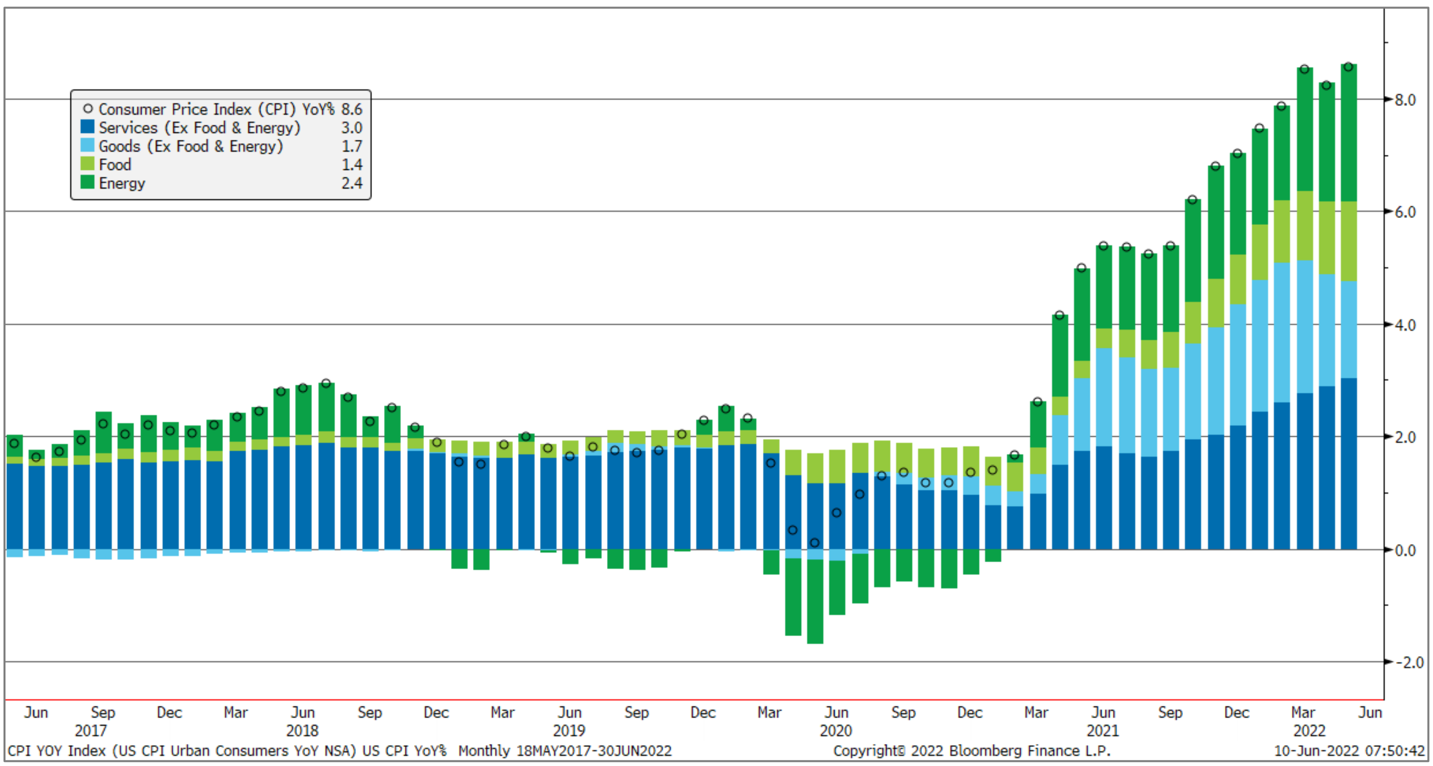
Economic Update

Consumer Price Index – June 10, 2022

Inflation is a common topic on investors' minds these days, and the most quoted economic statistic related to inflation is the Consumer Price Index (CPI). The CPI is an index prepared by the Bureau of Labor Statistics each month and tracks year-over-year price changes on more than 200 categories.

The most recent CPI release, reported on June 10, 2022, was an 8.6% increase year over year. This rate of price increases in America is higher than normal over the last four decades, and much higher than what the Federal Reserve, investors, and consumers desire.

Below is a chart showing the CPI increase over time and is subdivided into four major categories: Services, Goods, Food, and Energy. As the chart indicates, the Services category was the main source of inflation in previous years but has increased only slightly recently. However, the main contributors of the recent higher inflation reports are Goods, Food, and Energy.



Source: Bureau of Labor Statistics; Bloomberg Finance L.P.

In simplest terms, inflation is a rise in prices due to an imbalance of supply and demand of goods and services. Therefore, a rise in prices is a result of too little supply to offset the demand for any given product.

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In the case of the CPI survey, this supply and demand imbalance is measured across a broad variety of goods and services. Some of the items with the largest increase year over year are as follows:

- Fuel oil, up 100.6%
- Gasoline, up 48.7%
- Eggs, up 32.2%
- Public Transportation, up 26.3%
- Margarine, up 25%
- Used Cars and Trucks, up 16.1%

By contrast, the prices of certain goods have actually fallen in recent times, including:

- Audio Equipment, down 0.7%
- Televisions, down 9.5%

While the supply side of the inflation equation is affected by the disruption of production and delivery chains, the demand side is usually driven by the abundance of available money. The availability of money is not only determined by accessible funds in individuals' checking or savings accounts but is also influenced by the borrowing costs of money (i.e., interest rates). Hence, increasing the cost of capital can slow the demand side of the equation.

Given this context, we turn to the Federal Reserve, to whom much of the country is looking for a resolution on the current inflation situation. But while much is made of the Fed's role in responding to inflation, it should be noted that Federal Reserve actions can only address the demand side of this equation; the disruption of production and delivery chains mentioned earlier influencing the supply side of inflation is well beyond the scope of anything the Fed can control.

However, the Federal Reserve does have some tools at its disposal to help decrease available money in the system, thereby reducing the demand currently contributing to inflation. To that end, they recently raised the target on Federal Funds Rate from a low of 0.75% to a high of 1.0% on May 4, 2022. The next Fed decision is scheduled on June 15, 2022, where the expectation is continued rate increases to help slow the demand side of the inflation equation.

Additionally, the Federal Reserve expanded its balance sheet by buying debt in recent years, which also introduced liquidity (i.e., more available money) into the marketplace. On top of the aforementioned interest rate hikes, the Federal Reserve also plans to reverse this balance sheet expansion policy by not purchasing additional debt, and by not reinvesting proceeds from bonds that have matured. The shrinking of the Federal Reserve balance sheet will likely contribute to additional tightening of the money supply alongside the increase of interest rates, with the intent of further reducing demand.

Investors need to be aware that these efforts to slow demand could have a negative impact on the economy in the short-term. Equity markets have a history of not liking uncertainties, and uncertainties like we face today can cause excessive market movement, both up and down. This volatility could potentially continue until the Federal Reserve settles on a long-term Fed Funds target rate, coupled with inflation levels showing signs of decreasing.

However, the ability to time these market movements has historically been nearly impossible and trying to do so can be disastrous to an investor's nest egg. We encourage investors to remain focused on the long-term, and to focus on aligning portfolios to established objectives. Please contact your trusted financial professional if you would like to review these objectives.

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