

On The Mark

Will High Inflation Last Forever?

Special Edition

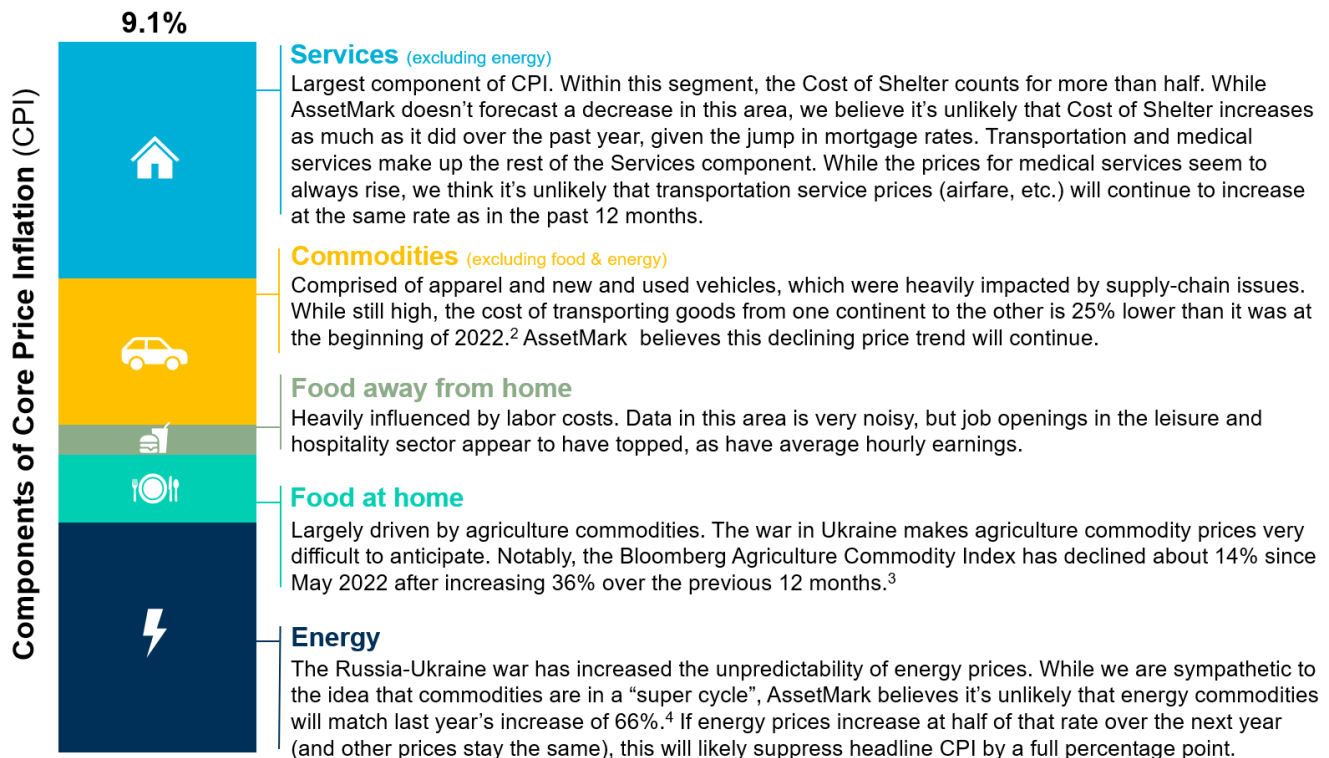
Highlights:

- Inflation hit 9.1% in June—its highest level in four decades.¹
- The Fed raised interest rates in an effort to slow US growth and moderate inflation. Fed officials are signaling another 75 basis points (bps) hike at the July 26-27 meeting due to the latest inflation numbers.
- A lower inflation rate doesn't require falling prices; it simply requires prices to not rise as fast as they did last year.

Milton Friedman famously declared that inflation is “always and everywhere a monetary phenomenon”. While it's hard to disagree with a legendary economist, monetary economics don't quite capture real life and how we're feeling today. Inflation hurts all of us, and it can profoundly influence our expectations and behaviors. For many, inflation brings back 1970s-era memories of long lines at gas stations and ballooning mortgage rates. If inflation persists for too long, it can spur people to make panic or bulk purchases which can drive prices even higher. We haven't seen this scenario play out yet because the US economy is slowing and reducing demand.

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As a refresher, inflation is measured by the Consumer Price Index (CPI), which calculates the average monthly price that consumers pay for a basket of goods and services. As inflation recently increased 9.1% through June 2022, the largest 12-month increase since November 1981, let's review the key components that drove the increase and assess if the category prices may rise or fall over the next 12 months. See the chart below for details.



Slowing Down Inflation Doesn't Mean Prices Will Be Lower

In an inflationary environment, higher prices eventually lead to lower growth, which contributes to lower prices, and ultimately, lower inflation. By recently raising interest rates to combat inflation, the Fed is accelerating the lower growth phase of the process. Does this mean prices will fall? Probably not, because slower inflation just means that prices don't rise as fast as they did last year.

Sources:

1. Bureau of Labor Statistics. Economic News Release – Consumer Price Index (CPI). July 13, 2022. <https://www.bls.gov/news.release/cpi.nr0.htm>
2. Bloomberg
3. *Ibid.*
4. *Ibid.*

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