

# **The Inflation Update**

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Inflation for the U.S. rose a very modest amount in December 1999. The change from November to December was only 0.2% for the total CPI, 0.1% excluding food and energy, and 0.2% for the median CPI. For the entire year, increases in the core measures were a modest 2.2% for the median, and 1.9% for ex food and energy. At worst, inflation is steady, and it could be falling.

The most interesting development in the current report concerns owner equivalent rent, which accounts for 20% of the CPI and makes up 2/3rds of household expenditure on shelter. The monthly change in this component was only 0.2%, and the increase was 2.4% for the past year. A number of observers have been predicting that the recent increases in housing [prices]costs --- over 4% by some measures --- will feed into this statistic soon, driving core inflation up over 2 1/2%. Is this a reasonable concern?

Beginning in January 1999, the BLS changed its methods for measuring the rental equivalence of owner occupied housing, and now does so using a sample based on rental units alone. But the price of rentals depends largely on the rental vacancy rate, which has been rising as people increasingly buy new homes. While this suggests that the CPI is temporarily understating inflation, as the value of rental properties rise much less rapidly than the price of owner occupied housing, the implication for the overall index is fairly clear. This will have to reverse itself eventually, as the rental and owned housing markets come back into equilibrium. But the process of people selling relatively expensive houses, and moving into cheaper apartments is likely to be slow.

Overall, my conclusion is that the shelter portion of the CPI is very unlikely to accelerate, and so a rise in core inflation, does not seem imminent.

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