The U.S. Inflation Outlook

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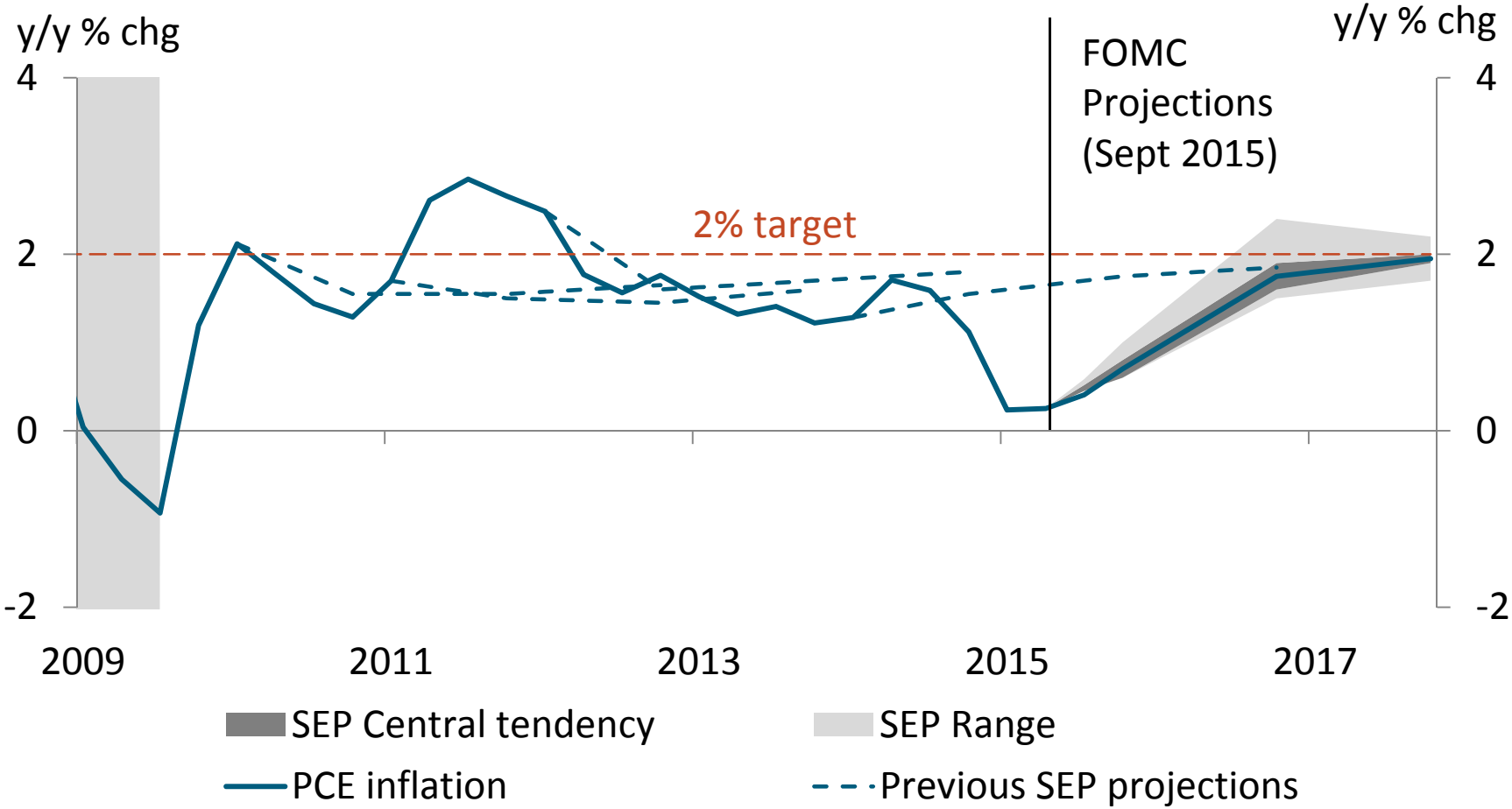
*The views expressed herein are those of the authors and do not necessarily represent those of the Federal Reserve Bank of Kansas City or the Federal Reserve System.

