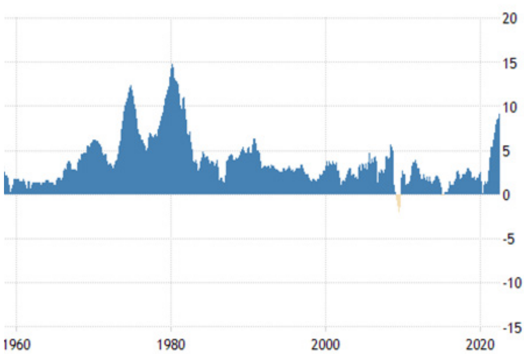
WHO INVITED INFLATION TO THE PARTY?

Like most economic questions, inflation is a matter of supply and demand. Put simply, inflation (rising prices) occurs when too many dollars (demand) are chasing too few goods and services (supply). High demand and low supply equals rising prices. That means there are generally two sides of the equation that can lead to inflation—overheated aggregate demand, or limitations on supply. Right now, we appear to have both, thanks largely to the COVID-19 pandemic and responses to it.

Recall what happened: COVID-19 hit in early 2020, immediately causing severe supply disruptions. People stayed home (voluntarily and involuntarily), businesses were closed and the production of the goods and services economy ground nearly to a halt. The country—and really, the entire world—went into steep recession and job loss. In response to this, governments (especially the U.S. government) injected unprecedented sums of money into the economy in an effort to soften the blow to the public and to avoid even worse contraction in the economy. Simultaneously, central banks, including the Federal Reserve, took interest rates to zero and made unprecedented credit facilities available. In layman's terms, the government opened a fire hydrant of cash into the economy, letting the money flow in a way unmatched by anything in modern times.

In essence, the economy—globally and domestically—has experienced cascading demand and supply shocks over the last couple years. The result has been inflation not seen since the early 1980s.



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For perspective, the annual inflation rate in the U.S. peaked (hopefully) in June 2022 at an over 40-year high of 9.1%. Energy CPI reached a 42-year high of 41.6% that same month. July 2022 saw a slight easing of overall inflation—clocking in at 8.5%—driven mainly due to a slow down in energy prices. Despite this welcome progress, inflation continued to march higher for food (10.9% in July, the largest increase since May of 1979, versus 10.4% in June); shelter (5.7% vs 5.6%); and used cars and trucks (6.6% vs 1.7%). While economists are cautiously optimistic that inflation has, indeed, peaked, very few anticipate returning to the steady, low inflation of the last 20 to 30 years in the short term.