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Update on the Inflation Fight

> "Inflation has fallen a lot more than the flawed price indexes suggest. If the fictional "owner equivalent rent" (OER) were removed from the consumer-price index, the year-over-year inflation rate falls from 3.2% to about 1.5%. The Fed's preferred measure, the personal-consumption expenditures price index, would decline from 3% to about 2.2%. OER is the hypothetical rent you pay yourself, as if you were your own landlord. It is the most heavily weighted item in both the CPI (25.5%) and the PCE (11.2%), but it is a "price" no one pays. It has no effect on household budgets. To claim, as the CPI does, that OER is 25.5% of average household "expenditures" is nonsense."

The above is a direct quote from Emeritus Prof. Robert F. Stauffer, Roanoke College, published in the WSJ on Aug 20th 2023.

In 2012 the Federal Reserve picked the headline Personal-Consumption-Expenditure index (PCE) as the official index used to measure their progress on managing inflation. The rest of us use the more familiar consumer-price index (CPI). We have mentioned how useless OER is in previous notes and the concept is being mentioned more and more in the press. It's interesting that in the Eurozone they don't ask the silly question, as if anyone actually knows what they would get if they were to rent their own home from themselves, unfurnished of course.

Excluding OER, CPI is currently running below the Fed's target and PCE is within ¼ point of the 2% target. The next 3 months will be interesting. We have mentioned numerous times our view that inflation is just about the only economic data measured on a year over year (YOY) basis. 11 months of history and one month of what's happening now. Remember how Powell explained "transitory" in his July 28, 2021 press conference:

> "The concept of "transitory" is really this: It is that the increases will happen. We're not saying they will reverse. That's not what "transitory" means. It means that the increases in prices will happen, so there will be inflation, but that process of inflation will stop…"

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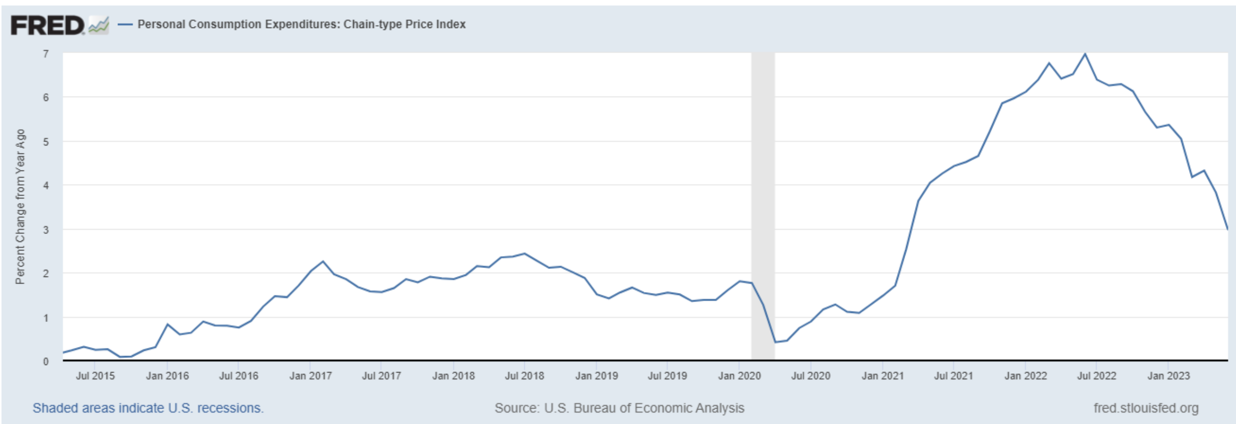
If you have high inflation in the beginning of the year, caused by an outside factor (supply chain disruption due to Covid for example), and the Fed steps in during the year, causing inflation to drop through tightening, it doesn't make sense to weigh the early, high-inflation months the same as the more recent post-tightening months of inflation. A cursory glance at the YOY PCE shows that inflation has been increasing at a decreasing rate since June of '22.



August, September, and October of last year will fall off the YOY inflation numbers in the next 3 months. In those 3 months of '22 PCE annualized 4.0%, CPI annualized 4.4% and PCE Core (the new official index the Fed pays close attention to) annualized 5.6%. If inflation continues to fall, it's possible we may hit the Fed's target including OER. Excluding OER we may actually experience deflation, which is not a good thing.

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