As Inflation Ticks Back Up to 6.4%, It's Time for a Broader View

If you can't stay in the saddle on the horse, your ride is going to get painful.

By Erik Sherman

With the announcement of January's CPI numbers — 0.5% increase in January after a 0.1% increase in December, higher than predicted. That made a 12-month 6.4% inflation rate, which was still down from 6.5% in December, although over expectations. A lot of people are trying to understand where things are. A lot of things are moving at the same time.

There are the hawkish. "So much for immaculate disinflation," wrote Steven Blitz, managing director of global macro and chief US economist at TS Lombard. "January CPI data make clear that inflation is not dropping to 2% without a recession raising unemployment above 4.5% and this underscores my long-held view that the Fed erred by downshifting hikes."

And the more dovish. "Inflation is easing but the path to lower inflation will not likely be smooth," Jeffrey Roach, chief economist for LPL Financial, wrote in a note. "The Fed will not make decisions based on just one report but clearly the risks are rising that inflation will not cool fast enough for the Fed's liking. … But according to the University of Michigan's benchmark survey, long-term inflation expectations are well-anchored at 2.9%, unchanged for the third consecutive month and this supports the view that the Fed will hike by 0.25% at the next meeting and not revert to larger rate hikes."

Two very different views. One issue is that the Bureau of Labor Statistics has made some changes in how inflation is calculated. Housing has been high and a major contributor to calculated inflation. Starting with January 2023, the Owner's Equivalent Rent (OER) — what homeowners would equivalently pay if they weren't locked into longer fixed mortgages for the most part — got bumped up.

"Rent inflation for different types of housing units sometimes diverge, even in the same neighborhoods," BLS wrote in 2020. "We estimate during 2013 to 2016 apartment rents outpaced rents for detached housing in the United States by 0.75 percentage points annually after controlling for location effects." So, heavier weighting.

However, shelter — the category including OER as well as apartment rents — has become the driving force for higher inflation, as energy costs chilled some. That means higher inflation in January 2023 than it would have been had the previous formula governed the calculations.

"Increase in housing prices contributed for half of the monthly rise," wrote Credit Union National Association (CUNA) Senior Economist Dawit Kebede, in an email. "Its contribution to core consumer price index (CPI), excluding food and energy items, is even higher at 60%. The index for housing is a lagged indicator in measuring the CPI relative to current market trends. If this index stayed sideways in January, inflation would have slowed in line with expectation. The CPI is

expected to reflect current market declines in housing prices in the second half of the year."
A second issue is more entrenched in human understanding. People look for changes, even though, statistically speaking, reacting to the month-to-month data is a sure way to madness of a sort. This is the type of decision-making that people in statistical process control and management warn against. Reacting to every variation makes actions unstable and is like someone riding a horse but not staying deep in the saddle. The bounces will leave you with an experience whose memory won't shortly depart.

Carlos Vaz, founder and CEO of CONTI Capital, a multifamily investment firm, said in an emailed statement, "Inflation in the U.S. has been moderating for months, and we believe that it will continue to fall to more typical levels through the first half of 2023. With inflation still running relatively hot and the labor market showing few signs of a significant slowdown, the Fed is likely to hike interest rates by another 25 bps at the next FOMC meeting in March."