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Inflation Expands Beyond Supply-Chain Struggles to Service Sector

Core service prices jumped in September, driven by shelter, medical care and car insurance

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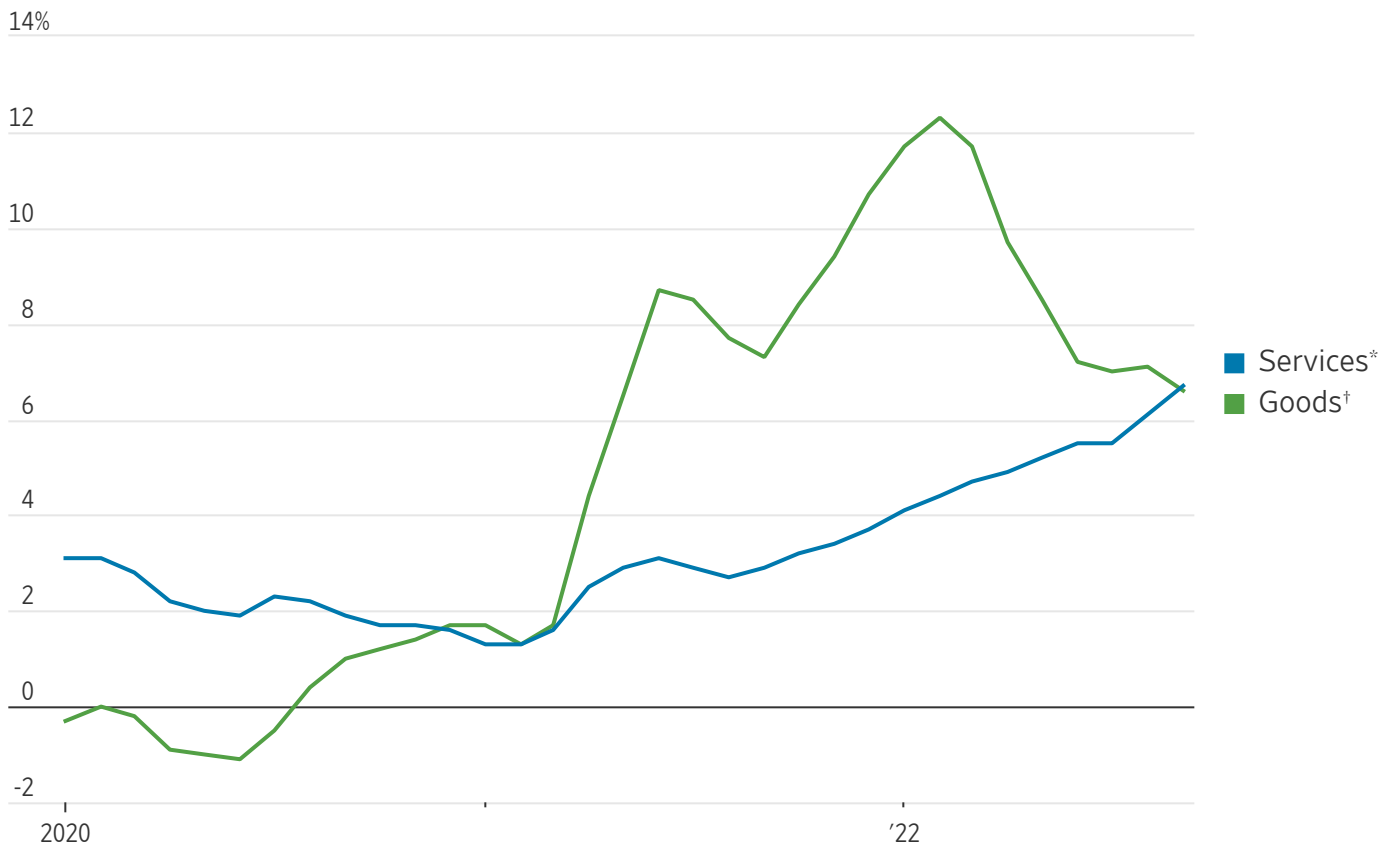
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Inflation started in goods affected by supply-chain issues. It isn't ending that way.

While costs to transport goods have declined and supply-chain snarls are easing, prices are now rising briskly in services.

Core service prices, which exclude energy, jumped 0.8% in September from August, the Labor Department reported Thursday, driven by shelter, medical care and car insurance. Core goods prices, which exclude food and energy, were flat. For the 12 months ended September, core service prices were up 6.7%, the fastest since 1982. They are now rising faster than core goods prices, which rose 6.6% the same month, down from a peak of 12.3% in February.

12-Month Change in Core Consumer Prices



*Excluding energy services †Excluding food and energy

Source: Labor Department

Services made up 74% of the 12-month increase in the core consumer-price index in September, the most in 18 months, according to investment bank UBS. That is up from around 50% earlier this year. In the separate price index of personal-consumption expenditures, which the Fed prefers, prices declined in both July and August for goods while rising in services.

Some economists are concerned that the broadening of inflation to the service sector is making it more difficult for the Federal Reserve to lower inflation to its 2% target over the long run.

Nathan Sheets, global chief economist at Citigroup Inc., said while goods inflation is starting to diminish he thinks services-based inflation could linger longer.

“There’s been this tightening of the labor market, wage pressure, services price inflation,” he said.



Shelter, nearly a third of the full consumer price index, rose 6.6% in September from a year before, the most in more than 30 years.

PHOTO: CAROLINE BREHMAN/SHUTTERSTOCK

High inflation typically reflects demand for goods and services running ahead of what companies can supply. In 2020 at the start of the Covid-19 pandemic, locked-down consumers shifted spending to goods such as backyard furniture and away from services such as vacations. Spending was also boosted by government stimulus. At the same time, the pandemic made it harder to produce and move goods around the world. That resulted in rising goods prices in 2021 and 2022.

As supply chains have untangled though, inflation in long-lasting durable goods has slowed, to 7.1% in the 12 months ended in September, down from 18.7% in February.

Gregory Daco, chief economist at EY-Parthenon, said inflation has shifted from being driven by the mismatch of supply and demand in goods to being more widespread, with services and wage growth playing an important role. Average hourly wages in the three months through both July and August were 6.7% higher than a year before, according to the Atlanta Federal Reserve, the highest in 20 years.

Ayşegül Şahin, a professor at the University of Texas at Austin, said higher wages are now a main driver of inflation, because they comprise more of the costs in services than goods.

“The recent inflation readings are driven by labor market tightness,” she said.



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PHOTO: CHRISTOPHER DILTS/BLOOMBERG NEWS

Wages, for example, are a major part of restaurant costs. Food eaten away from home, which includes restaurant meals, makes up around 5.2% of the consumer-price index, and its prices were up 8.5% from a year earlier in September, its fastest in decades. (The CPI actually classifies restaurant meals as goods, not services.)

Other labor-intensive services include haircuts and pedicures, which rose 5.1%, and miscellaneous services, such as lawyers and dry cleaning, up 6.5%. Combined those make up about 1.4% of the index.

Buck Services, which cleans churches, private schools and offices in the Chicago area, has raised wages for its 275 workers to \$15 an hour up from around \$13 before the pandemic, said human resources director Bill Buchholz. Those wage increases are now being passed onto the company's customers in the form of rate increases around 7% and above.

"The cleaners have to get paid more so the clients have to understand they have to pay more, too," he said.
