More inflation is on the way, and health care bills are set to rise

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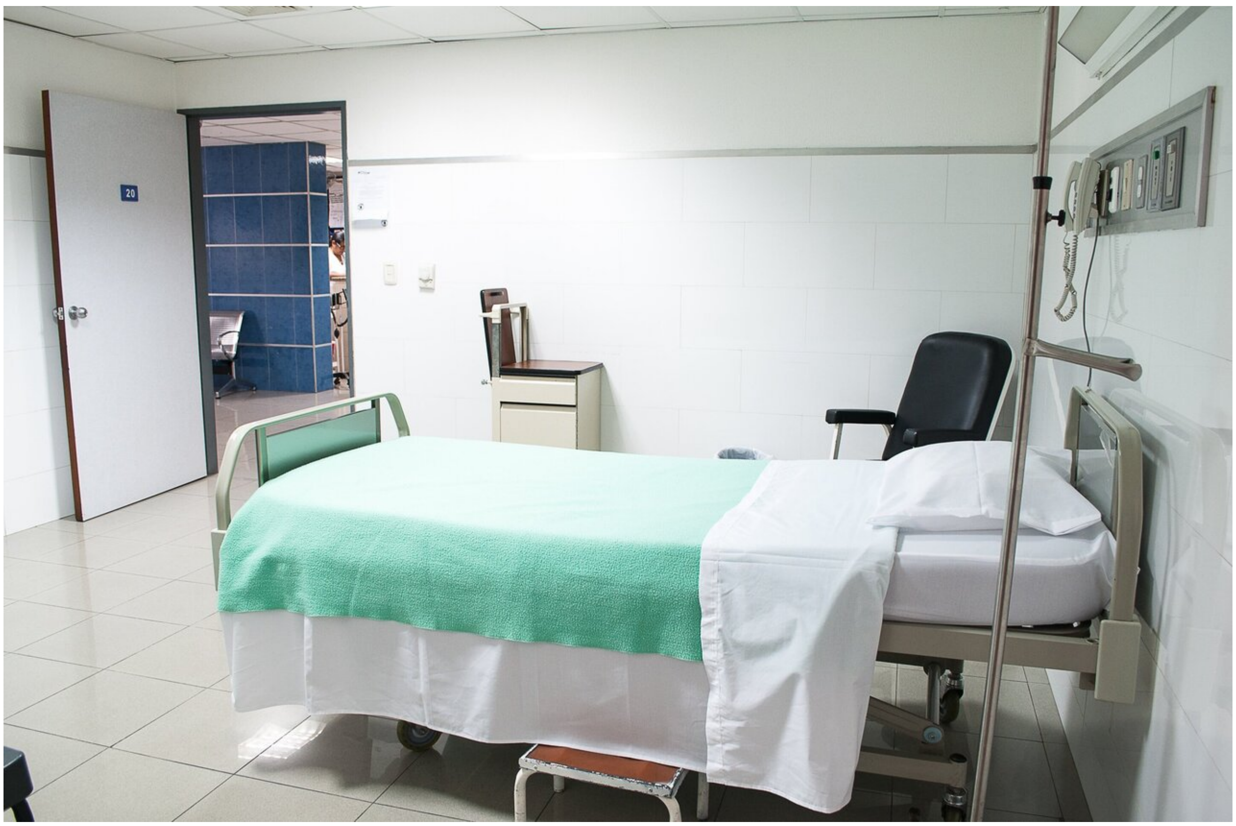

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Skyrocketing rent and food costs have company: Health care costs also are soaring, and what's worse, they're likely to rise much more and could help keep overall inflation elevated for some time, analysts say.

Inflation is expected to boost annual U.S. national health expenses by $370 billion by 2027 compared with pre-pandemic projections, consulting firm McKinsey estimated in a report in September.

The medical care index, a subset of the consumer price index, accelerated to 0.7% in the month of August from 0.4% in July. Over the past year, it was up 5.4%, the largest 12-month increase since 1993 but still below the overall 8.3% pace of inflation.

That lag in health care inflation to overall consumer inflation could be an ominous sign for consumers.

"This is unusual, as health prices historically outpace prices in the rest of the economy," said a team of analysts led by Emma Wager at the Peterson-Kaiser Health System Tracker in a report last month. "This may lead to steeper premium increases in the coming years."

Why is health care getting more expensive?

Higher costs of supplies and labor are contributing to the increases.

Early in the pandemic, health care supply prices spiked amid supply disruptions and higher demand. Between 2019 and 2022, pharmaceutical prices rose 21% and supplies by 18%, McKinsey said. Those costs are still higher than normal but are showing signs of slowing.

In contrast, labor costs are still growing strongly and probably will outpace the overall inflation rate, analysts say.

"Labor's very significant because it has the potential to be persistent," said Shubham Singhal, global leader of McKinsey's Healthcare, Public Sector and Social Sector practice.

He expects wages will continue to rise as the health care labor shortage worsens while demand for services grows, partly the result of an aging population.

Between 2019 and March 2022, a measure of hospital labor costs called the median labor expense per adjusted discharge rose 37% to $5,494 from $4,009, Kaufman Hall consulting firm said in a report in May.

Will health care premiums go up?

Consumers who buy their own insurance could start seeing steep premium increases next year.

Across 72 insurers in 13 states and the District of Columbia in the Affordable Care Act (ACA) Marketplaces, the median proposed premium increase next year is 10%, higher than in recent years, early estimates by Peterson-Kaiser Health System Tracker show.

Health care prices are set at least a year ahead, creating a delay before wage increases and other costs related to broader inflation are fully incorporated into health care costs.

Providers who have dealt with soaring costs in the past 18 months only recently are getting a chance to renegotiate payments and pass on some added costs to insurance companies or government entities.

By 2024 all employers' costs "will be crushing in full force," Singhal said. "Much of that will fall to consumers because employers have premium sharing" with employees.

"It's a slow-moving train," he said, but it's coming.

How do medical care costs affect inflation and Fed rate decisions?

Because health care, like rent, typically doesn't see regular price surges, when its prices rise, economists consider this "sticky" or persistent inflation. They take a long time to rise and a long time to decline.

Inflation could stay higher longer and lead to the Fed raising its short-term benchmark fed funds rate even higher to squash inflation. Most consumer rates follow the Fed's benchmark rate higher, which makes borrowing more expensive and discouraging spending. Less spending means less demand, which cools inflation.

How can the cost of health care be reduced?

Layoffs and increasing productivity can cut costs, McKinsey said.

More than 25% of executives in a McKinsey survey believe they may have to cut at least 10% of their workforce, mostly nonclinical employees like personal care aides, in the next six to 18 months, it said.

Executives (66%) also want to improve productivity with technology, especially in processing paperwork.

Longer-term, Singhal said, the industry can accelerate value-based care, which ties payments to the quality of care provided. This contrasts with the dominant fee-for-service reimbursement, which pays providers for services delivered based on bill charges or annual fee schedules.

Another strategy would be moving some hospital care to different sites. "Some surgeries can be done cheaper in an ambulatory surgery center instead of a hospital," Singhal said. "Home care settings can also be the same or better quality at lower costs."

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