The Truth Buried in Weak Inflation Data

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Rick explains what many interpreters of inflation data are missing.

The Consumer Price Index (CPI) measure of U.S. inflation came in below economists' consensus expectations last week, and the July headline number represented the fifth weak CPI print in a row. Many market watchers are again focusing on the disappointing headline number and taking a pessimistic view of the strength of the U.S. economy, characterizing the current economic environment as one lacking demand-driven pricing power for companies.

I believe this interpretation misses the truth buried in the data: Tech disruption is having an epic impact on U.S. consumption, driving one of the greatest supply-cost revolutions of all time. In short, new disruptive technologies in demand by consumers are a powerful disinflationary force holding down prices. A large part of what we're witnessing here could be described as the "Amazon effect," as the e-commerce retailer is disrupting large swathes of the goods economy. But this disinflationary dynamic isn't limited to e-commerce.

Take the transportation industry, and particularly the auto sector. Ride-sharing companies are disrupting the demand curves for auto purchases and the rental car business (think Uber, Lyft, Via, etc.), particularly in major urban areas. And electric vehicles are likely to disrupt the kinds of cars purchased and how much conventional fuel will be used in the years to come (to wit, the high demand for the Tesla Model 3). Already, expiring leases from the strong auto sales of recent years are combining with fleet disposals from struggling rental car businesses to place significant downward pressure on used car prices, as evident in the chart below. This in turn places downward pressures on new vehicle pricing and on the number of units sold.

New and Used Vehicle Pricing Pressured By Tech

chart-vehicle-pricing

In our view, what's occurring in the auto industry now is unlike the dynamics of prior cycles, so history is unlikely to be a reliable guide. These factors are ripping into the fabric of how we need to think about growth and inflation in this industry and more broadly. Other sectors and industries experiencing similar tech disruption include energy, telecom and hospitality.

The takeaway: We need to think about inflation differently than we have in the past. It's important to recognize the secular trends behind the data, namely technology disruption and changing demographics, and not just focus on the frequently reported headline numbers. These underlying forces are the key to returns today and in the years ahead.

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