MOORE
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Understanding Inflation

The debate about inflation is a longstanding one in macroeconomics. There are always doomsayers warning that inflation is around the corner, and then others trying to calm those fears. Alarmists most often recall the tumultuous 1980s 14% inflation rate and are concerned a relapse might be on the horizon. There is currently considerable disagreement about how concerned people should be about inflation. Before the pandemic, the unemployment rate had fallen by quite a bit, to the point that typical economic thinking would have said it should have caused inflation to rise. But we did not see that happen. Some economists think the pent-up demand from the pandemic lifestyle is driving a rise in spending as COVID-19 becomes more under control. That influx of money into the economy could push prices higher, in turn potentially driving inflation above the Federal Reserve's target rate of just over 2%.

What is inflation?

Simply put, inflation is a general rise in prices. Your dollar doesn't go as far as it used to. Each month, the Bureau of Labor Statistics releases a report called the Consumer Price Index (CPI) to track these fluctuations. It is based on detailed expenditure information provided by families and individuals on purchases made in food and beverages, housing, apparel, transportation, medical care, recreation, education and communication, and other groups and services.

Here is a recent example, based on the CPI measures for April 2021. The index was up 0.8 percent for the month, more than the 0.6 percent increase in March. And Core CPI was up 0.9 percent. Compared to a year ago, the index was up 4.2 percent, a big jump, but the core index increased by 3 percent. When you take out food, gas, and used cars (the price of which increased by 10 percent over the course of a month), year-over-year inflation was 2.6 percent. In other words, depending on which segment of the economy you're looking at, you can see there are different stories to tell about what's happening with inflation.

What are we seeing now?

We are all feeling the rise in energy prices, up 25% over the past year, including a near 50% increase for gas. This reflects the latest numbers available and don't include any increases from the oil pipeline that was shut down by a cyberattack. Iron, copper, lumber, cotton, and computer chips are jumping in price. The dollar has weakened, making imports more costly. Employers are having to raise wages to fill record openings; the federal government is spending heavily; and consumers emerging from the pandemic are in the mood to spend some money. It is worth noting that oil, the most important industrial commodity, has been a catalyst for every big spike in consumer price inflation since the early 1970s. Fiscal and monetary stimulus are also pushing up prices.

Why should I care about inflation?

I do not believe that Inflation is something that should keep you up at night. Yet it wouldn't be prudent of me as a community bank leader not to warn you of some risk ahead. Investors are now beginning to say they are more worried about inflation than the pandemic, and bond yields, often a sign that investors expect inflation, have gone up. The expectation of inflation also matters because those expectations can affect how businesses and consumers act. If businesses think inflation is coming, they may increase prices, and that can push inflation up. It has been my experience that once everybody starts worrying about it, inflation can take root.

But remember, inflation is one of many measures to gauge what's going on in the economy, along with things like unemployment and wages. A small amount of inflation can be a sign of a healthy economy.

How can I protect myself against inflation?

To be clear, I do not expect catastrophic inflation anytime soon. But it never hurts to reinforce your financial plan ahead of uncertain economic times. Here are three steps to help you prepare.

1. Continue to invest in the stock market. Companies that produce, distribute, or sell necessities (utilities, milk, toilet paper, blood pressure medicines for example) can do well in inflationary times. Discretionary products and services (restaurants, travel, entertainment) are more likely to slow down.
2. Keep up with your emergency fund. A saving account is a valuable tool, even in a low rate environment, and gives you great peace of mind.
3. Work to reduce debt. Any variable rate consumer debt could rise so work to reduce these balances.

My bottom line? Inflation will likely be a factor in the coming months. Chances are, it will be temporary and, hopefully, uneventful. Work to protect your finances. If inflation starts to increase too quickly, the Federal Reserve can increase interest rates to try to slow things down. That means consumers could see higher interest rates on car loans and credit cards. On the flip side, they will earn a little more on their savings. Pay attention but do not panic and shift your money into gold and bitcoin! All of us here at Anahuac National Bank are here to advise you so call on us at any time. We appreciate your patronage and your confidence.