

Investing Perspective: Consumer Price Index

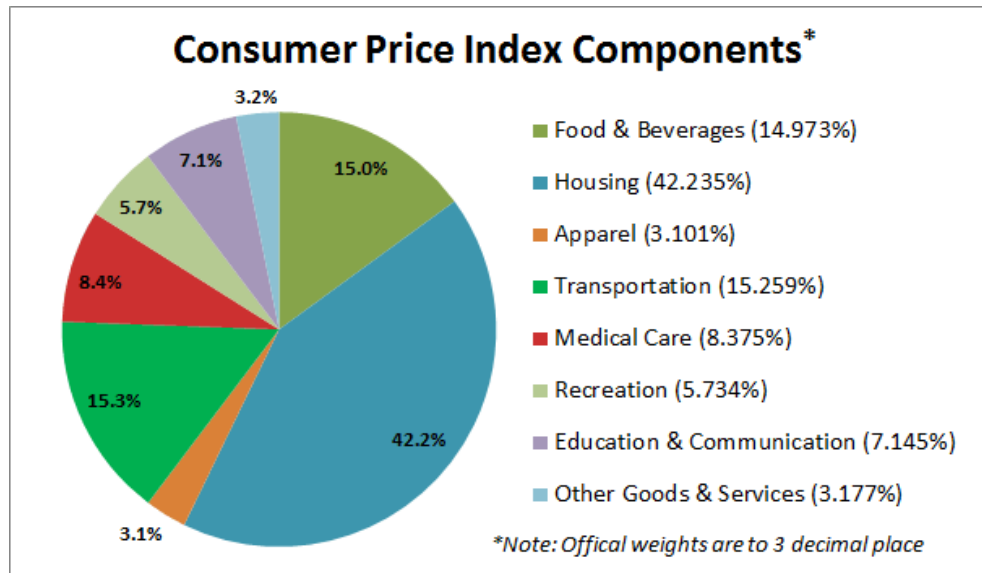
Although inflation often has a strong influence on the course of stock prices, its changes also affect other investments, bonds in particular. Although Fed uses the Department of Commerce's personal consumption expenditures (PCE) measurements as its primary inflation gauge, most analysts and news sources think of it in terms of the Consumer Price Index (CPI) that is produced by the Department of Labor (DOL). The CPI almost always means the CPI-U, which is for "all urban consumers U.S. city average," and I will just use CPI in what follows. The PCE and CPI generally show trends that are quite similar. I will take a closer at the CPI, its components, and its relevance to some categories of people.

DOL's Bureau of Labor Statistics (BLS) subdivides the CPI into eight general categories. The pie chart shows what they are and their current weightings. The largest three, Housing, Transportation, and Food and Beverages account for almost three-quarters of the weight. Each of the eight contains several subcategories. For example, Food and Beverages consists of food at home (8.233%), which in turn has six sub-items, food away from home (5.798%), and alcoholic beverages (0.965%). While I like to have a beer before dinner most nights, I doubt that it is anywhere close to almost one percent of my spending. On the other hand, I suspect that eating out, particularly when traveling, ends up being more than six percent of expenditures in a typical year.

The BLS issues a monthly report showing the price changes by various categories and subcategories. You can get it at

<http://www.bls.gov/news.release/cpi.t01.htm>.

Although they are not organized the same way as in the pie chart, the weights of the components and subcomponents are shown in the report.



Source: BLS; The most recent reweighting was in December 2015.

One measure that is often referenced and to which the Fed pays the greatest attention is so-called core inflation. It does not consider Energy and Food because those, particularly the former, often have large fluctuations that can obscure the essential trends in consumer prices. The two have over 20% of the weight and are items that everyone spends on, so the core may not reflect the effects on many the changes that affect many people. Due to the drop in oil and other energy prices this year, the difference for March is fairly dramatic. The overall CPI was up by 0.9% year-over-year in March, but without food and energy it was up 2.2%. Which is more accurate for individuals likely depends on how much they drive and how they heat their homes. Gas prices are down over 20% as is fuel oil for heating, and gas used for heating is down over 9%. On the other hand, electricity is down less than two percent. So someone, like me, who usually drives less than average and has electric heating, likely finds the core measure more indicative of inflation than the overall CPI when there are large differences. For the other excluded

category from the core measure, food at home costs dropped by half a percent over the past year, while food away from home was up by 2.7%.

Another group that may find that the CPI does not reflect personal inflation very well is senior citizens. Often they have paid off their mortgages, so housing costs are not likely to be anywhere close to 40% of their total expenditures. On the other hand, medical costs may well be more than eight plus percent of what they spend. A shelter cost, which reflects

the costs of the house excluding the costs of running the house, were up over three percent, while medical care services were up not quite four percent, a lower rate than has been typical. Since 2000, medical costs are up by nearly 80%, the highest of any of the eight components. Other goods and services is second, up 60%, food and beverages is third, up about 50% and housing a fourth with an increase around 45% over the last 15 years.

How relevant is the CPI to you? It depends on how closely your spending is to the component's weightings.
