

Inflation Fears



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Recently, we've been hearing a lot about inflation, and the government statistics released on April 15 didn't do a lot to quiet the chatter. The government reported that the Consumer Price Index for All Urban Consumers rose to an annualized 2.7% in March, up from 1.6% in February. Troll through the latest batch of YouTube videos, and you see pundits and other observers suggesting (sometimes screaming) that the Federal Reserve Board is printing money, leading the U.S. to become another Zimbabwe or Weimar Republic.

The March jump is eye-catching, although the raw numbers are hardly alarming. Since 1914, the inflation rate has averaged 3.38% in the U.S., so the current rate is still below average. Moreover, a closer look at the various components of the U.S. inflation rate suggests that prices in general are not rising (as you would expect if a drunken Fed were printing money); most of the price rise is taking place in the energy sector. The gasoline index is up 27.5% over the past 12 months, which most of us probably suspected based on our last visit to our favorite gas station. The index for all items less food and energy rose just 1.2%—a rate one would hardly compare with the multi-million percent inflation experienced by the unfortunate citizens of Zimbabwe.

In fact, if you look at two charts created by the St. Louis Bank of the Federal Reserve Board, you see something interesting. The first chart is the inflation rate since 2006. The second chart is the price of West Texas Intermediate Crude oil, which can be used as a proxy for global oil prices. Notice that the two charts look virtually identical. When oil prices have risen—over the past five years, at least—so too has inflation, and in roughly the same proportion. Oil prices go down, and so too does the inflation rate. Price changes elsewhere, while not perfectly stable, have been moderate enough that this one factor has tended to control changes in the overall cost of living.

Is there a lesson from this? First, we don't know what oil prices will do in the future, but even if they stabilize at the current higher rates, the inflation rate—which measures changes in cost of living—will moderate. If the various uprisings in North Africa and the Middle East ever calm down—and an optimist might anticipate that they eventually will—then oil prices could fall. Then, suddenly, you might be reading about how the Fed has somehow engineered a disastrous round of deflation.

