

## US Daily: Updating Our CPI Forecasts to Reflect Changes to the Health Insurance Methodology (Walker)

- The Bureau of Labor Statistics (BLS) recently announced changes to its methodology for measuring the cost of health insurance. Under the new methodology we expect the health insurance component to swing from -4% per month to +1% per month starting in October before slowing to 0% per month starting in April 2024.
- The BLS is implementing two main changes that address separate issues with the current methodology. First, the BLS is switching from a one-year moving average of the underlying data to a two-year moving average in order to dampen its volatility. Second, the BLS is switching from an annual version of the main underlying data to a semiannual version in order to reduce the lag between the underlying data and the CPI index by six months.
- Our PCE inflation forecasts are not impacted by the methodological changes to CPI health insurance, as the PCE price index uses different source data to measure health insurance costs.

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## Updating Our CPI Forecasts to Reflect Changes to the Health Insurance Methodology

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A couple of weeks ago, we argued that the last two CPI reports have overstated the slowdown in core inflation because residual seasonality and health insurance have made negative contributions that will soon turn around. Since then, the Bureau of Labor Statistics (BLS) has announced changes to its methodology for measuring the cost of health insurance. We expect those changes will initially leave intact the acceleration in the health insurance component from -4% to +1% per month implied by insurer profit data, but will cause the component to slow to 0% per month starting in April 2024.

Starting with the October reading (released on November 14<sup>th</sup>), the BLS is implementing two main changes that address separate issues with the current methodology. First, the BLS is switching from a one-year moving average of the underlying data to a two-year moving average in order to dampen its volatility. Second, the BLS is switching from an annual version of the main underlying data to a semiannual version in order to reduce the lag between the underlying data and the CPI index by six months.

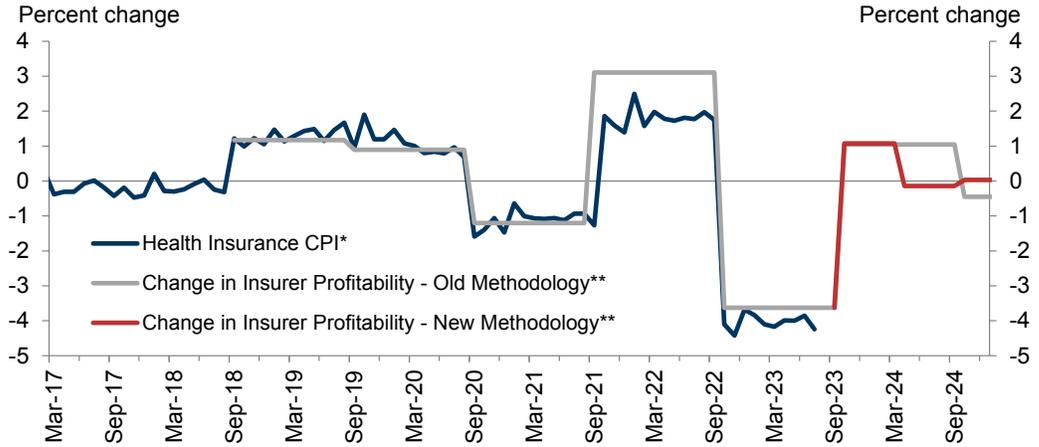
Under the prior methodology, we had expected the incorporation of the 2022 underlying data to result in a swing in the CPI health insurance component from -4% m/m over the prior year to +1% m/m for twelve months (between October 2023 and September 2024; Exhibit 1 gray line). Under the new methodology, switching to a two-year moving average means that the 2022 underlying data would instead contribute roughly +½pp for 24 months.

However, the methodological changes the BLS is implementing require a few one-time adjustments to avoid adding permanent distortions to the CPI index. Most importantly, in order to transition to a shorter lag, the BLS will accelerate the period over which the 2022 underlying data is incorporated into the CPI index by condensing twelve months of readings into six months.<sup>1</sup> This means that incorporating the 2022 data will contribute +1pp per month from October 2023 to March 2024 before falling to +½pp for the next twelve months starting in April 2024. In April 2024, the CPI index will begin incorporating underlying data from 2023H1, which we expect to offset the boost to the two-year moving average from the 2022 underlying data and push the monthly CPI readings down to roughly 0% (Exhibit 1, red line).

