Inflation watch - September 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'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 2.2 percent in September 2017 vs. September 2016, before seasonal adjustment. Core inflation—the overall index minus the effects of price changes for food and energy—rose 1.7 percent for the 12 months ending September 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 flat at 1.7 percent since May 2017. 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 (for two months at the start of 2012 it reached 2.1 percent) and, as of August 2017 (the latest data as of this writing), was 1.3 percent. By some measures there still appears to be a little 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, 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 2017 to range between 1.8 and 2.2 percent, and for 2018 to range between 1.7 and 2.3 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 outpaced both headline inflation and the overall price index for medical care, and this is still true today. In September 2017, seasonally adjusted on a year-over-year basis, prices for inpatient hospital care rose by 3.9 percent. Seasonally adjusted prices for outpatient hospital services rose by 4.5 percent in September 2017 over August 2016. Price changes for prescription drugs have been moderate lately. In the last nine months they fell four times: In November 2016 (-0.5 percent vs. October); in February 2017 (-0.2 percent vs. January); in April 2017 (-0.9 percent vs. March, which was flat vs. February), and in September 2017 (down -0.6 percent vs. August). Still, September 2017 saw a 1.4 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, rose by 0.3 percent in September 2017 vs. September 2016. These prices fell 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. Current prices for motor vehicle parts and equipment are about even with prices in May 2011. Prices for motor vehicle repair rose by 1.8 percent for the 12 months ended September 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 body work rose by 3.1 percent year-over-year (not seasonally adjusted). The BLS survey of consumer prices for motor vehicle insurance in September 2017 rose by 8.2 percent year-over-year. The year-over-year increase has not been this high since the end of the hard market in June 2003. 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.

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 August 2017 shows a 5.4 percent increase over the index in August 2016.

Also, there are some signs that wages are growing slightly faster than inflation. The Bureau of Labor Statistics reported that, on a year-over-year basis, average weekly earnings grew by 2.9 percent in September 2017 over September 2016, and average hourly earnings grew by 2.9 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, shortages of workers will appear (that has already occurred in the construction industry), and as a result, wage gains over inflation are expected to widen. Despite the lowest unemployment rate in over a decade, there still appears to be some slack in the labor market, but it is hard to gauge how much. For example, BLS reports that there are 5.1 million people who are working part-time, but want full-time employment. However, even in the most recent prosperous times (such as the late Clinton administration), this number was never lower than about 3 million. Likewise, it is the same for the 421,000 people who say they are "discouraged" from even looking for a job. In the last 20 years this number has never been lower than about 200,000. So we are probably getting close to a labor market in which demand will outstrip supply, leading to above-inflation pay raises that will get passed along in the form of higher prices.

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