INFLATION - A REAL CONSPIRACY THEORY?

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In the movie, Conspiracy Theory, released in 1997, Mel Gibson plays a man obsessed with conspiracy theories whose theories prove out to be right. One bit of humorous dialogue from the movie, as I remember it, was between Julia Roberts, who is trying to help the character played by Mel Gibson (but still believes he is a nut case) and Mel Gibson. Mel Gibson is continuing to talk about "they" did this and "they" did that etc., and Julia Roberts finally says "who are 'they'?" Mel Gibson responds, "If I knew who 'they' were, they wouldn't be 'they'." I don't think of myself as a conspiracy theorist - but if you continue reading this article, there might be a little something to it, at least as it relates to inflation.

I have always been a St Louis Cardinal baseball fan, and the Cardinal's greatest all-time player was Stan Musial. Stan was the first player in baseball, in 1958, to earn $100,000 in one year. In recent times, the closest Cardinal to reaching Musial status might have been Albert Pujols. In fact, for a while, he was called "El Hombre" or "the Man" in Spanish. When Pujols signed a contract in 2011 to leave the Cardinals to play with the Angels, the Angels agreed to pay him roughly $25 million a year for 10 years. We have all come to believe (because we are told this) that the long-term inflation rate has been 3%. At a 3% rate of inflation, a $100,000 salary in 1958 should equate to a $479,000 salary today. A salary of $25 million in 2011 compared to $100,000 salary in 1958 equates to an annualized rate of inflation of 11%. That is a pretty big difference between 11% and 3%. Of course, we can say that baseball is more popular and that television increased the value of sports franchises and player, and so forth. So, here are a few more examples of items that I have researched on the internet that most every consumer should consider.

According to University of Missouri Extension numbers, average farmland prices in Missouri have increased from $1380 in 2002 to $2900 in 2012, an annualized rate of increase of 7.70%. (Most land that has sold that I am aware of has sold considerably higher than $2900, but I used these numbers as reported by Mo Extension.) Iowa farmland during the same period has gone from$1920 per acre in 2002 to $7000 per acre in 2012, a 13.80% increase. Gold per ounce has increased from $309 per ounce 10 years ago to an average of $1832 in 2012, an annualized increase of 19.48% a year. (Gold has had a pull back this year, but the overall increase is still very large.) Oil has gone from $22.81 per barrel in 2002 to $91.82 per barrel at the end of 2012, an annualized increase of 14.94%. According to Bureau of Labor Statistics, the Consumer Price Index (a measure of inflation on consumer prices) was 181 on January 1, 2003, and 10 years later (on January 1, 2013), it was 230 - an annualized increase of 2.39%. What gives? How could it be that low?

I Googled "what items make up the consumer price index," and the best answer was the following.

“The CPI represents all goods and services purchased for consumption by the reference population. BLS has classified all expenditure items into more than 200 categories, arranged into eight major groups. Major groups and examples of categories in each are as follows:

* FOOD AND BEVERAGES (breakfast cereal, milk, coffee, chicken, wine, full service meals, snacks)
* HOUSING (rent of primary residence, owners' equivalent rent, fuel oil, bedroom furniture)
* APPAREL (men's shirts and sweaters, women's dresses, jewelry)
* TRANSPORTATION (new vehicles, airline fares, gasoline, motor vehicle insurance)
* MEDICAL CARE (prescription drugs and medical supplies, physicians' services, eyeglasses and eye care, hospital services)
* RECREATION (televisions, toys, pets and pet products, sports equipment, admissions);
* EDUCATION AND COMMUNICATION (college tuition, postage, telephone services, computer software and accessories);
* OTHER GOODS AND SERVICES (tobacco and smoking products, haircuts and other personal services, funeral expenses).

Also included within these major groups are various government-charged user fees, such as water and sewerage charges, auto registration fees, and vehicle tolls. In addition, the CPI includes taxes (such as sales and excise taxes) that are directly associated with the prices of specific goods and services. However, the CPI excludes taxes (such as income and Social Security taxes) not directly associated with the purchase of consumer goods and services.

The CPI does not include investment items, such as stocks, bonds, real estate, and life insurance. (These items relate to savings and not to day-to-day consumption expenses.)

For each of the more than 200 item categories, using scientific statistical procedures, the Bureau has chosen samples of several hundred specific items within selected business establishments frequented by consumers to represent the thousands of varieties available in the marketplace. For example, in a given supermarket, the Bureau may choose a plastic bag of golden delicious apples, U.S. extra fancy grade, weighing 4.4 pounds, to represent the Apples category. It should be noted that, many times, core inflation is discussed in the news, which excludes energy and food price increases which are considered more volatile. However we as consumers still have to buy food and pay for energy.