Inflation themes

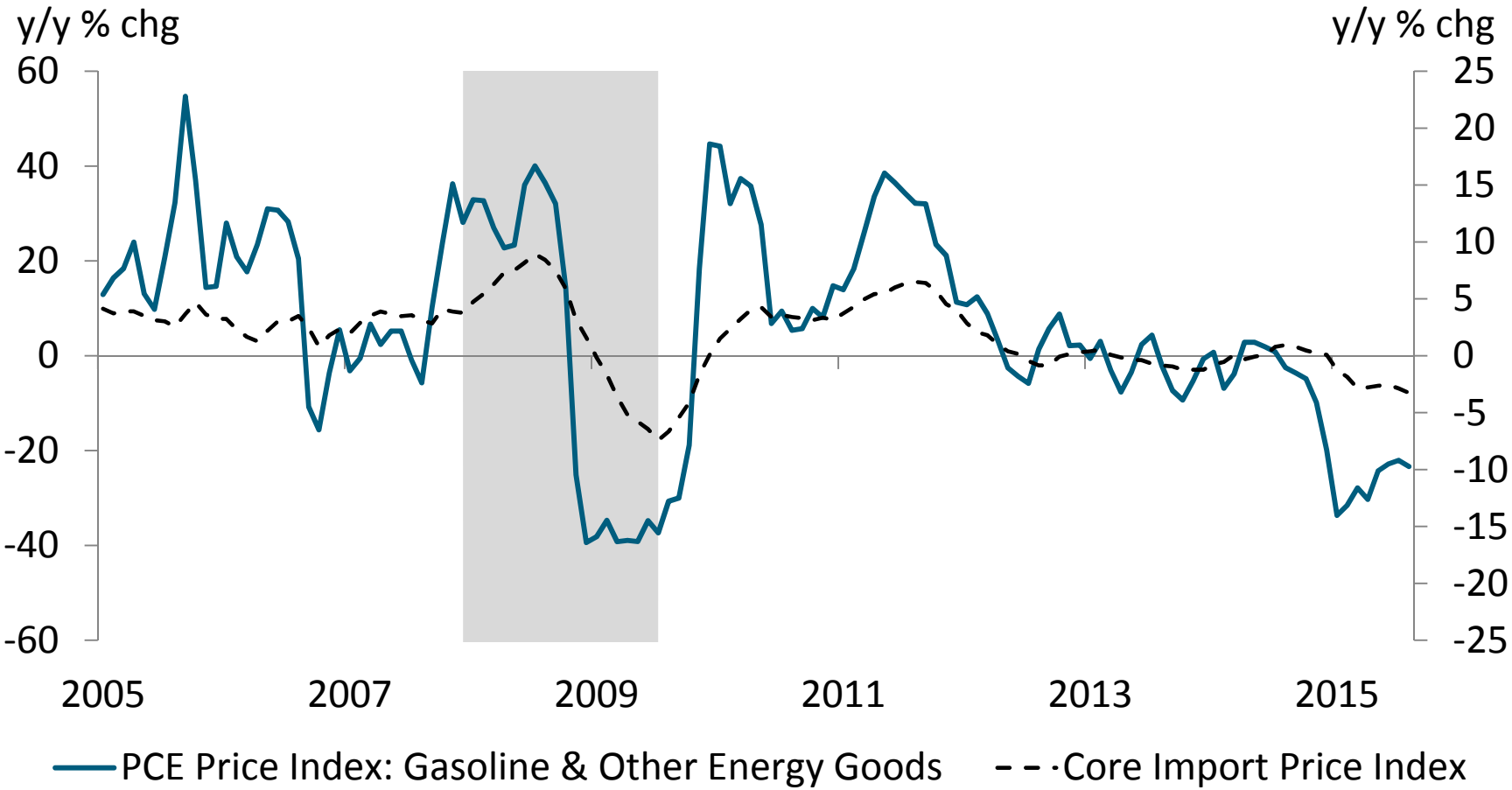
- Inflation has been running below the Fed's 2% target since mid-2012
- The baseline case is for inflation to return gradually to 2%
  - 1.9% in 2017 (FOMC median, SPF median, both q4/q4)
- In the near term, stabilizing energy prices to support inflation
- In the medium term, diminishing labor market slack and a stabilizing foreign exchange value of the USD are expected to support inflation

The median forecast of FOMC participants has inflation moving gradually toward 2%



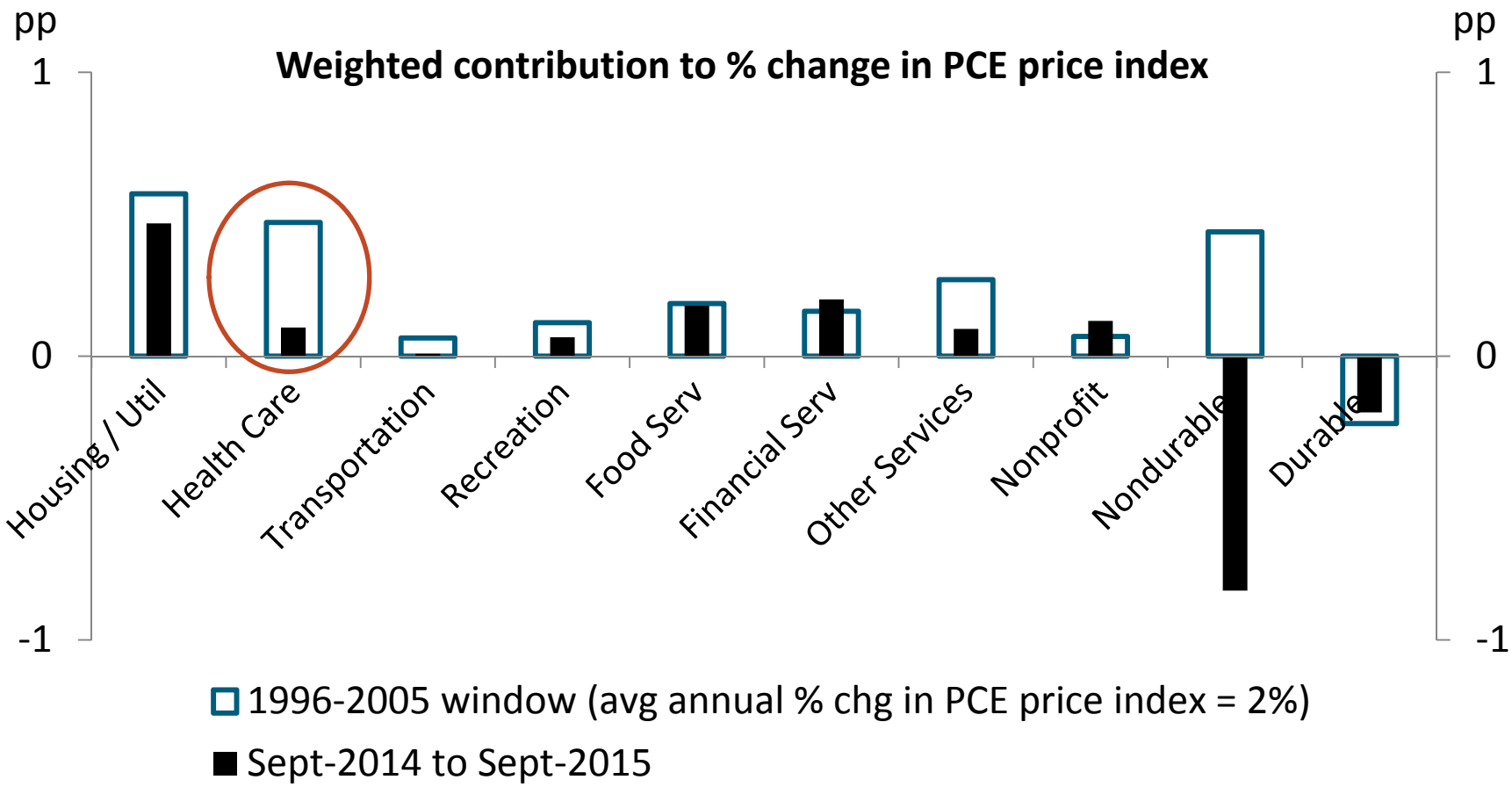
Source: Bureau of Economic Analysis, Federal Reserve Board, NBER, Haver Analytics

