

## Does Core Inflation Predict Overall Inflation?

By [DAVID LEONHARDT](#)

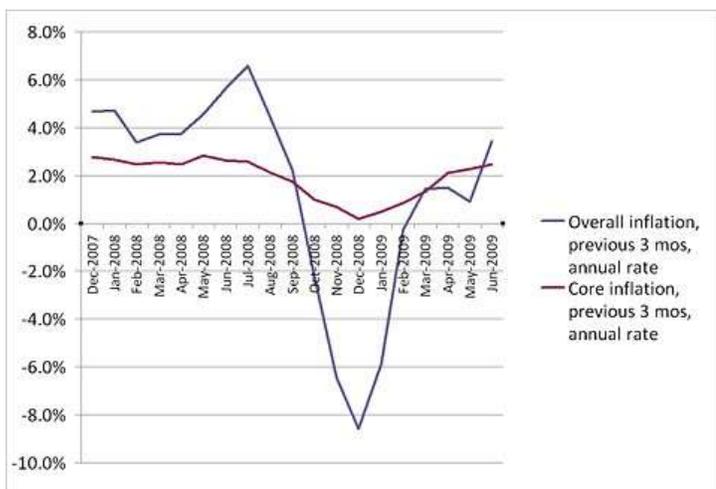
In his recent op-ed in The Times, Laurence Meyer, a former Federal Reserve governor, [argued](#) that core inflation — excluding oil and food prices — was a better predictor of future inflation than overall inflation was. In other words, if overall inflation is rising rapidly but core inflation is not, as is happening now, we should assume that overall inflation will soon drop.

That makes some logical sense. Oil and food prices are strongly influenced by forces outside the United States, like Mideast politics, South American crop yields and global economic growth. Unless American workers have enough leverage to demand raises that help their wages keep pace with inflation, their wages won't keep pace. And the economy won't then fall into the dreaded wage-price spiral, in which price increases lead to wage increases, wage increases cause companies to increase prices further and so on.

To see if reality matched this theory, I plugged the numbers on overall inflation and core inflation since 1980 into a spreadsheet. (I used [the inflation measure](#) from the gross domestic product report, which is the Fed's preferred measure, rather than the Consumer Price Index.) I then looked at two different correlations. First, the correlation between the last three months of overall inflation and the following three months of overall inflation; second, the correlation between the last three months of core inflation and the following three months of overall inflation.

If Mr. Meyer's theory is correct, the second correlation should be stronger. And indeed it is. On a scale of 0 to 1, it is 0.68. The first correlation — between the last three months and the next three months of overall inflation — is only 56 percent.

The first year of the recent recession offers a nice example:



Bureau of Economic Analysis, via Haver Analytics

In the fall of 2008, shortly after Lehman Brothers collapsed, overall prices plunged, driven by a sharp drop in oil prices. If you were looking at only headline inflation, you might think that the United States was entering a deflationary spiral. But core inflation never suggested deflation was at hand.

Sure enough, it wasn't. Prices soon began rising sharply — but the country was not then entering an inflationary spiral. Overall inflation was simply returning to the larger trend that core inflation showed all along.

The moral is that the Fed should not overreact to the recent increases in food and oil prices.