

## Inflation Beyond The Numbers

A couple of years ago a colleague was interviewing for a marketing position with a large hedge fund family. Panicked, he called me to ask for what questions he should ask. Without hesitation I said, “How do you go behind the numbers?” It worked.

All of this, naturally, brings us to the subject of inflation and whether it can be defined by a set of numbers or whether it is something else. If you want numbers, I can tell you where to get them, and in great detail. Our good friends at the Bureau of Labor Statistics and Bureau of Economic Analysis churn them out for categories and sub-categories beyond reason. Still, I think the exercise has huge holes involved.

### A Psychological Approach

I am going to offer a definition of inflation beyond the track-the-basket [Laspeyres](#) Consumer Price index or track-the-changing-basket [Paasche](#) indices: Inflation is the tension between what we feel the claims on our means are and what we feel our capacity to meet those claims will be.

If we use this and not the tracking of a basket to conceive of inflation, certain phenomena become easier to explain such as the outsized mental space devoted to tracking price-inelastic food and energy expenses. Those claims on our household budget are smaller than, say, housing costs but as we cannot cut back on our consumption significantly in the short-term, we feel trapped if not abused.

If we try to offset this psychological stress with stable-to-falling prices for, say, iPads as some have tried to do in their Marie Antoinette moments, the “does not compute” light starts flashing. As all behavioral finance studies point out, the pain of loss is about three times the pleasure of gain, and as you cannot eat your iPad, you feel squeezed by higher prices.

The definition works on the income side of the equation. Just as people save more when they are less confident about the future, they tend to diminish their self-perception of wealth, defined as the capacity to consume, when they see their future income streams at risk. If each dollar on the wherewithal side of the ledger is worth less, how different is that than the classic definition of inflation being too much money chasing too few goods and services?

Finally, when people see their governments at all levels in parlous financial straits and yet printing money like there is no tomorrow and acting as if they have an open-ended claim upon our income in the form of higher taxation and/or reduction of services provided in return, that contributes to the rising tension between claims on our substance and our ability to meet those claims. Is it any wonder the most effective way to get elected is to run against the government itself?

Inflation thus is a state of mind, not a series of numbers. If the price of ‘X’ rises and you do not want or need ‘X,’ who cares? I am not in the market for a Rolls Royce, so put the price wherever it amuses you. If the price of what I feel I need rises and I am trapped into paying it, I feel my money is worth less. If I feel my income is threatened or my investments are threatened, I feel my money is worth less. Those perceptions, that fear, are very real. The CPI is an abstraction and that is why, more and more, there is such a disconnection between what is reported and what people believe.