Falling energy and import prices have weighed on inflation



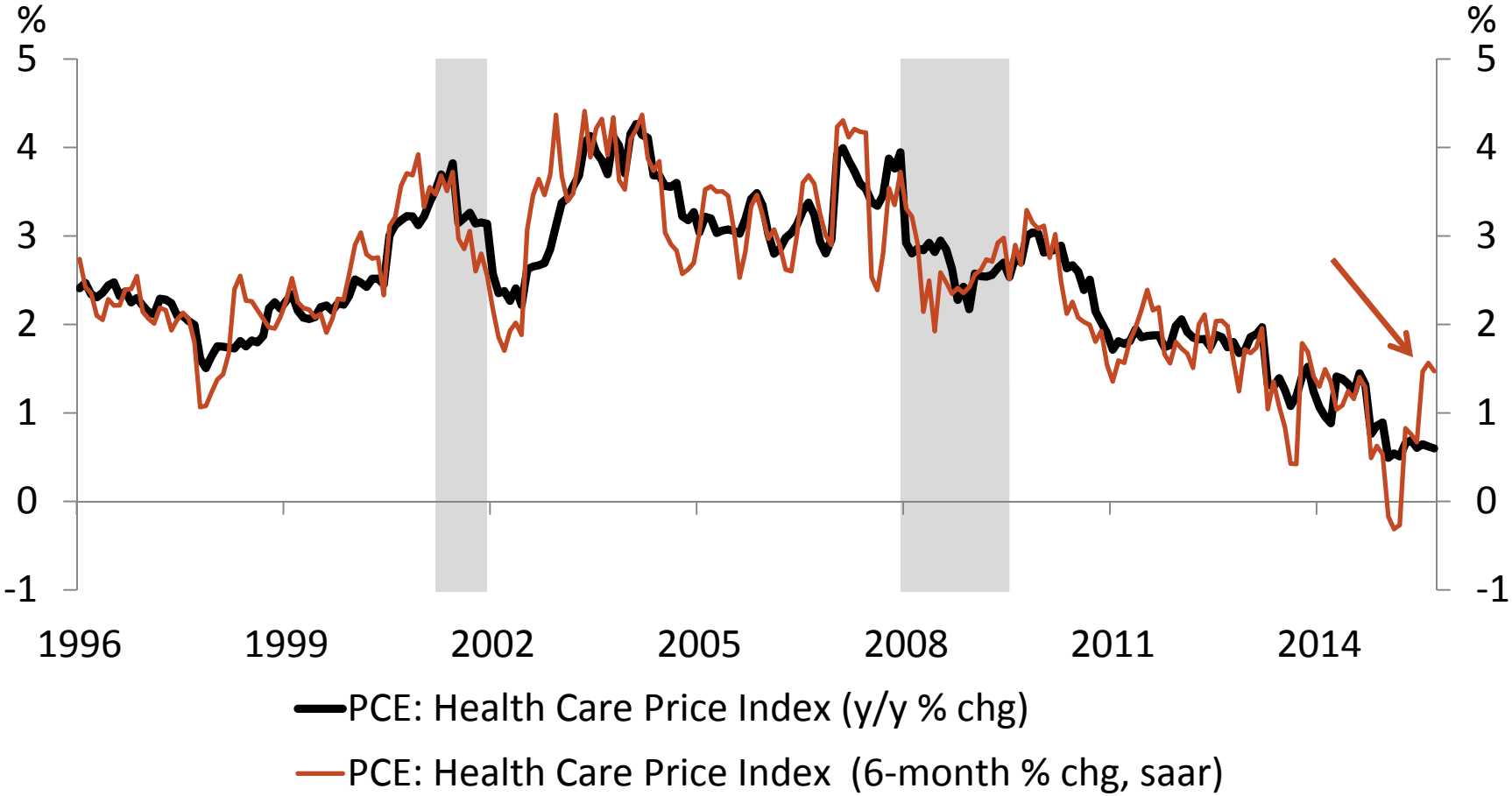
Source: Bureau of Economic Analysis, Bureau of Labor Statistics, NBER, Haver Analytics

