



Warsh Has Different Take on Inflation

THE OUTLOOK |

By Nick Timiraos

One number released this past week says inflation is running away from the Federal Reserve's 2% target. Another says it's nearly there.

The Commerce Department said Thursday that a widely watched measure of "core" consumer inflation, which excludes volatile food and energy items, was 3.3% over the last year. But a lesser known gauge called "trimmed mean" inflation, which filters out the most extreme price moves, was just 2.3%.

Ordinarily, that more benign number would carry little weight in where the Fed and the markets expect interest rates to go. That may be about to change.

At his confirmation hearing in April, Fed Chairman Kevin Warsh urged the central bank to pay more attention to measures like the trimmed mean, turning what had been a technical debate among economists into a live question for policy.

The question is whether these alternative measures are better at filtering out the effects of tariffs, AI investment and geopolitical shocks to produce a more accurate (and, for now, benign) picture of where underlying inflation is headed. Or do they understate underlying pressure because those same effects aren't actually one-offs but persistent forces shaping the economy?

Warsh has signaled he favors the first interpretation.

"What I'm most interested in is what's the underlying inflation rate, not what's the one-time change in prices because of a change in geopolitics or a change in beef," Warsh told lawmakers.

The consumer-price index, released by the Labor Department, tends to get the most headlines because it comes out early in the month and because Social Security payments, inflation-protected bonds and private contracts are tied to it.

But Fed officials pay more attention to the Commerce Department's personal-consumption expenditures price index, or PCE, which the central bank uses to define its inflation target. The measure captures a broader range of spending and adjusts for how consumers shift between products as prices change. Overall PCE inflation was 3.8% in April.

Core prices receive the most attention because volatile food and energy prices can obscure the underlying trend. Warsh called that measure a "rough swag" or inelegant approximation because it leaves in too many other one-off distortions.

Fed officials already consult a range of gauges that exclude outliers, such as a plunge in wireless phone prices or a one-off tariff bump. The trimmed mean makes that filtering more systematic.

Warsh didn't specify which trimmed mean he had in mind. The most widely cited is the Dallas Fed's version, which removes categories accounting for more than half of consumer spending each month.

Research from the Dallas Fed has shown its trimmed mean measure can be better than core inflation at forecasting future price growth over long stretches. But it failed in 2021, which weighs heavily on its usefulness now. Inflation began rising sharply during the pandemic in 2021, which most policymakers and forecasters thought at first would be transitory. For support, some pointed to the trimmed mean which showed inflation rising much more slowly.

It turns out that was partly because of the way the index was designed. From 1977 to 2009, price de---clines tended to be steeper than price increases. Excluding both equally would have biased the trend in inflation upward. To remove that bias, the Dallas Fed designed its index to discard the 31% biggest increases in a given month, but only the 24% biggest decreases. -Note

But the historical pattern flipped during the pandemic, and price increases became steeper than decreases. By discarding more of the increases, the Dallas Fed index inadvertently understated the upward trend in inflation.

As in 2021, the trimmed mean is today showing less inflation than the broader indexes. Is it understating the trend again?

It is too soon to tell. Tariffs have pushed up a range of prices for goods. AI-related spending is doing the same in software and computing.

Dallas Fed researchers said trimmed mean inflation was 0.7 percentage point lower than core PCE in April, mainly because it gave less weight to goods excluding food and energy, the items most directly affected by tariffs. -Note

Trimming the PCE index symmetrically—cutting the same share from the top and bottom of the distribution—closes much of the gap with core, according to a measure constructed by Employ America, a left-leaning think tank. It stood at 3% in April.

The think tank produces another version that excludes housing and other categories whose prices trail market conditions or aren't directly measured. That measure was 2.8% in April and has risen year-over-year for 13 consecutive months.

The strongest evidence that inflation isn't getting better comes from looking at the whole distribution of prices, which hasn't been consistent with the Fed's 2% goal since 2021 and which has drifted higher in recent months, said Riccardo Trezzi, a former Fed economist who runs an inflation-research firm. -Note

Warsh's position matters because it isn't really about one statistic, but how the Fed deals with the price shocks that an era of tariffs and geopolitical disruption may keep producing. Central bankers call this "looking through" a price move—deciding any price pressure isn't worth a policy response because they expect it to fade. -Note

"The question is whether 'looking through' becomes a principled framework or simply a way to downweight inconvenient inflation prints when needed," said Trezzi.

If these shocks truly are one-offs, the trimmed mean is giving the Fed a cleaner read on the trend and less reason to consider tightening policy. If they are masking broader demand pressures, these alternative gauges are providing false comfort and could leave the Fed behind the curve again.

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