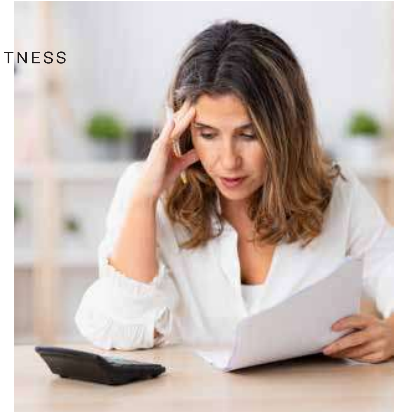
The Economics Lessons of Inflation

BY ERIK FORD

We are all living the economics lessons of inflation. We are being told by the powers that be that inflation is coming down and it is all good, but every trip to a grocery store or gas station reminds us that it is not good at all. The inflation rate coming down does not result in prices actually declining, only in prices rising at a slower pace. We are stuck with the current price level and it is only up from here, even if at a slower pace. The speed at which this latest bout of inflation kicked off surprised everyone, not least of which was the Federal Reserve Board, which reacted late with one of the most rapid interest rate increases in history.

The increase in overall price level over the last three years has been around 20% cumulatively, although some items have increased more than that. Food, for example, has increased more than the overall price level. Wage increases have not kept up with the increase in prices, meaning "real wages" have declined. Real disposable income is down 7.5% since January 2021. Our dollars do not go as far as they once did. It is no wonder that the average American is grumpy.



There is a valid argument that what we are feeling is an actual cost of living increase that is even greater than the reported figures because the sharp increase in interest rates does not flow through the consumer price index (CPI) calculation. For example, if the prices of cars and trucks does not change, but vehicle loan rates increase, the higher resulting payments will not be reflected in the CPI calculation, but the effective cost of a vehicle to the consumer increases.

The same can be applied to other financed items such as student loans, credit cards, and the biggest typical household payment of all, mortgages. The higher costs of everything plus the cost of financing is putting a strain on households across the country. As a result, personal savings are down, and credit card balances are up. The latter 38.7% higher since 2021.

Granted, inflation has come down from the peak, but the February and March inflation readings ticked up from January and remains above the Federal Reserve's target of 2.0% annualized. The last few points of reduction toward the target are the hardest to achieve. Much like losing 25 pounds, the first 20 may be a lot easier than the last five.

Beyond the immediate impact on family budgets, inflation is a factor that must be included as we work through our financial planning. How if affects future costs of living may be the biggest, but also how it may affect investment return expectations and our ability to save during our working years. A financial professional can be very helpful in pulling all of these factors together and guide your thinking for a comprehensive financial plan.

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