Health care service inflation has also been weighing on core PCE price inflation



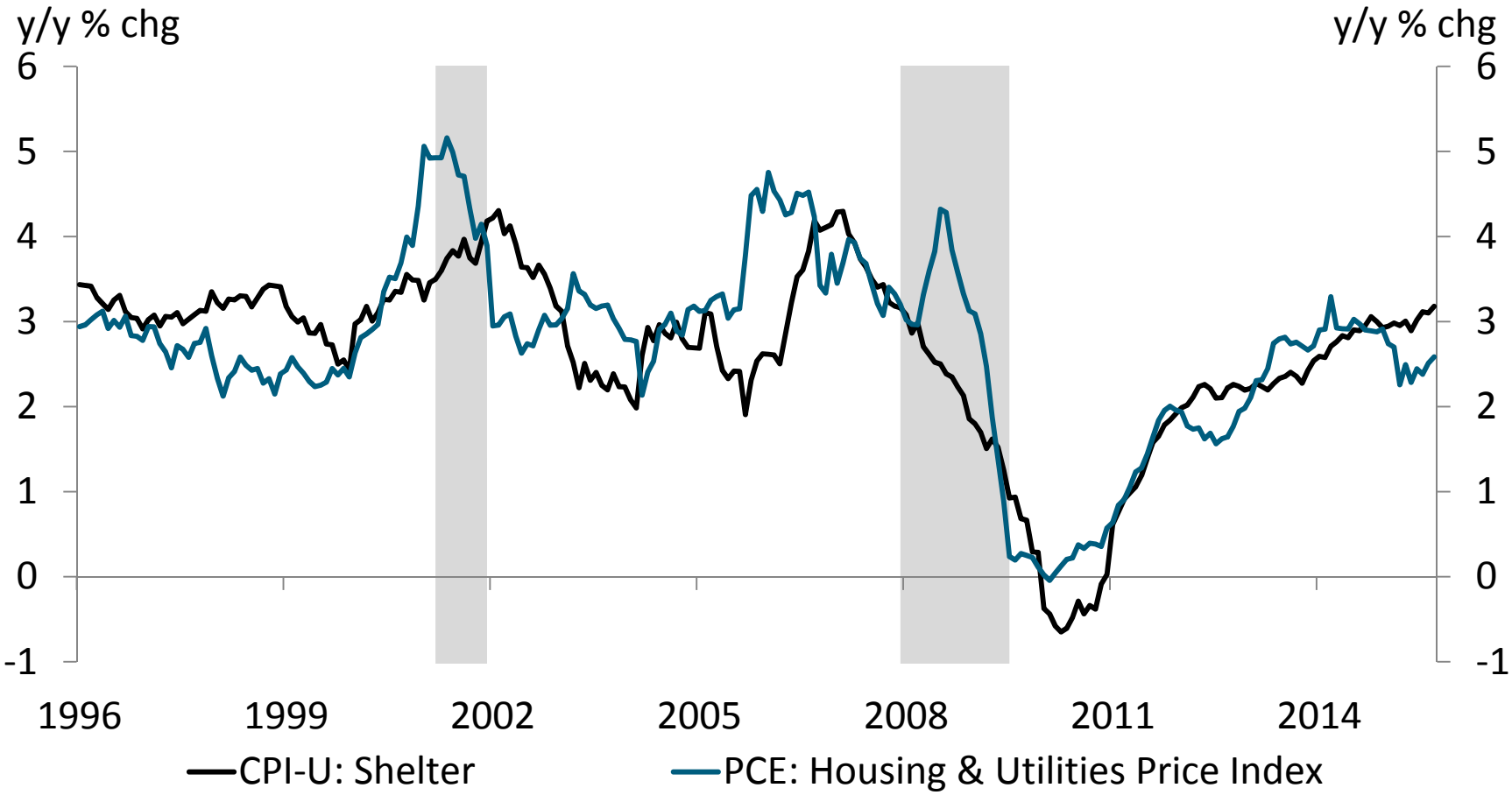
Source: Bureau of Economic Analysis, Haver Analytics

Health care inflation has risen at a faster pace over the past six months



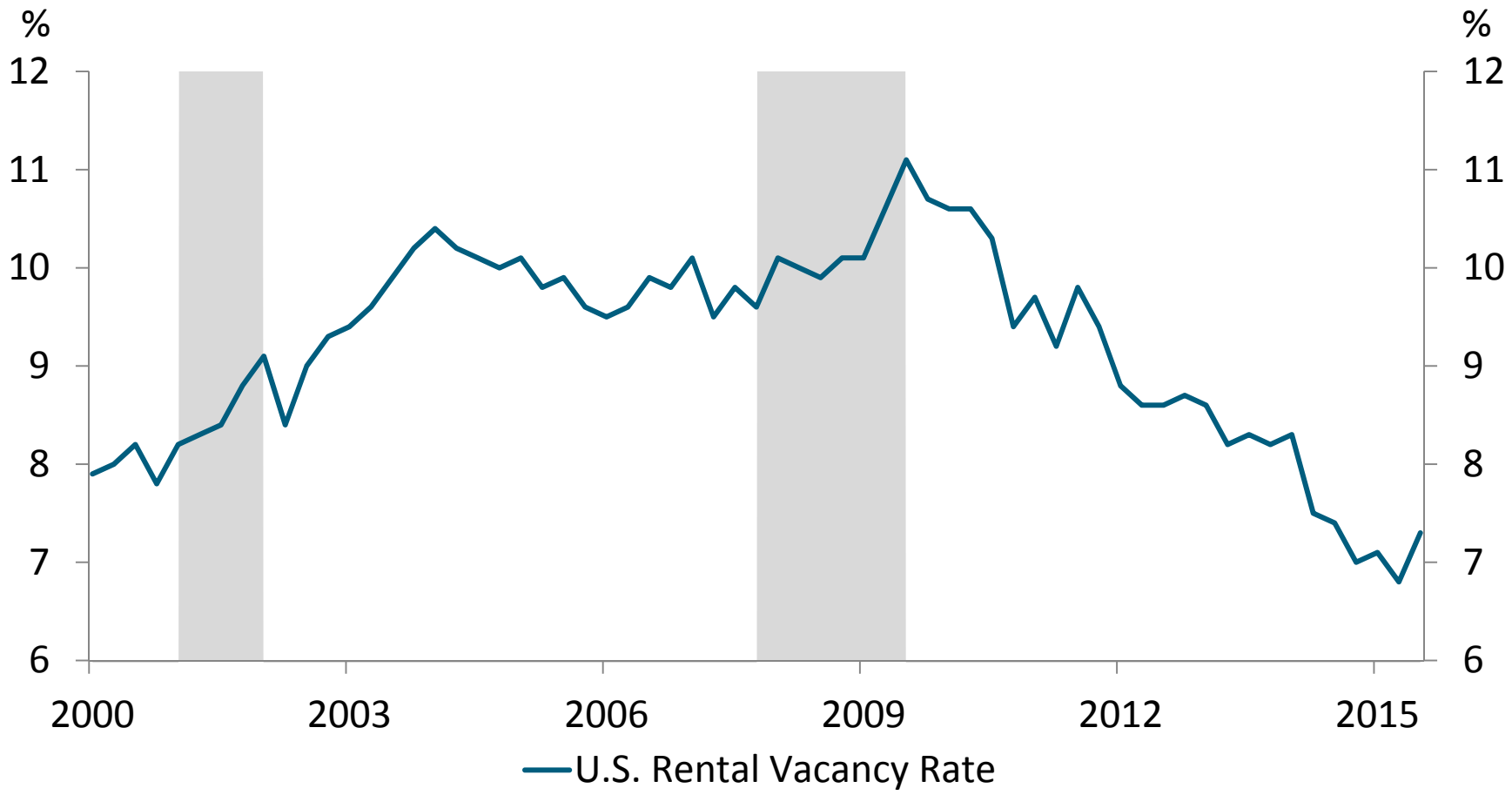
Source: Bureau of Economic Analysis, NBER, Haver Analytics

