FLORIDA PRIME™

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What's a central bank to do?

Last week brought good news to those—pretty much every American—who have hoped the retracement in the annualized inflation rate in November was a sign it had finally peaked. The year-over-year increase of the Consumer Price Index that month was 7.1%, comparing favorably from October's 7.7% rise. It actually fell 0.1% in from November to December, putting it at "only" 6.5%. That's a long way from June's 9.1% y/y increase, but it is still higher than the Fed's 2% goal. Some of the decrease is due to lower energy prices, but core CPI—which strips out that element (as well as food costs)—also fell significantly. It was 6% y/y in November, but fell to 5.7% in December.

Monetary policymakers likely are less sanguine about this improvement. Or, more to the point, they have made clear they aren't going to claim victory until the downward trend continues for many months. We expect they will raise the federal funds rate 0.50% at their next meeting, taking place the first week of February. A 0.25% hike is possible if data shows the economy is slowing rapidly. It is a delicate time, as a hike of lesser magnitude might brighten investors' outlook for when the Fed will pause and then reduce rates. Policymakers are keen to avoid that.

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