



The Consumer Price Index *aka* Inflation

I'm sure many of you have heard of the Consumer Price Index, or CPI as it's commonly called. And you'd probably heard about it because CPI data is published every month by the U.S. government's Bureau of Labor Statistics and is reported on heavily by financial and general interest news channels. Why? Simply because CPI measures monthly changes in the prices of goods and services most commonly consumed by U.S. households, and is a measure of supply versus demand, which in turn is a measure of the health of consumer spending, one of the key pillars that holds up the U.S. economy. Governments and businesses also use CPI data to adjust wages, social security, retirement benefits, food stamp programs, budgets for school lunches across the nation, adjust rents and for a host of other reasons.

The Bureau of Labor Statistics has classified expenses into 200 categories, arranged into eight major groups. Government statisticians compile CPI data from about 23,000 retail and service establishments and 50,000 landlords and tenants. The increase in CPI over twelve months is what's commonly called *annual inflation* and our government watches this closely to set economic policies. And inflation, for those of you who remember my piece from a few months ago, directly impacts the value of our dollar relative to foreign currencies, primarily of our trading partners, and so impacts imports and exports – key drivers of our economic growth.

So now that you have some background on CPI, here are its eight major groups:

1. Food and Beverages: Food prices, broken down into food *at home* and *away from home*. This includes breakfast foods, full meals, beverages and snacks - fruits, vegetables, dairy, meat, fish, poultry, eggs, cereal, bakery products, beverages, oils, sugars, sweets – items most Americans typically pick up at grocery stores, and prices of food typically consumed outside such as burgers, pizza, sandwiches, shakes, steak and so on.

2. Housing: Price increases tied to housing - mortgages, rents, hotel room costs; owner's and renter's insurance; household energy and utility bills, water, sewer, trash collection; home furnishings; and general household expenses such as for cleaning supplies, repairs, maintenance, etc.

3. Apparel: Price changes on clothes, jackets, suits, sweaters, footwear, jewelry, accessories and so on, worn by typical American families.

4. Transportation: Costs associated with private and public transportation – new and used vehicles; insurance expenses; gasoline, diesel costs; parts, maintenance and repairs; on the public transportation front –price changes for flight, bus, train, subway tickets and so on.

5. Medical Care: Expense changes related to home medication, prescription drugs, medical supplies, physician services, hospital stays, routine dental and eye care, prescription eye glasses and so on – for all age groups – infants, children, adults and seniors.

6. Recreation: Prices on items like movie tickets, amusement parks, video games, DVDs, books, television, cable or satellite, toys, sports equipment, sporting events and so on.

7. Education and Communication: School and college tuition increases, prices for books and supplies, childcare and everything related to education; then for communication expenses tied to phones, Internet, computers, laptops, printers, postage supplies and the like.

8. Other Goods and Services: Prices on items like tobacco, smoking, haircuts, personal care, funeral expenses and so on.

When tracking CPI, the BLS also includes government fees such as water and sewerage charges, auto registration fees, vehicle tolls and sales and excise taxes – because these are real expenses borne by American households.

However, income and social security taxes and investment items (stocks, bonds, real estate and life insurance) are excluded because taxes can never be applied to purchasing consumer goods and services, and investments relate to savings, not to consumption.

Food and energy prices are typically very volatile because of supply disruptions – for food due to storms, severe weather, cold or heat waves and other such factors that disrupt costs; for energy due to global supply fluctuations related to fires, political instability, disruptive moves by cartels and so on. And remember too, that a major cost of food is the cost of hauling it to your table, which directly depends on gasoline and diesel prices... so food and energy are often clubbed together when talking about CPI data.

I'm speaking about the CPI this week because it is a key measure of your wallet's ability to keep pace with rising prices, of the drop in the dollar's purchasing power each year, and of a minimum hurdle that your investments should surpass, on average, year after year. So the next time someone talks about CPI, they likely will tell you where prices have risen the most, and give you some insights on where to cut back spending and stay within budget. Your earnings, investments and assets must ideally at least keep up with inflation so you can afford to maintain your standard of living. But ideally, you must grow your investments at an even greater pace. So that, in a nutshell, is a bit about CPI. And for the record, CPI or inflation stood at 3.4% for the 12 months ended November 2011.