Inflation in housing services and shelter costs have been rising over the past few years



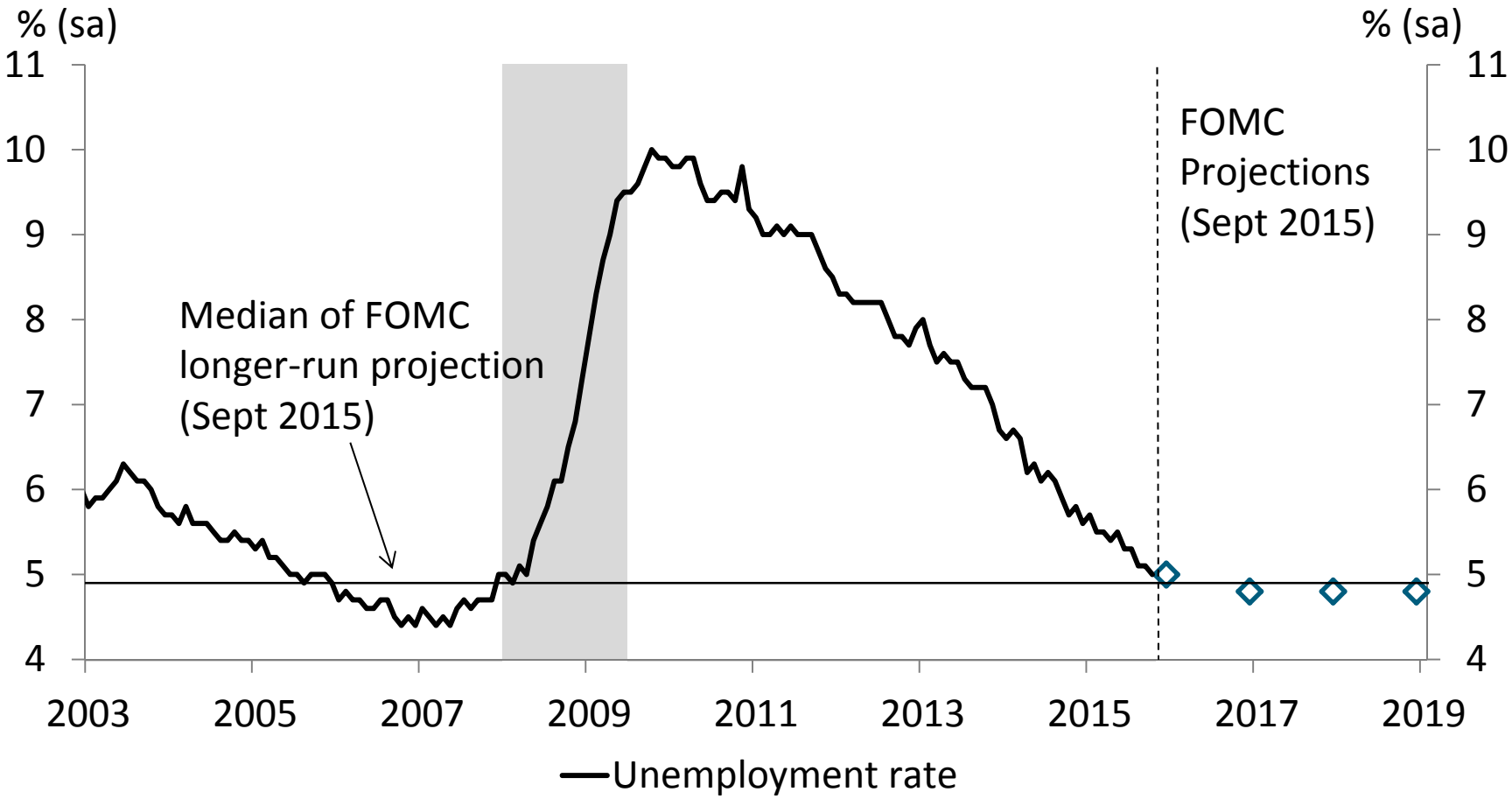
Source: Bureau of Economic Analysis, Bureau of Labor Statistics, NBER, Haver Analytics

