DIVISION OF AGRICULTURE
RESEARCH & EXTENSION
University of Arkansas System

COVID-19 Impacts on Arkansas' Agricultural and Rural Economies

UPDATE: April Consumer Price Index Report

Prepared by:

John Anderson
Department of Agricultural Economics and Agribusiness

May 13, 2021

On May 12, the U.S. Department of Commerce, Bureau of Labor Statistics (BLS) released consumer price index (CPI) figures for April. Released monthly, the CPI provides a broad measure of inflation and is one of the more closely-watched economic indicators.

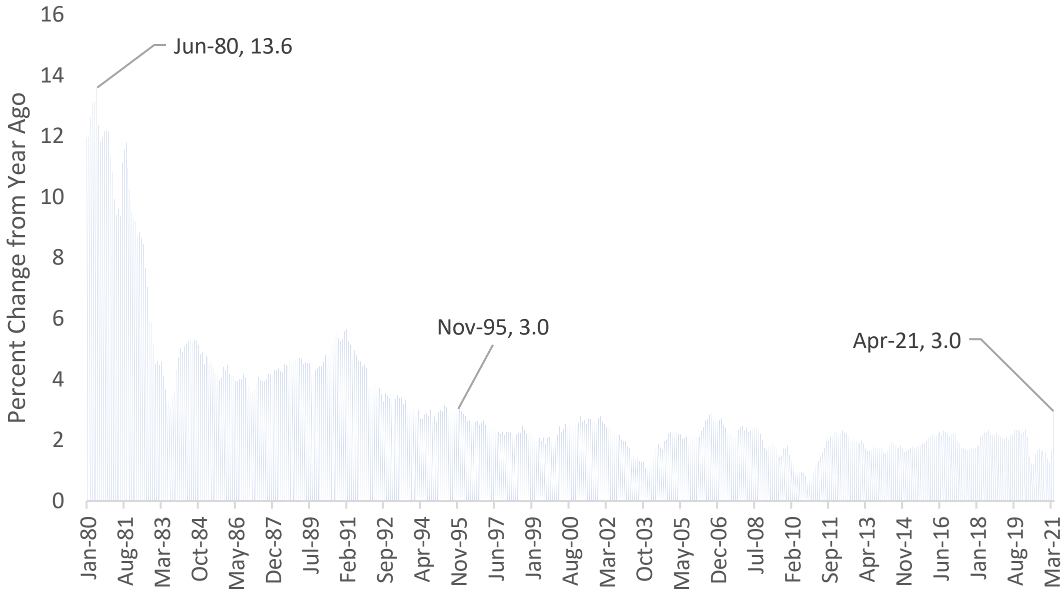
As most observers expected, the CPI for April showed a marked increase in the general level of prices. The CPI for all items (that is, based on all items surveyed by BLS for CPI calculation) rose by 0.8% from March to April. In context, that's a sizable jump in prices. The last time the CPI rose by that much in a single month was in June 2009. It is common to look at inflation figures on a year-over-year basis. The CPI for April 2021 was up by 4.2% from April 2020 – the largest year-over-year increase in CPI since September 2008.

Beyond these headline numbers, the CPI report for April included some interesting details. The CPI for gasoline actually fell by 1.4% in April compared to March following four consecutive months of sharp increases – including a 9.1% month-over-month increase from February to March. This supports the argument that the recent run-up in fuel prices was driven by a convergence of temporary factors. Unfortunately, temporary factors seem to have a way of cropping up in quick succession lately. It remains to be seen how this month's east coast pipeline hacking will translate into retail gasoline prices for May, but it clearly is not going to do anything to keep them down.

The April CPI for food was a bit higher than the prior month, up 0.4%. This represents an acceleration in prices from the last few months, but it is obviously far below the unprecedented spikes in food prices that occurred in April through June last year during the height of the pandemic.

It is common to look at the CPI on all items excluding food and energy, often referred to as core CPI. This is not meant to imply that inflation on food and energy are less important. Obviously, for assessing the significance of price impacts on households, these are some of the most important items in the CPI market basket. But food and energy prices tend to be relatively volatile over short time frames, introducing quite a bit of noise into the CPI series. Removing these items permits a focus on more persistent price movements that might point more accurately to inflationary pressure in the economy. It is a way of identifying trends in price moves that may be driven by longer-term underlying factors. Core CPI rose by 0.9% in April compared to March. That is a large month-to-month increase. In fact, it the largest monthly increase in core CPI since April 1982.

Any time inflation figures invite comparisons with the 1980s, people get understandably concerned. It is important to recognize, though, that a month or two of price increases does not necessarily make an inflation spiral. The year-over-year price change numbers probably provide a more appropriate context for assessing the current situation. The core CPI for April 2021 is up 3% over the past twelve months. This is not a small change: it is the largest year-to-year percent change in core CPI since the mid-1990s – but it is a far cry, still, from the double-digit annual inflation rates that those of us of a certain age remember so well from the early-1980s. In short, recent inflation estimates should be taken seriously – the general level of prices does appear to be rising. This should be expected as the economy re-engages and consumers begin to spend more freely – remember that through the pandemic, consumers have been saving at historically high rates. But a round of 1980s-level inflation is not at all inevitable from our current position. Figure 1 shows the year-to-year percent change in monthly core-CPI going back to January 1980.



Data Source: Bureau of Labor Statistics through St. Louis Federal Reserve Bank

Figure 1. Consumer Price Index for all Urban Consumers, All Items Less Food and Energy in U.S. City Average (Core CPI): Percent Change from Year Ago, January 1980 to April 2021

One of (several) reasons that increasing inflation is so concerning is that it puts irresistible pressure on interest rates. No lender is going to loan money at 5% when the rate of inflation is 7%. In real terms, the lender actually loses money on that deal. Interest rates will cover the expected rate of inflation plus a return to the lender. Interest rates are therefore a good place to look for signs of inflation. So far, they don't seem to be showing a whole lot of concern about rampant inflation. The 10-year treasury bond yield – the rate of interest on a U.S. treasury bond maturing in 10 years – rose by 0.05% on the day of the latest CPI release. That is a pretty healthy daily jump but far from unprecedented. The 10-year treasury yield hit 1.69% on May 12 – still lower than it was as recently as April. To be sure, there are some signs of growing inflation concerns. The spread between interest rates on regular 10-year treasury bonds and 10-year treasury inflation protected securities (the TIPS spread) is often used as a measure of inflation expectations. That spread has recently reached its highest level since 2013. Overall, though, most market participants seem to be chalking up the latest CPI figures to pandemic dynamics. Consumers are resuming more normal life: eating out, traveling, spending on things that they couldn't or didn't spend on during the pandemic. Those are overall positive developments, and the price pressure of this re-adjustment is likely to be temporary and manageable. This is certainly not an argument for complacency – nobody wants a replay of the early 1980s – but it is a pretty good case for not panicking.

\