Will Inflation Continue to Fall?

February 7, 2023

The U.S. economy has experienced high inflation since the spring of 2021, with disagreement over how long this trend will last. Policymakers have debated whether more contractionary fiscal and monetary policy is needed to return to price stability or if it is unnecessary because price stability is already on track to be restored.

Inflation has been falling recently, but the current level is still very high—inflation from 2011 to 2020 averaged 1.7%. According to the consumer price index (CPI), inflation stood at a seasonally adjusted 6.4% for the year ending in December, down from the June 2022 peak (9.0%). The question remains whether this trend will continue.

What Do the Data Tell Us?

Twelve-month inflation rates get the most attention because monthly inflation is volatile. However, currently those rates are not necessarily indicative of the most recent trends, because they include the very high monthly changes in January through June 2022. Assuming those increases are not repeated in future months, they will roll out of the 12-month rate in future months, automatically causing the 12-month change to decline. For example, energy prices rose 11% and headline inflation rose 1.2% in a single month in March 2022 (see **Figure 1**). In March 2023, those increases will fall out of the 12-month change.

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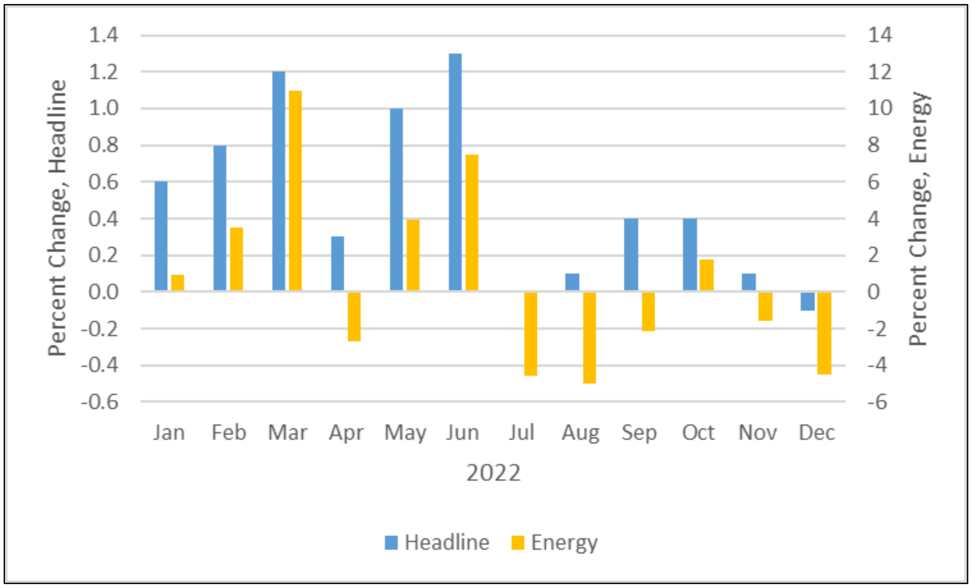
Figure 1. Monthly Change in CPI