Vacancy rates remain low, suggesting additional rental price pressures going forward



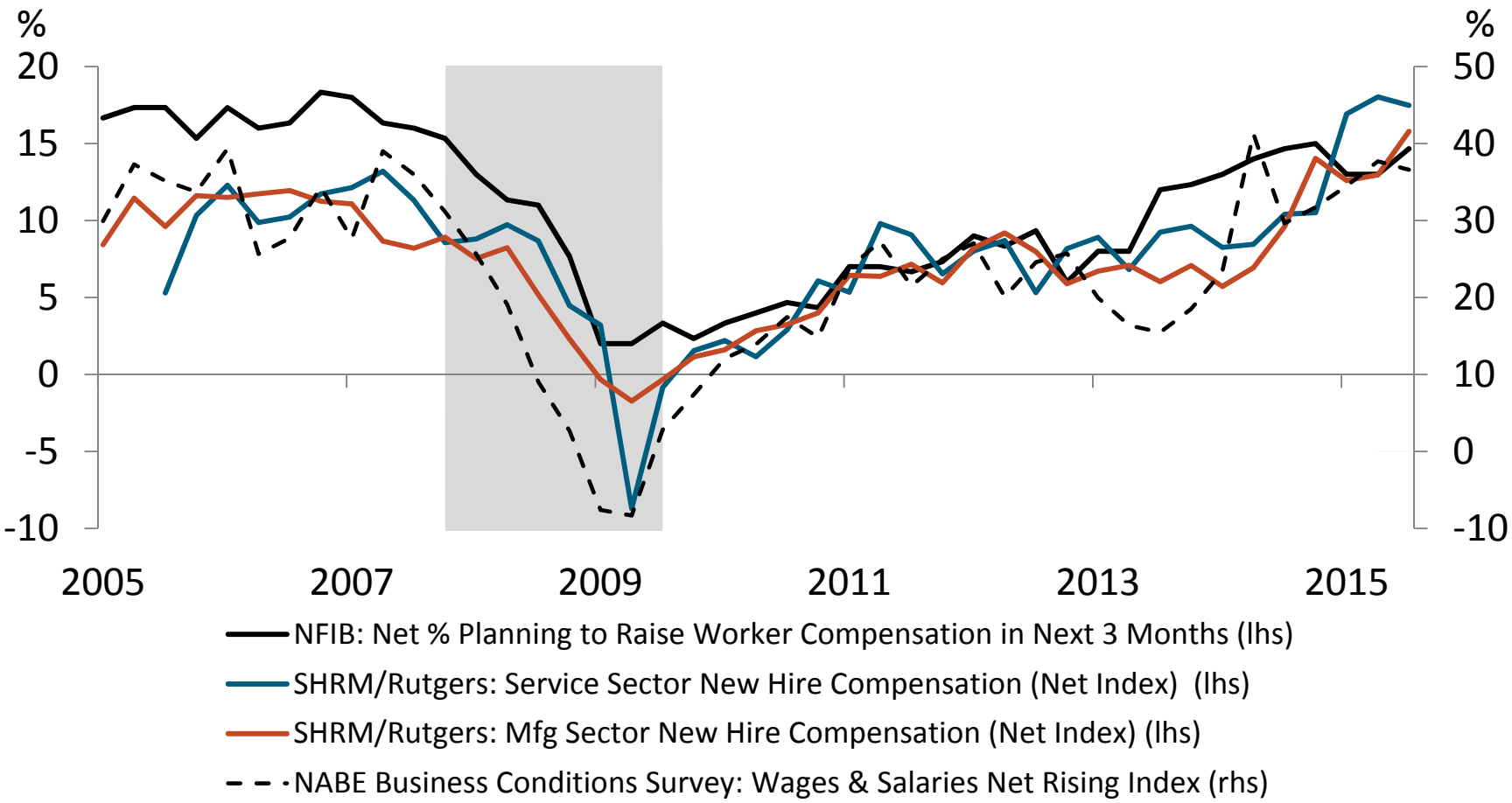
Source: Census Bureau, NBER, Haver Analytics

The unemployment rate is near its longer-run normal level and other measures show diminishing labor market slack



