Inflation watch - November 2017

Insurance Industry

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The Insurance Information Institute (I.I.I.) Inflation Watch spreadsheet contains the latest data from the U.S. Department of Labor Bureau of Labor Statistics (BLS). Both current and expected near-term general inflation continue to be low by historical standards, but there are pockets of rising inflation. The CPI-U—the popular measure of inflation, sometimes called headline inflation—rose by 2.2 percent in November 2017 vs. November 2016. Core inflation—the overall index minus the effects of price changes for food and energy—rose 1.7 percent for the 12 months ending November 2017. (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 1.8 percent or lower since May 2017. The core year-over-year Personal Consumption Expenditure (PCE) deflator—the Federal Reserve Board's preferred inflation measure—has ranged from 1.3 percent to 1.9 percent since the end of the Great Recession (for two months at the start of 2012 it reached 2.1 percent), and as of the third quarter of 2017 (latest data as of this writing), was 1.5 percent. The U.S. economy is still growing, but capacity constraints might increase the likelihood of near-term price increases. From a macroeconomic viewpoint, gradually rising inflation is possible and is being watched by the Federal Reserve Board's Open Market Committee, among others. Many forecasters project headline CPI for 2018 to range between 1.7 and 2.5 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 Personal Injury Protection (PIP), med pay and obviously medical expense insurance. For many years these price increases have outpaced both headline inflation and the overall price index for medical care, and this is still true today. In November 2017, seasonally adjusted on a year-over-year basis, prices for inpatient hospital care rose by 4.2 percent. Seasonally adjusted prices for outpatient hospital services rose by 4.7 percent in November 2017 over November 2016. Price changes for prescription drugs have been moderate lately. In the last 12 months they fell five times: In November 2016 (-0.5 percent vs. October); February 2017 (-0.2 percent vs. January); in April 2017 (-0.9 percent vs. March, which was flat vs. February); in September 2017 (down -0.6 percent vs. August); and in October 2017 (down 0.2 percent vs. September). Still, November 2017 saw a 2.2 percent year-over-year rise.

Price increases relating to auto insurance property claims 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, fell by 0.3 percent in November 2017 vs. November 2016. These prices have fallen in most months since August 2012, although oddly the December 2016 change from November 2016 was +0.6 percent—the largest one-month rise in five years. In contrast, the most recent one-month change, November 2017 vs. October 2017, saw the second largest price drop (-0.5 percent) since September 2016, with the largest month-to-month drop in the immediately-preceding month (October 2017 vs. September 2017). Current prices for motor vehicle parts and equipment are about even with prices in April 2011. Prices for motor vehicle repair rose by 1.3 percent for the 12 months ended November 2017, thanks primarily to a one-month jump of 0.8 percent in September 2017 over August 2017, and a one-month drop of -0.9 percent in June 2017. Prices for motor vehicle bodywork rose by 2.3 percent year-over-year (not seasonally adjusted). The BLS survey of consumer prices for motor vehicle insurance in November 2017 rose by 8.0 percent year-over-year. The year-over-year increase is slightly lower than it has been in recent months, but only because recent monthly increases, though high, are lower than in comparable months in 2016. Of course, many factors other than prices for auto repair likely are affecting these increases. These factors include the continuing drop in insurers' investment income, continuing above-CPI growth in the prices for intensive medical care, and an unusual upturn in the collision rate—which is related to the increase in the number of people employed, thus adding cars to rush hour..

Some prices relating to property insurance claims have risen recently. For example, the Census Bureau computes a price index for new single-family houses under construction. The latest data for October 2017 shows a 4.7 percent increase over the index in October 2016.

Wages are growing, but barely faster than inflation. The Bureau of Labor Statistics reported that on a year-over-year basis, average weekly earnings grew by 3.1 percent in November 2017 over the prior November, and average hourly earnings also grew by 2.5 percent. 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. However, the economy appears to be approaching full employment, as indicated by the lowest unemployment rate in the last 17 years. There might still be some slack in the labor market, but it is hard to gauge how much. For example, BLS reports that there are 4.8 million people who are working part-time but want full-time employment. However, even in the most recent prosperous times (the late Clinton administration), this number was never lower than about 3 million. Likewise, the 469,000 people who say they are “discouraged” from even looking for a job; in the last 20 years this was never lower than about 200,000. Therefore we are probably getting close to a labor market in which demand will outstrip supply, leading to pay raises that will get passed along in the form of higher prices.

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