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# Rents Are Falling, But CPI May Take Months to Catch Up

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In October 2022, rents tracked by Zillow recorded the slowest month-to-month growth since January 2021.<sup>1</sup> Because shelter represents nearly one-third of household expenditures, the cooling housing market prompted many to believe that the stubbornly high inflation may fall soon—they will likely be disappointed when the next inflation report comes out. This article explains why.

## Cost of Shelter in CPI

The Bureau of Labor Statistics (BLS) calculates inflation by tracking the prices of a basket of goods and services households regularly consume, commonly known as the Consumer Price Index (CPI). The shelter index within CPI has two main components (1) rent of primary residences and (2) owner's equivalent rent of residences. BLS collects information on rents tenants pay through its Housing Survey. BLS also conducts, though less frequently, Consumer Expenditure Survey (CES) to collect information on implicit rent for owner-occupied units, i.e., what homeowners *think* they can rent their home for. But information collected via CES is only used for the purpose of weighing expenditures within the CPI basket. On a month-to-month basis, BLS's shelter index is mostly driven by rent information collected from Housing Surveys.

## CPI's Rental Index Lags Market Rates

The Housing Survey collects price observations of rental housing units across the United States, divided into segments (one or more Census blocks). The CPI program collects rent data from each sampled unit every 6 months. Importantly, renters in the sample are asked about *contract rates*, i.e., the rent they would pay if they remained in the current lease. Since CPI is a cost-of-living index, tracking contract rates makes sense because they indicate how much families currently and actually pay for rental units.

Contract rates, however, are lagged indicators of the prevailing market rates. This is because new rates are not priced in BLS's data until the existing lease is renewed and rental leases are usually lengthy. Therefore, the rent index, and consequently the shelter index, almost always lags the market rental rate, by as much as 12 months according to some study.<sup>2</sup> In other words, even if the

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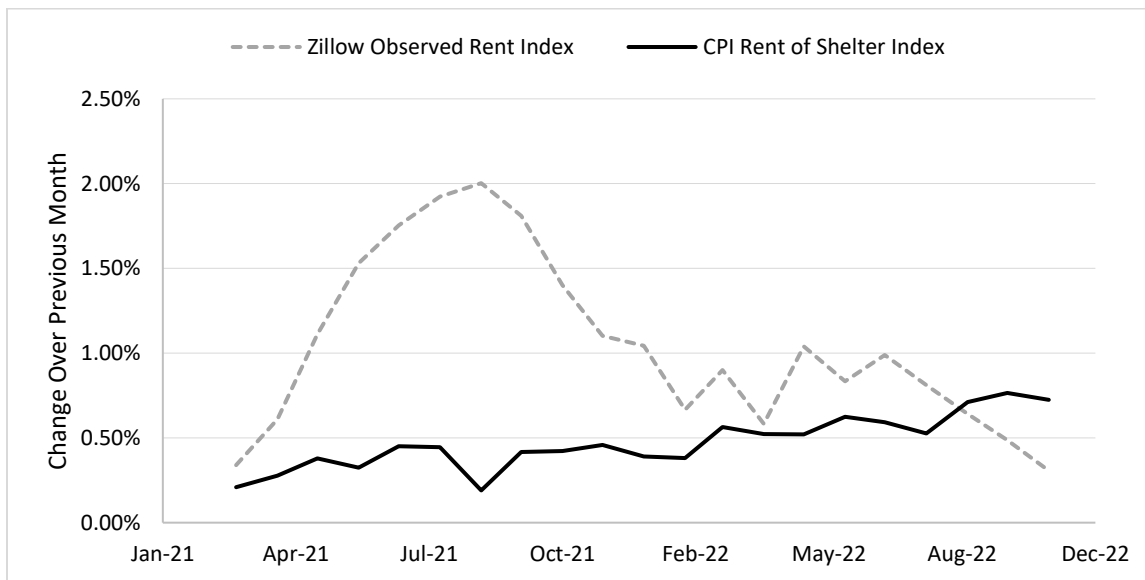
<sup>1</sup> "ZORI (Soothed and Seasonally Adjusted): All Homes Plus Multifamily Time Series (\$)". *Zillow*. <<https://www.zillow.com/research/data/>> (accessed Nov. 21, 2022).

<sup>2</sup> Adams, Brian, Lara Loewenstein, Hugh Montag, and Randal Verbrugge. "Disentangling Rent Index Differences: Data, Methods, and Scope." (2022). <<https://www.bls.gov/osmr/research-papers/2022/ec220100.htm>> (accessed Nov. 22, 2022).

housing market continues to cool off, the impact on CPI likely won't show up in official inflation reading until 2023.

**Figure 1** compares the month-to-month percentage change in two indices: (1) CPI's Rent of Shelter index and (2) Zillow's Observed Rent index, which measures the "typical observed market rate rent." The two indices show marked different dynamics since 2021. Two observations are particularly interesting. First, in the first two quarters of 2021, Zillow's rent index shows high and accelerating rent appreciation—over two percent for the month of August alone, which contrasts sharply with the low and stable growth in CPI's rent index. Second, CPI's rent index started to show an uptick in rent inflation around July 2022, when Zillow's rent index instead conveyed easing up in rent inflation.

**Figure 1:** *Comparing CPI Rent of Shelter Index Against Zillow Observed Rent Index*



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