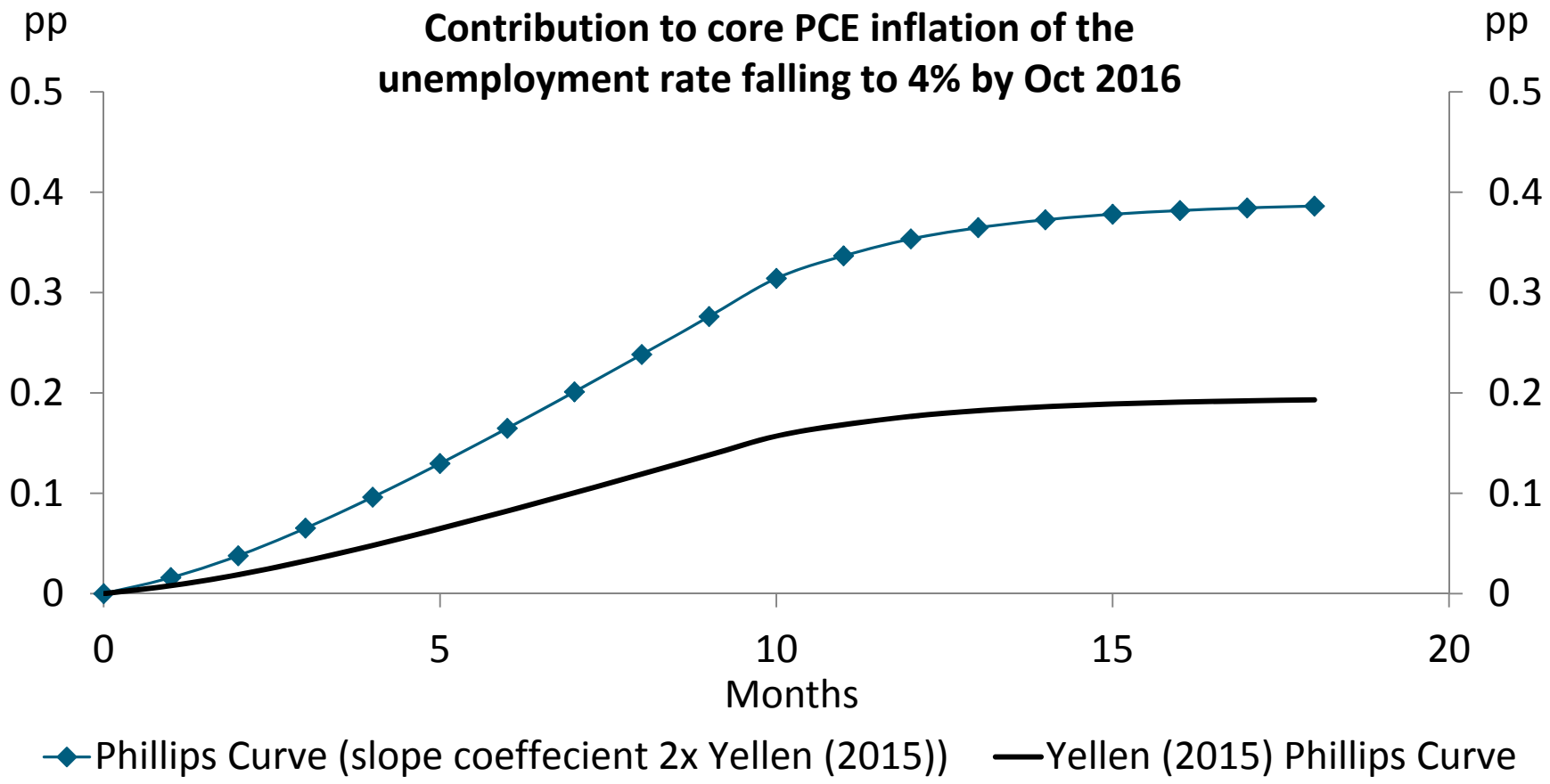
Source: Bureau of Labor Statistics, Federal Reserve Board, NBER, Haver Analytics

Surveys suggest firms are experiencing increasing wage pressures



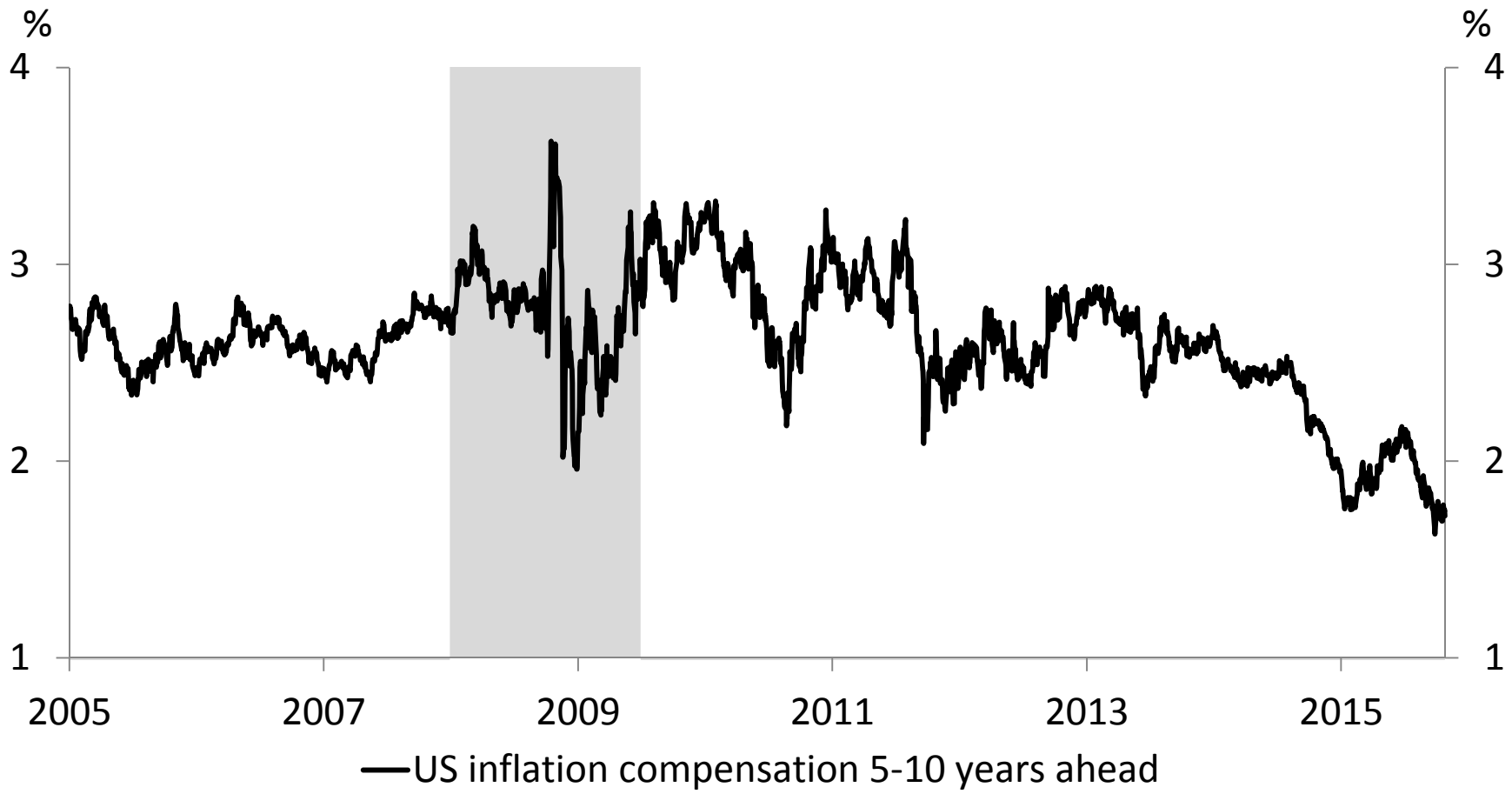
Source: NABE, NBER, NFIB, SHRM/Rutgers, Haver Analytics