2022

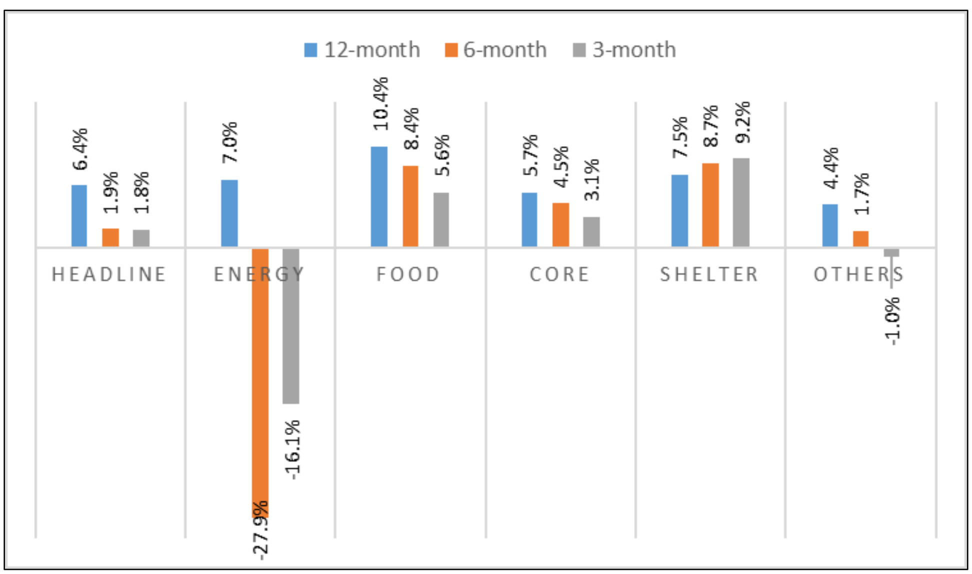


Source: BLS CPI.

To analyze more recent inflation trends, **Figure 2** shows annualized inflation rates over the three-month, six-month, and 12-month periods ending in December 2022 for various categories. *Annualized* inflation rates will be used to calculate how much prices would change over a year if the rate of change stayed at that pace, allowing comparisons of time periods of different length. The 12-month rate of headline (overall) inflation (6.4%) is higher than the six-month (1.9%) and three-month (1.8%) rates, indicating an overall downward trend, particularly in the past six months.

Figure 2. Annualized Inflation Rate by Category

Periods ending December 2022



Source: BLS CPI.

To determine whether headline inflation will continue to slow, it can be helpful to consider its subcomponents. Food, energy, and shelter account for about half of CPI. Some of the movement in headline inflation in the past year can be accounted for by extreme movements in food and energy prices. Those prices rose rapidly in the first six months of 2022 with the Russian invasion of Ukraine. Energy prices then fell rapidly in the last six months of 2022, while food inflation moderated but remained relatively high.

Inflationary pressures have not been limited to just food and energy prices, however. They are present across nearly all types of goods and services. Assuming no further disruption in energy markets, low inflation will be restored in future months only if prices of other goods and services stabilize. Here, the data tell a mixed story. Because food and energy are notoriously volatile from month to month, economists often look at core inflation, which excludes them. Annualized core inflation fell from 5.7% over 12 months to 4.5% over the past six months to 3.1% rate in the three months ending in December. However, although core inflation is lower than headline inflation over 12 months, it is higher over the past six and three months and it has fallen less, so the 12-month change in core inflation is less likely to benefit from high monthly values falling out in future months. The slower decline in core inflation could indicate that inflationary pressures will persist.

Shelter (housing costs) makes up 33% of CPI. In December, the 12-month inflation in shelter (7.5%) outpaced headline inflation for the first time in the past two years. Unlike other categories, shelter inflation has accelerated in the past six months (8.7%). Given increases in house prices and rent prices over the past year, and shelter's large weight in CPI, it is possible that the shelter category will keep headline inflation high over the coming months. However, current shelter inflation may be overstated because of how it is calculated. Data for rent (and imputed rent for owners) is collected from the same household only once every six months, which may allow for a lag for price increases to be incorporated into inflation. There has been debate about whether rent increases have slowed rather than accelerated over the past six months, causing shelter CPI to overstate current inflationary pressures. For more information, see CRS In Focus IF12164, *Housing and the Consumer Price Index*.

If food, energy, and shelter are removed, the remaining portion of the CPI (comprising 53% of the total) rose 4.4% in the past 12 months, but the three-month rate was -1%, a sign that other prices are potentially beginning to stabilize.

Outlook

Until the last six months, food and energy price increases were concerning because they were feeding through to the rest of the CPI, which had not happened in recent decades. If this is no longer happening, it would be a positive sign that inflation may be back under control. Inflation less food, energy, and shelter over the past six months is consistent with price stability. However, that measure represents only one half of the CPI.

Although these trends are promising, it would be premature to assume that high inflation is no longer a problem. As seen in **Figure 1**, inflation was still high in two of the past six months. Shelter inflation is high and rising, although to some extent that may have methodological causes. Core is only slightly above average in the past three months, but one should not read too much into three months of data given the volatility in monthly price movements. Inflation would need to continue falling over the next few months to verify that price stability has been restored. The improvement in six-month headline was partly caused by the large decline in energy prices, which is unlikely to be repeated. Conversely, while additional food and energy price shocks are not expected soon, if they occurred they might feed through to core again.

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