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## The Nature of Cumulative Price Increases

I received a question lately about inflation that I'd like to share with you. I was asked how inflation can be coming down, and yet groceries still feel incredibly expensive with just a few items costing \$100. I think that's a great question that many people have, and the answer relates to what economists call the baseline effect.

To understand, you just have to think back to when prices started increasing significantly in the spring of 2021. Every month since then that prices have increased, those increases have added up to today's much higher prices. At its peak in June of 2022, inflation was 8.9% compared to 12 months prior. Most recently, in May of this year prices increased by 4.0% compared to a year ago. Certainly, that's better than almost 9% inflation, but again, remember that any price increases we are now seeing are cumulative, meaning they are on top of the higher prices we started paying two years ago. It's a snowball effect. If wages were keeping up with inflation, it wouldn't be as painful for the average household. But even with the significant wage increases across most industries over the past couple of years, May was the first month in two years that average hourly earnings increased more than inflation did.

What does this mean for the future of inflation and the higher interest rates that the Federal Reserve is using to bring down inflation? Well, the latest comments from the Fed hint that the rate pause they decided to do last week will be followed by at least one more hike in July and perhaps one more before the end of the year. This is because prices are indeed still increasing even if they are not increasing as much as they once were. It's also due to the increases happening across most goods as represented by what's called the core CPI.

And the bad news for consumers is that prices are not coming down, in other words, there isn't any disinflation going on. For us to see grocery prices like we had in early 2020, we would need prices to decrease by the large percentages that they have increased over the past three years. And unfortunately, that's not likely to happen.

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