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CFA Trending Topics

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Is technological disruption helping maintain low inflation?

Key takeaways:

- U.S. inflation has climbed above 2% this year and wage growth reached 2.9% in August. August's year-over-year growth in hourly earnings was a 9-year high, but both CPI and core inflation returned to May levels in August (2.7% and 2.2%, respectively).
- Will business cycle strength and global macro factors push inflation higher, or will deflationary factors such as widespread technology-driven disruption contribute to keeping inflation contained?

Last year, inflation hovered persistently below the U.S. Fed's target of 2% and economists' forecast models even as the macro-economy strengthened. Janet Yellen described this as a "mystery", and some economists and forecasters have argued that the traditional relationships between the unemployment rate and wage growth no longer apply, or that prevailing theories on the mechanisms of monetary policy are due for major revisions.

Technology-driven disruption is among the factors that may have shaped inflation results alongside the inflation target-setting expectations of the Federal Reserve and other central banks. Underneath the headline inflation of 2.7%, there is a wide range of inflationary and deflationary components. Technology advancements have long contributed to decline in the prices of goods; for example, TVs were down 18% year-over-year in the latest August reading, which continues a long trend. Cross-industry disruption using technology, such as Internet comparison shopping or the growth of the sharing economy (e.g., lodging and travel) have spread technology's deflationary properties across more of the consumer basket. Dishes and toys got 12.8% and 9.3% cheaper, respectively, in the last year. August's 1.6% seasonally adjusted m/m decline in apparel prices was the largest drop since 1949. Some commentators link the competitive effects of things like price comparison to sluggish wage growth, with deflationary pressure in retail also compressing companies' margins.

However not all segments have seen price declines. Gardening and lawn care services rose 8.9%, elementary and high school tuition 4.8% and hospital services 4.2% in the last year. Do the offsetting pockets that contribute to modest inflation in the whole basket identify top candidates for future disruption?