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INVESTMENT AND WEALTH MANAGEMENT

What a little-known indicator can tell us about inflation

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In January 2022, inflation was at a 40-year high and a leading concern among consumers and investors. If you want to get a handle on where it is heading in the next few months, it will pay to keep an eye on the **Manheim Used Vehicle Value Index**.

This tracker of used car prices has been published since 1997, but it attracted little notice from economic forecasters until 2021. With the COVID-19 pandemic then in its second year, many people were moving out of densely populated areas, and they were wary of using public transportation. That spurred more demand for new cars than the auto manufacturers could supply, due to supply chain disruptions such as a shortage of semiconductors.

As vehicle-hungry buyers increasingly shifted their sights to the secondhand market, prices soared. As a result, used car prices suddenly became a major component of monthly changes in the Consumer Price Index (CPI). Forecasters realized that if they could predict the direction and magnitude of changes in the Manheim Index, they would gain a pretty good sense of the upcoming CPI numbers. Since then, the Manheim Index and other indicators (shipping costs, port congestion, …) have become a “proxy” to measure supply chain disruptions.

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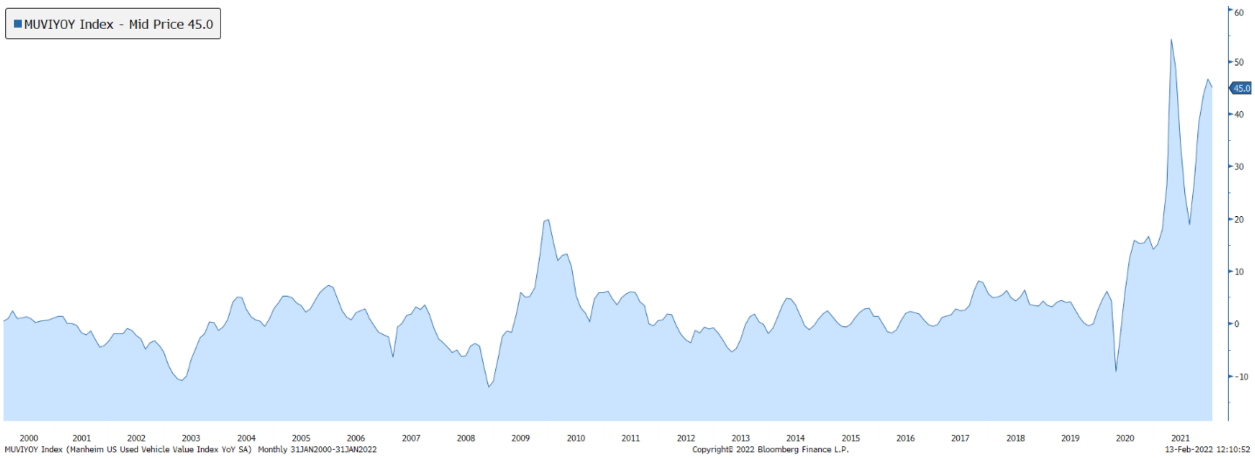
Graph 1 - Manheim Used Vehicle Value Index (year-over-year change)
In January 2022, the index increased over 45% compared to the previous year. This is a higher frequency indicator than the official Consumer Price Index and it can provide valuable hints as to what may be coming in future CPI Index releases.



Source: Bloomberg Professional Services

Manheim Index prognostication has not been easy. In April 2020, the year-over-year (YOY) change was a deflationary -9.1%. One year later, the figure was +54.2%. At that point, the rate of YOY increase in used car prices reversed direction. The series dropped to +18.8% in August 2021. Woe to any forecaster who expected that trend to continue, however. Once again, the rate of YOY increase changed direction, climbing to 46.6% in December 2021.

The most recent Manheim Index report was mildly encouraging for investors who fear that accelerating inflation will add substantially to the interest rate escalation already observed since the ten-year Treasury bond's August 2, 2021, low of 1.17%. (That benchmark rate breached the 2% barrier on February 10.) In January 2022, used car prices rose by a formidable +45.2% YOY, but that was down from the previous month's +46.6%. Given the Manheim Index's high volatility over the past two years, it could conceivably drop much further within a few months. That possibility offers hope for a tempering of CPI inflation, which made a new cyclical high of +7.5% in January.

Over the decades, certain economic indicators have experienced brief periods in the spotlight, only to return to the obscurity from which they emerged. Absent unusual circumstances that hinder the production of new vehicles, used car prices do not ordinarily drive the Consumer Price Index. Before COVID-19 came along, the Manheim

Index never rose by more than 20% year over year and frequently registered negative numbers. Until the present pandemic-related supply chain upheavals definitively end, however, this once little-known economic indicator will continue to bear close watching.

Sincerely,
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