in the real estate market. Recall that price movements in the housing sector are typically reflected with a big lag which means that the current drop in house prices, and the stabilization in rent prices, will therefore not be felt in inflation data until the middle of the year. January's numbers were also skewed by a surge in the index tracking utility piped services (+6.7% m/m). As today's Hot Chart shows, these tend to be tightly correlated with wholesale gas prices. Knowing that these have collapsed over the past few weeks, we expect a series of negative results in this category in the coming months. And although some will brush off these declines by saying that movements in the energy segment are of little importance, we would point out that the Fed is targeting *headline* prices. It's true that it has recently put much more emphasis on the price of core services excluding rent of shelter but, even on that front, the news wasn't too bad in January, with the associated index rising just 0.24% m/m and tracking a 3.6% annualized increase over the past three months, not that far above its long-term average (3.0% since 1998). No, January's CPI data were not ideal, but we haven't yet given up hope to see inflation come down closer to the Fed's target by year end.

U.S.: Gas prices as expressed within CPI report due for a major correction

CPI for utility piped (gas) services vs. natural gas prices for delivery in the U.S.



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