

Another Look at “Inflation”

October 24, 2022

Last week, the government reported that overall inflation rose by 8.2%. Core inflation, a measure of prices excluding food and energy, rose 6.6%. The announcement added further concern that the outlook for Federal Reserve interest rate policy likely results in higher interest rates. Before panicking, first look at the components of inflation - which give us a better understanding of what is happening. In previous missives we have discussed the difference between inflation and a wealth transfer from the buyer to the seller in the form of higher prices. Looking at the latest contributors to inflation can be hopeful.

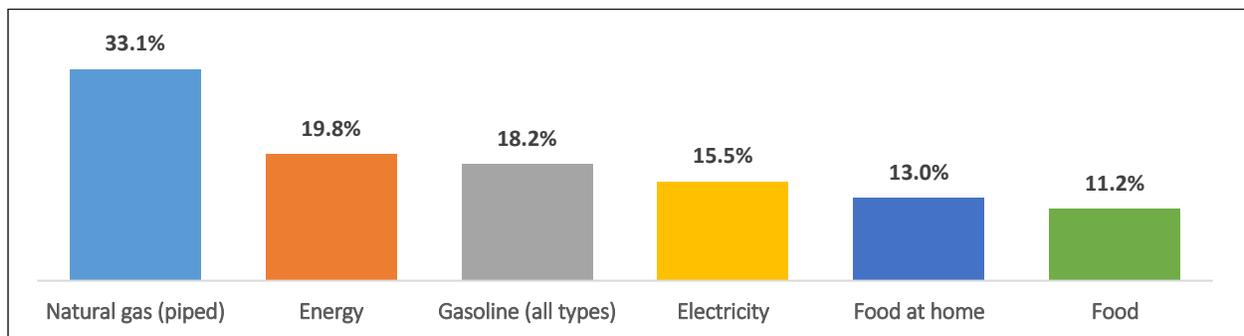


Figure 1: 12-month percentage change, Consumer Price Index, selected categories, not seasonally adjusted

By far and away, the largest contributor was the rise in natural gas prices. The enormous surge in exports of liquified natural gas (LNG) may be a big contributor to the rising demand for this component. Fortunately, this is a “good” sign where there is ample supply. However, regulations are keeping LNG in short supply. The next three categories: energy, gasoline and electricity make up the top four. Of the highest categories, four of ten are energy related (electricity went up partially because utility companies had to pay more for fuel, especially natural gas). These four components are not included in core CPI but are imbedded in the costs of other goods and services, giving energy prices a broader impact on inflation. With OPEC recently lowering oil output by 2 million barrels a day, another uptrend in energy prices could be on the horizon.

On another note, the war in Ukraine will also continue to be a factor influencing prices of both energy and food. Expectations for a global recession are increasing and history suggests that a downturn will take prices down across the board. Fortunately, energy and food price increases will not encourage an economic downturn in the U.S. because our virtual independence in food and energy. In other words, the last energy crisis ended up transferring billions of dollars from the U.S. to the Middle East. Today, some of those higher prices pay for U.S. energy and food, which increases the standard of living for workers and communities serving these industries.