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<sup>1</sup> In order to transition to a two-year average, the BLS also needs to purge the impact of the recent underlying data that has already been incorporated into the CPI index from the two-year moving average. This is referred to as the “adjustment term” in their technical documentation.

**Exhibit 1: We Expect Health Insurance Inflation to Swing From -4% Per Month to +1% In October Under the New CPI Methodology Before Slowing to 0% in April 2024**

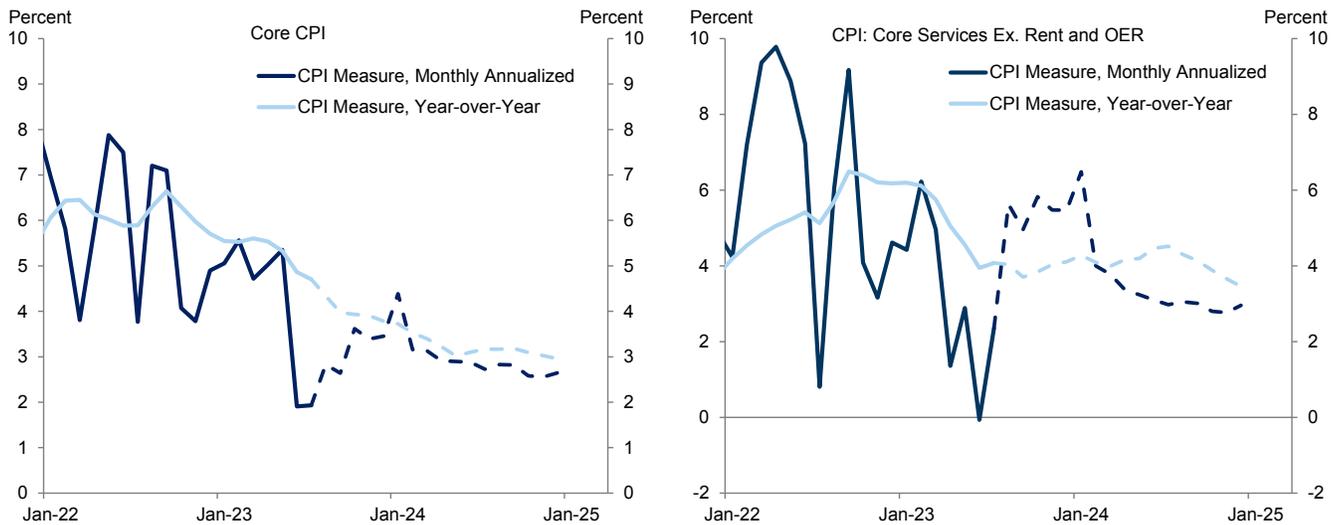


\*Adjusted to exclude the trend in hospital services and physician services prices (average, 3CMA).  
 \*\*Data on retention-benefit ratios transformed to CPI-equivalent basis. Forecasts average across United Health, Cigna, Humana, Centene, WellPoint, and Molina, and use company guidance for future quarters when available.

Source: Department of Labor, Company data, Goldman Sachs Global Investment Research

Under our new forecast for CPI health insurance, we continue to expect core CPI and especially core services ex. housing inflation to accelerate in the coming months but to slow more quickly next spring (Exhibit 2). We expect monthly core CPI inflation to rise from 0.16% in June and July to 0.22% on average in August and September and 0.30% from October through January before slowing to 0.24% by April 2024. We expect monthly CPI core services ex. housing inflation—where health insurance holds 3x the weight—to accelerate from a three-month average of 0.14% to a 0.46% average over the next six months before slowing to 0.28% by April 2024.

**Exhibit 2: We Continue to Expect Core CPI Inflation and Especially Core Services Ex. Housing Inflation to Accelerate in the Coming Months but to Slow More Quickly Next Spring**



Note: Dashed lines indicate GS forecast.

Source: Department of Labor, Goldman Sachs Global Investment Research

Our PCE inflation forecasts are not impacted by the methodological changes to CPI health insurance, as the PCE price index uses different source data to measure health insurance costs.

**Ronnie Walker**

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