

## January PPI, Small Business Confidence, Fed Speak

### *Producer Prices Hotter than Expected, Fed Hike Earlier?*

- The Producer Price Index for Final Demand increased by a greater-than-expected 0.6 percent in January.
- Core Producer Prices gained a calmer 0.2 percent.
- The NFIB's Small Business Optimism Index remained high, at 105.9 in January, after surging in December.
- FOMC Chair Janet Yellen began two days of testimony to Congress this morning.

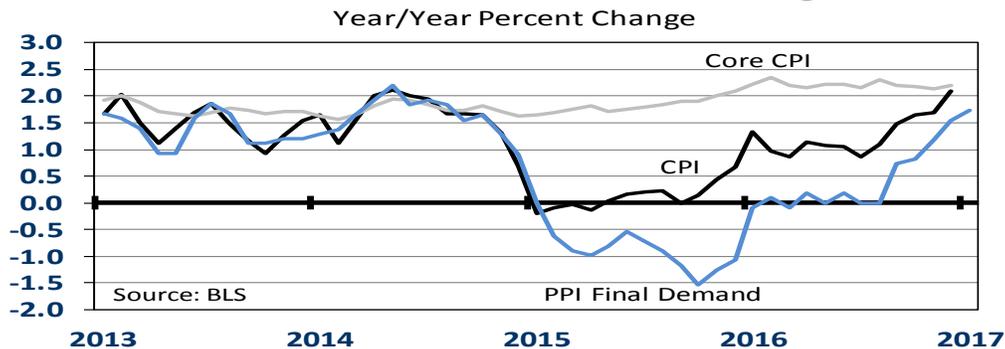
The Producer Price Index for Final Demand was hotter than expected in January, increasing by 0.6 percent for the month. The push came from the goods side, where energy prices gained 4.7 percent for the month. Prices for services warmed up by 0.3 percent in January. Over the previous 12-month period, the headline Producer Price Index is up by 1.6 percent. Year ago comparisons for energy prices will be hot over the next few months reflecting the dive in oil prices to a daily low of \$26 per barrel for WTI last February. Reports of production restraint by OPEC members are supporting WTI crude oil in the range of \$52-\$54 per barrel so far this year, a 100 percent year-over-year price gain. Core producer prices (final demand less food, energy and trade) gained 0.2 percent in January and were also up 1.6 percent over the previous 12 months. Energy price swings are often characterized as "transient," so the Fed does not want to set interest rate policy solely based on higher energy prices. But higher energy prices will squeeze margins for a wide spectrum of industries, eventually resulting in a broader inflationary push.

The National Federation of Independent Business's Small Business Optimism Index for January retained its elevated position from December. In December, the headline index shot up to 105.8 after years of grudging gains since the Great Recession. In January, the index ticked up to 105.9. The price changes index flipped to positive last October and has stayed there through January, indicating a positive net percent of businesses have raised their prices. This also adds a little heat to inflation expectations.

Dallas Federal Reserve Bank President Robert Kaplan released a thought piece this morning. He is a new voting member of the Federal Open Market Committee this year. According to Kaplan, inflation will reach the Fed's target over the medium term. He favors taking small steps to normalize interest rates sooner rather than later so that the Fed's removal of accommodation can remain gradual. In her prepared remarks, FOMC chairwoman Janet Yellen told the Senate Committee on Banking, Housing and Urban Affairs that further gradual increases in the fed funds rate will be warranted. Further, she said "waiting too long to remove accommodation would be unwise." The combination of Yellen's and Kaplan's comments this morning should pull expectations for the next fed funds rate increased forward. According to the fed funds futures market, the implied probability of a March 15 fed funds rate hike have increased a bit to 13.3 percent. The cumulative probability for a May 3 rate hike is 37.4 percent. June 14 gets a cumulative probability of 72.0 percent.

**Market Reaction:** U.S. equity markets fell at the opening. The yield on 10-Year Treasury bonds is up to 2.48 percent. NYMEX crude oil is up to \$53.37/barrel. Natural gas futures are down to \$2.91/mmbtu.

### Inflation Indicators Normalizing



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