# Inflation watch - April, 2016

## Insurance Industry

May 18, 2016



The Insurance Information Institute Inflation Watch spreadsheet contains the latest data from the U.S. Department of Labor's Bureau of Labor Statistics (BLS). Both current and expected near-term general inflation continue to be quite low. The CPI-U—the popular measure of inflation, sometimes called headline inflation—rose by 1.1 percent in April 2016 vs. April 2015, before seasonal adjustment. However, core inflation—the overall index minus the effects of price changes for food and energy—rose 2.1 percent for the 12 months ending April 2016. When the headline inflation report for April vs. March was released, the media made much of the fact that the 0.4 percent increase was the highest since February 2013, suggesting that perhaps an inflation spike was just beginning. However, most economists prefer a year-over-year time frame and the core—not the "headline"–inflation measure. The BLS year-over-year core inflation rate has been slowly trending up since May 2015, but actually dropped slightly in the last two months. The core year-over-year Personal Consumption Expenditure (PCE) deflator—the Federal Reserve Bank's preferred inflation measure—has ranged from 1.3 percent to 1.9 percent since the end of the Great Recession and, as of March 2016, was 1.6 percent. There is still some slack in both the U.S. and especially the larger global economies, making sharp near-term overall future price increases unlikely. From a macroeconomic policy viewpoint, sharply rising inflation does not appear to be a current or near-future problem to combat. Most forecasters project headline CPI for the full year 2016 to range between 0.9 and 1.4 percent.

Price trends for items that more directly affect property/casualty (P/C) insurance claims do not necessarily follow broad-based price indexes. Prices for items such as intensive healthcare affect claims under third-party coverages such as workers compensation and bodily injury liability, as well as first-party coverages like PIP and medical pay and, obviously, medical expense insurance. For many years these price increases have far outpaced both headline inflation and the overall price index for medical care. This pattern continued in 2016 for inpatient hospital services, but not for outpatient services. Seasonally adjusted on a year-over-year basis, in April 2016 prices for in-patient hospital care rose by 4.0 percent. Seasonally adjusted prices for outpatient hospital services rose by 1.0 percent in April 2016 over April 2015! This is by far the lowest year-over-year increase in prices for outpatient hospital services in at least 28 years. Price changes for prescription drugs, which had been moderating are rising fairly rapidly again; on a month-over-month basis in the last four months they rose by 0.5 percent or more. In April 2016 prices for prescription drugs rose by 4.0 percent over those of April 2015.

Price increases relating to auto insurance property claims also have been quite moderate recently. Prices for motor vehicle parts and equipment, which affect not only comprehensive and collision claims, but property damage liability as well, rose by 0.2 percent in April 2016 vs. April 2015. These prices fell in most months since August 2012 and, despite some monthly increases, are about even with prices in June 2011. Falling prices for motor vehicle parts and equipment are welcome, but they should be put into context: between August 2000 and August 2012 these prices rose virtually every month, for a cumulative gain of 46.7 percent (a compound annual growth rate of about 3.3 percent). Prices for motor vehicle repair rose by 2.5 percent for the 12 months ended April 2016, thanks primarily to a one-month jump of 0.6 percent in March 2016 over February 2016; prices for motor vehicle body work rose by 2.2 percent year-over-year (not seasonally adjusted). The BLS survey of consumer prices for motor vehicle insurance in March 2016 rose by 6.0 percent year-over-year; this is partly attributable to a 1.2 percent increase in April 2016 over March 2016 and another 1.0 percent increase in November over October 2015. The April-over-March increase is the largest one-month increase since July 2013 and only the second time since April 2003 that we’ve seen an increase of that size. Many factors other than prices for auto repair—such as the continuing drop in insurers’ investment income, and continuing above-CPI growth in the prices for intensive medical care, as noted above—likely are affecting these increases.

Finally, average weekly earnings of all employees in private employment rose 2.5 percent in April 2016 on a year-over-year basis—about one-fifth of a percentage point faster than the rise in the core CPI. Wage growth affects workers compensation and, indirectly, liability and PIP claims. Wage growth above inflation means consumers have increased buying power, which could lead to stronger economic growth near term. As the economy approaches full employment wage gains over inflation are expected to widen, but that might take some time to develop. There is still slack in the labor market, as evidenced by the 6.1 million people who are working part-time but want full-time employment, the 585,000 people who say they are discouraged from even looking for a job, etc. The labor market slack is generally believed to restrain higher inflation, at least in the coming months.

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