State Street LIVE – Thursday, October 27, 2022
“The Trend and Persistence of Inflation”
Alberto Cavallo, associate professor at Harvard Business School, and Co-founder of PriceStats and Academic Partner at State Street Associates

“We have the opportunity to measure things differently than before and collect data in different ways. When you have daily indicators you can predict better, you can start to see the change in inflation trends.”

-- Alberto Cavallo, Harvard Business School associate professor an State Street Associates academic partner

Executive Summary

Despite their best efforts, central banks are having trouble taming inflation. The persistence and depth of the 2022 inflationary surge surprised economists and markets participants alike.

As Harvard Business School Associate Professor and State Street Associates Academic Partner Alberto Cavallo explained, the combination of supply chain disruptions, increased wage pressure, and the ongoing war in Ukraine are complicating the path to normalcy and will continue to make inflation trends particularly unpredictable.

For that reason, focusing purely on monthly or annual rates, like the US Consumer Price Index (CPI), to measure inflation, can be misleading, says Cavallo. That data largely depends on what happened months earlier. Instead, daily price indicators, like the ones available through PriceStats, are more timely gauges of inflation, he argues. Daily price tracking helps investors spot “structural breaks” in a series sooner.

State Street’s PriceStats, the world’s leading private source of high-frequency inflation statistics, measures inflation in 24 economies across a variety of sectors on a daily basis using online prices. Cavallo, a co-founder of PriceStats, says online prices tend to react to shocks faster than offline prices and, therefore, useful for predicting inflation trends.

For example, when US fuel prices jumped around the time the war in Ukraine started people assumed a causal relationship. But Cavallo says the “high trend of energy inflation actually predated the war.” In fact, PriceStats’ high frequency data indicates fuel inflation has been trending down since June. On the other hand, a similar PriceStats analysis reveals “a worrisome trajectory” in US food prices. Since July, price levels have steadily increased, suggesting food inflation is not showing any signs of peaking.

So why does high inflation persist? Inflation expectations is part of the reason, according to Cavallo. As prices go up, people begin to buy more affordable options, fueling greater demand of these products. According to PriceStats data, cheaper varieties of goods have experienced nearly twice as much inflation as pricier ones in recent months, leading to a “hidden inflation inequality” that is largely impacting low-income US households.

While headline inflation is showing pockets of slight improvement, Cavallo sees US core inflation still struggling. Sectors like household goods and furnishings saw small structural breaks in early 2022 but not enough to create real change; while health and medical products have been trending up since the spring. Unless core goods sectors begin to experience structural breaks, the overall inflation rate will remain high.

Conclusion

Despite stubborn inflation, Cavallo sees signs the US economy is starting to move in the right direction. While some sectors, primarily core goods, continue to see inflation trends go up, structural breaks in other sectors, primarily energy and durable goods, provide evidence that interest rate hikes are helping rein in demand. Still, Cavallo cautions against thinking that we’ve turned the corner on inflation. Supply disruptions and volatility in commodity prices will continue to push prices up, keeping overall inflation significantly high into next year. In particular, food, housing, healthcare and other core goods will continue to be impacted in 2023.