Inflation Woes

Dear Dr. Per Cap:

I keep hearing that rising inflation is hurting the economy. What exactly does that mean?

Signed,

Worried Budget

Dear Worried Budget

The simplest and best way I know to describe inflation is how much more you have to pay this year than last year to achieve the same level of well-being.

We all know that over time things go up in price – rent, food, cars, college degrees. Rising prices are no joke and I'm old enough to remember when you could fill up a gas tank for ten bucks and buy a Big Mac for less than three quarters.

A little inflation is a normal part of a healthy economy, but if inflation gets too high and things get too expensive, consumers stop spending money. This hurts the economy and creates problems for businesses and consumers.

High inflation is usually caused by a really strong economy in which consumers have lots of cash. Everybody wants to buy stuff which creates pressure on materials and labor for goods and services as well as transportation. Limited supply and strong demand causes things to increase in price – always has, always will.

According to the consumer price index (CPI), a common tool for measuring inflation, we're currently experiencing the steepest rise in inflation in over a decade. CPI is a statistical gauge which calculates the price changes of about 300 common goods and services. As of June consumer prices are up 5.4% from the year before. That's more than double the inflation rate typically seen in the U.S. Moreover, CPI has been trending upward every month since January.

This latest bout of inflation is a result of a strong post-pandemic economic recovery that's getting a little too hot. Almost half the population is fully vaccinated, lockdowns have ended, and consumers are flush with stimmy money and savings. Because so many people are eating out again, shopping, and traveling businesses are struggling to keep up. They pay more for inventory and to hire employees. Then they pass these costs onto consumers by raising prices.

This makes it tough on families who have to pay bills. High inflation is also bad for investors because asset prices usually tumble when an economy goes south.

Pay attention to the U.S. economy between now and the end of the year. This latest inflation could just be a little bump in the road or it could signal the beginning of a longer economic drought.

In the meantime get ready to pay more for everything from donuts to doorknobs because some retail stores and restaurants are hiking prices by as much as 4%. Also keep a lookout for fewer discounts and "shrink-flation" which occurs when products don't come with a higher price tag but are repackaged in smaller weights and quantities. Like a few years ago when orange juice bottles magically shrunk from 64 ounces to 59 ounces. Talk about a day without sunshine.

We could be in for a rough ride. I suggest socking away a few extra bucks to inflate your savings cushion to offset inflated prices.

Ask Dr. Per Cap *is a program funded by First Nations Development Institute with assistance from the FINRA Investor Education Foundation. For more information, visit www.firstnations.org. To send a question to Dr. Per Cap, email askdrpercap@firstnations.org.*