Now, let’s get into the near conspiracy stuff. According to the Bureau of Labor Statistics, the “Health Insurance Index” over the last 4 years increased at 4.3% between 2008 and 2012; yet, the Kaiser Survey of Employer Health Insurance Premiums went up 24.2% (5.5 times faster). (Article by Peter Shiff – “Inflation Propaganda Exposed” written January 10, 2013) Even more glaring is that for some reason health insurance premiums are only 1% of the CPI even though the average annual premium cost for a family of four is over $15,000 per year, nearly one third the median family income. If health care premiums go up 50% next year (and this might happen for you if you are a young adult based on estimates of what is likely to occur to young adult premiums with the Affordable Care Act,), this would only cause a .5 of 1% increase in the overall CPI as it is today but might be an increase in median family’s cost of living of 15% - quite a difference.

Another possible factor (I say possible because I read varying and differing answers on this question from different sources) is that in recent years the newer CPI methodology of how the consumer price index is figured has changed from reflecting changes in prices of a basket of items to reflecting changes in spending patterns, substitution bias, consumer choices and product changes ("Inflation Propaganda Exposed"). So, the inflation number is no longer just prices of a basket of goods but the cost of living or surviving, which can be different. Also, if an increase in cost is considered a quality improvement, it may not increase the CPI. As an example, if an additive is added to gas that costs 10 cents a gallon, but is considered a quality improvement, this is not added into the CPI even though the consumer pays this extra 10 cents per gallon. One video that I listened to says that this measure of inflation using the old way that inflation used to be measured in the 80s shows inflation up 9% a year instead of 2%. Another factor to consider with the CPI is that a person's specific situation might be more effected than someone else's situation. As an example, if a parent has a student in college and is paying his bill, the cost of college is much bigger for that family than the 1.65% that is the college component of the CPI. Also, the CPI uses rent equivalent in their housing component rather than the price of a house. If housing prices increase but rent is the same, the CPI won't move. Without belaboring the point, there seems to be differences that can make inflation higher than reported, at least based on specific circumstances.

Why would it benefit the government to have a bias toward a lower growth in the CPI? There are several reasons. One reason is that the Federal Reserve is trying to ignite the growth of the economy by printing money, buying securities, and keeping interest rates low. If inflation registered significantly higher, that would severely restrict their ability to keep interest rates low. Additionally, artificially low interest rates benefit debtors and asset prices at the expense of savers. Who is the biggest borrower? It is, of course, the US government. When a federal deficit is over $16 trillion, near zero interest makes the interest cost to the government very low. With low interest rates, asset prices like land and stocks increase as investors look for alternatives to deposit rates, while savers have their buying power eroded. Historically, bonds have returned 5%, a 2% real return over the stated 3% historical rate of inflation. Now, however, with rates near zero, investors are losing nearly 3% or more of their buying power which hardly seems fair to savers. If artificially low rates and almost unlimited money printing lead to inflation, as I think it will, the value of the dollar will go down, which again hurts everyone's buying power. Finally, Social Security is now based on the annual increase of wages, but there is discussion of tying it to the increase in the CPI. Again, if this change is made, and if the CPI has a bias towards the low side, this could make the increased cost to the government less. I can't help but think there are a lot of reasons for the government to "fudge" a little on the CPI numbers.

There is one item that has NOT increased in price for over 50 years - tennis balls. I am serious. I started playing tennis seriously in the late 60s, and tennis balls cost $3 a can. Over 50 years later, a can of balls still costs $3 or less. I have wondered for years about this fact; and a few years ago I read an article in the *Wall Street Journal* that pointed out there are only two items that had not gone up in price over an extended period, and one of the items was tennis balls. (Unfortunately, I don't remember the second item.) But, I think I made the right choice to be a tennis player, at least in terms of the cost of tennis balls. Unfortunately, racquets and shoes have gone up with inflation, so I didn't totally get a free ride.

It would be great if “they” would only be truthful with us about what is really happening with inflation. Who are “they”? If I knew for sure, they wouldn’t be “they”. (Note to readers: Please don’t tell “them” about tennis balls, or I’m sure we’ll see an increase in those also!)

Remember that every investor’s situation is unique and that it is important to review your specific situation with a financial professional.

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