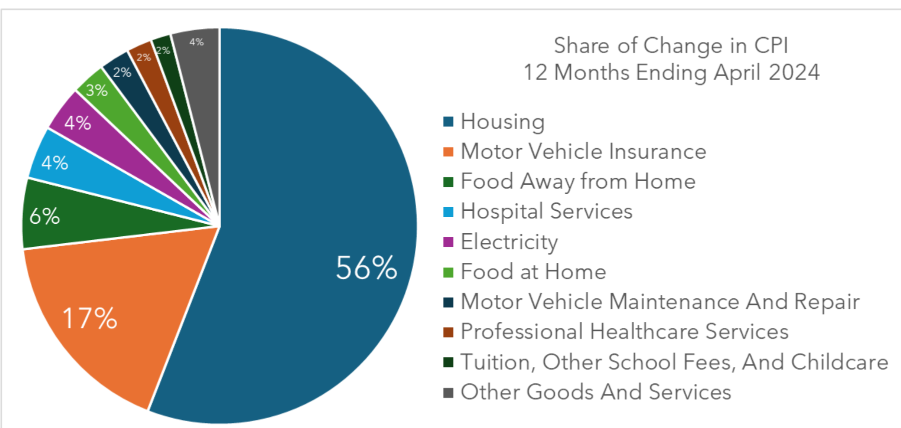
Saturday, May 18, 2024

The Consumer Price Index (CPI) for April came out this week, and it's not great. The CPI for all goods and services is +3.4 percent vs. April '23 and the same percentage on average for the last 12 months. Food and energy prices can deceptively sway total inflation due to their weight and volatility, so we sometimes strip them out to see if that's happening. "Core CPI," which excludes these, is rising even faster, +3.6 percent vs. last April and +4.2 percent over the last year. This implies there may be some downward bias in the full CPI, but in any case, despite some improvement, inflation is still well above the Fed's two percent target.

I generally prefer other inflation metrics, but CPI has its strengths. Some prices react differently to monetary policy, so knowing which specific prices are keeping inflation elevated should inform the Fed's actions. There's no other price measure I know with as much detail in its product and service categories as CPI has. If you want to, you can even use CPI to track the relative prices of white bread versus other types. Not kidding.



The chart at left gives the share of the total change in CPI over the last 12 months by category. To be clear, housing prices aren't up 56 percent; it's that 1.9 (56 percent) of the 3.4 percent increase in CPI was due to housing inflation. Another 17 percent was due to price hikes on car insurance premiums. Just those two categories make up almost three quarters of inflation right now.

Unfortunately, housing and insurance costs are among the hardest to influence through monetary policy. For changes in the money supply to affect demand for something, that demand needs to be flexible. You can change how often you go out for dinner, and that can change restaurant prices, but most people can't choose to skip out on housing or car insurance. Ergo, the Fed probably can't do much about inflation on those categories. Even worse, the Fed is statutorily required to promote "price stability", even when their power to do so is limited. As such, we're likely to see continued monetary tightness amid chronic inflation.

Could be worse I guess 🤷‍♀️

Until next week,

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