

There's a Hole in My Bucket

Key Takeaways

- Inflation has fallen dramatically over the last couple of years.
- However, it is important to remember that inflation measures change in price, not level of price.
- Because inflation was so high in 2022, many households continue to struggle with higher prices.

Change Not Level

Two years ago, inflation reached an eye-popping 9.1% (year-over-year, or YOY). In response, the Federal Reserve raised interest rates at the fastest pace in 30 years. Today, with inflation having declined to 3.0% YOY, the Fed is now talking about cutting interest rates. Before declaring victory on inflation, we believe it is important to highlight that the inflation spike of 2022 is still adversely affecting consumers.

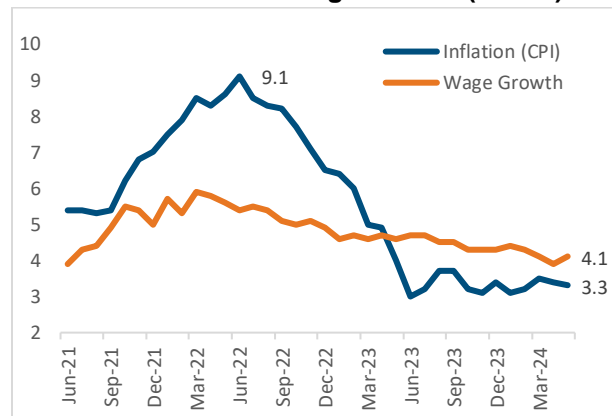
Inflation measures how much a good or service *changes* in price over a given period, but it does not measure its *price level*. For example, if gasoline prices increase from three dollars per gallon to four dollars per gallon over the course of a year, that would result in year-over-year inflation of 33%. If gas prices stayed at four dollars over the next year, that would result in year-over-year inflation of 0%. So even though we're stuck with four-dollar gas prices (five dollars if you live in California), economists would be cheering about zero percent

gas price inflation because inflation measures the change in price, not the level of price.

Inflation Has Fallen

With that in mind, inflation has fallen dramatically over the last couple of years. The most recent CPI report indicated that prices rose by 3.0% YOY, dramatically lower than the June 2022 peak of 9.1% YOY. In comparison, wage growth is running at about 4.1% YOY, nearly 1.0% above inflation.

Chart 1: Inflation and Wage Growth (YOY%)



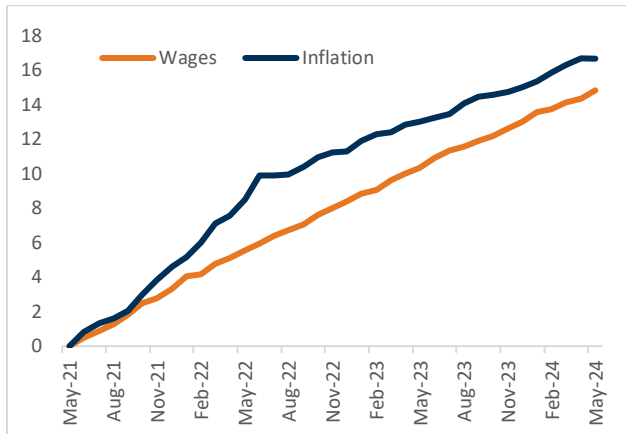
Source: Bloomberg

In fact, you can see in Chart 1 that wage growth has been above inflation since May of 2023. On the surface, this looks like a victory for the consumer. However, the inflationary effects from 2022 continue to impact consumers today.

Level Matters Too

To show how the 2022 spike in inflation impacts consumers, we show the cumulative growth of

Chart 2: Growth in Wages and Inflation (%)



Source: Bloomberg

inflation and wages over the last three years in Chart 2. You can see that inflation and wages grew at a very similar rate for the first six months of 2021. Inflation then accelerated sharply until June of 2022, creating a significant gap between inflation and wages. Thankfully, the gap has closed over the last year as inflation has come down and wage growth has stayed elevated. However, you can see that over the last three years, prices (inflation) have risen much more than wages.

While we should all be happy that inflation has declined, it will likely take consumers a few years to fill the hole in their spending power.

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