Inflation watch - September, 2016

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's 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 1.5 percent in September 2016 vs. September 2015, before seasonal adjustment. However, core inflation—the overall index minus the effects of price changes for food and energy—rose 2.2 percent for the 12 months ending September 2016. (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 had been slowly trending up since May 2015 but has been essentially flat since January 2016. 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 August 2016, was 1.7 percent (the latest value). There still appears to be 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 doesn't appear to be a current or near-future problem to combat, but 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 the fourth quarter of 2016 to move higher, ranging between 1.7 and 3.3 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) and med 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. Seasonally adjusted on a year-over-year basis, in September 2016 prices for inpatient hospital care rose by 6.3 percent. Seasonally adjusted prices for outpatient hospital services rose by 4.6 percent in September 2016 over September 2015. The 4.6 percent y-o-y rise in outpatient hospital prices, though modest compared to inpatient price increases, is a sharp change from the y-o-y increases for outpatient hospital services earlier this year (up 1.0 percent in April and 1.1 percent in May). The reason for the sharp increase is to some degree a statistical artifact in that, on a month-to-month basis in the past 12 months, there were two months in which outpatient prices spiked (up 1.5 percent in October 2015 over September, and up 1.8 percent in August 2016 over July). In two months from now the October 2015 price level will drop out of the year-over-year computation, and so that year-over-year change will appear to moderate unless prices for outpatient hospital services in November 2016 rise to a comparable extent. Price changes for prescription drugs have been rising strongly, on a month-over-month basis, in 2016, except in May (when they dropped by 0.6 percent). August 2016 saw the sharpest month-over-month rise (1.7 percent), which was preceded by month-over-month rises of 0.9 percent in February and June and 1.0 percent in July, and followed in September by a 0.8 percent increase over August, producing a year-over-year rise for September 2016 of 7.0 percent.

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, dropped by 1.2 percent in September 2016 vs. September 2015. These prices fell in most months since August 2012 and, despite some monthly increases, are about even with prices in April/May 2011. Falling prices for motor vehicle parts and equipment are welcome, of course, but they should be put into context: between August 2000 and February 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 1.7 percent for the 12 months ended September 2016, thanks primarily to a one-month jump of 0.6 percent in March 2016 over February 2016 and another 0.5 jump in April over March; prices for motor vehicle body work rose by 2.4 percent year-over-year (not seasonally adjusted). The BLS survey of consumer prices for motor vehicle insurance in September 2016 rose by 6.4 percent year-over-year; this is partly attributable to a 1.2 percent increase in April 2016 over March 2016 and another 0.9 percent increase in May over April 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. Of course, 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, and an unusual upturn in the collision rate, which is related to the increase in the number of people employed (and adding cars to rush hour)—likely are affecting these increases.

Also, there are some signs that wages are growing barely faster than inflation. The Bureau of

Labor Statistics reported that, on a year-over-year basis, average weekly earnings grew by 2.3 percent in September, and average hourly earnings grew by 2.6 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. 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 5.89 million people who are working part-time but want full-time employment, the 553,000 people who say they are “discouraged” from even looking for a job, and others who are not in the labor force but could join if job conditions tighten, etc. The labor market slack is generally believed to restrain higher inflation, at least in the coming months.

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