Additional labor market tightening could add support to core PCE inflation



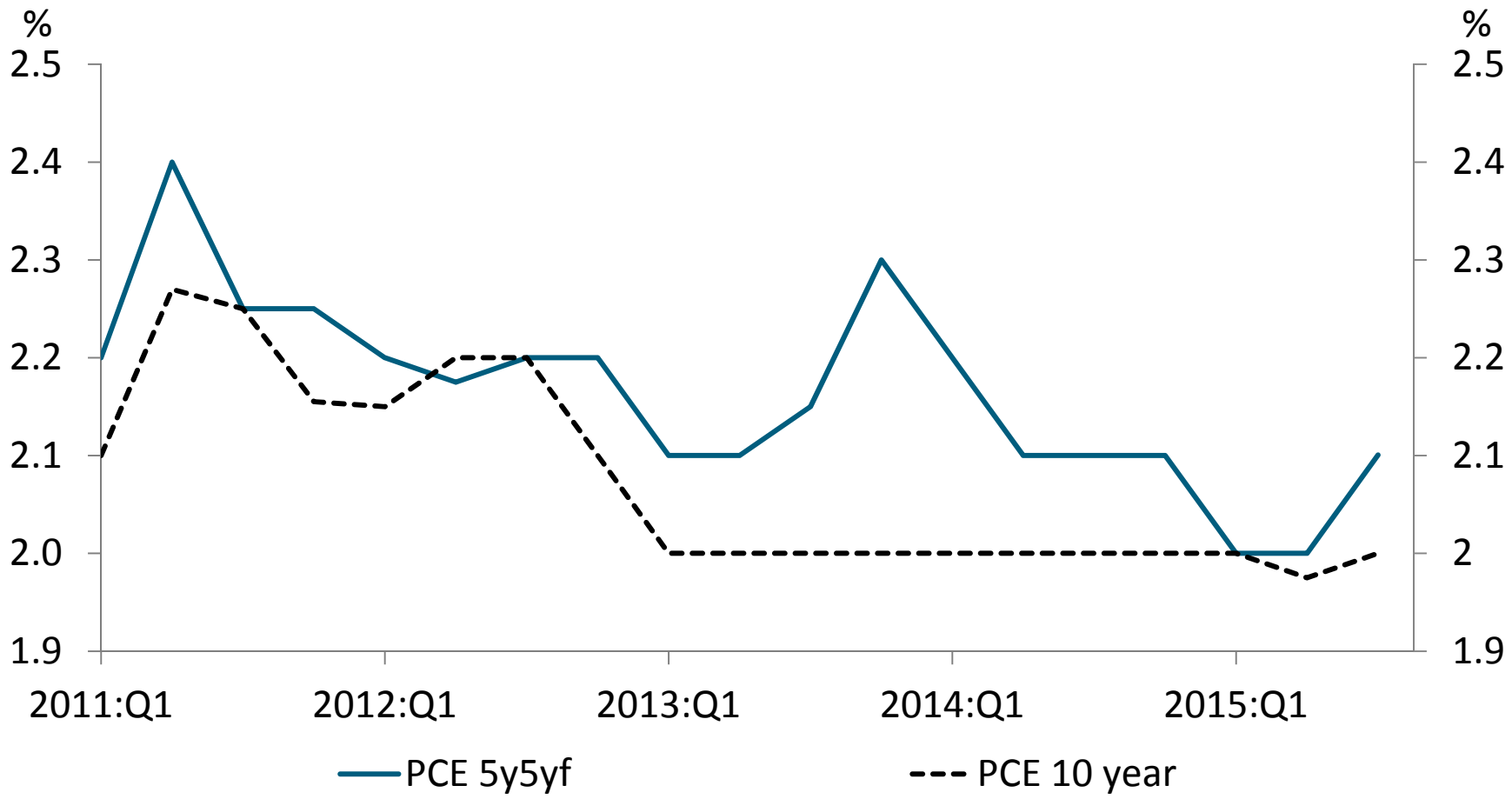
Source: Yellen (September 24, 2015), author's calculations

Market-based measures of inflation compensation have declined



Source: Federal Reserve Board, NBER, Haver Analytics

Survey-based measures have remained largely stable and are consistent with inflation returning to 2%



Source: Survey of Professional Forecasters, Haver Analytics

Upside inflation risks

- Upside factors:
  - Further labor market tightening under a “kinked” Phillips curve
  - Housing and/or health care services inflation rises at a faster pace
  - Upward movement in commodity prices
  - Persistently low productivity growth

Downside inflation risks

- Downside factors:
  - Further strengthening in the foreign exchange value of the dollar and additional softening in commodity prices
  - A “flat” Phillips curve results in little support to core inflation under additional labor market tightening
  - Inflation in health care services trends lower
  - Productivity rises towards longer-term historical norms

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