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Speaker 1

Welcome. My name is Andrew Baron, and this is Well, it Depends! The podcast where I present the pros and cons of financial decisions so that you, the audience, feel better informed when you are confronted with these decisions in your own life. In this episode, I ask the question, should I worry about inflation?

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Speaker 1

Getting into it, should I worry about inflation? Well, it depends. Inflation has been a hot topic so far in 2022 and I think it makes sense to take a step back and review where we've been to better explain where we're going. So in 2020, we as a society shut down the global economy because of the sheer suddenness and how unprepared most people were, this caused demand pressure to build up substantially.

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Then, as the economy opened back up, some of this demand was relieved. But remember, because we shut things down, we had bottlenecks from goods that weren't built or assembled during this time. There were mass layoffs, and companies had to scramble to rehire and train employees to meet those demands. Because labor was now valuable, employees took the opportunity to negotiate higher wages or changed employers to seek higher wages.

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Companies can choose to absorb these higher costs or pass them on to the consumer in the form of higher prices, which is a form of inflation. More recently, markets have been rallying for the last month because investors felt confident that the Federal Reserve was close to controlling inflation through interest rate increases.

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Inflation may have peaked, but that's not certain, and the overall number remains high, around 8%. Overall, CPI for June / July is up 8% year over year, which is similar to May / June. The big question is whether we are able to avoid a recession with inflation and prices still pretty high. We're at the edge of a big canyon trying to avoid falling in. Some analysts say we are already in a recession, but most disagree and say we aren't in one yet.

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Whether we can have a soft landing, being a mild recession or not at all, is still up in the air and the Federal Reserve is doing its best to avoid a major recession. If the short term rates continue to increase, we could see a significant inversion of the yield curve, which would be a solid indicator of recession. This means that compared to the three month yield and the ten month yield, the three month yield would have a higher yield value, which we would say is inverse of what we would expect where traditionally longer term would have higher rates.

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On the positive side, we see that oil prices are coming down as Saudi Arabia has announced that they will increase production. Recent legislation passed to increase semiconductor chip manufacturing as well as the Inflation Reduction Act have passed as well. The inflation Reduction Act has some aspects that are negative to the market, including a tax on companies who are buying back their own stock at a 1% tax.

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China's recent interest rate reduction does take a little pressure off the September rate increase by the Federal Reserve. Unemployment is still around 3.6. This means that the labor market is very strong and continues to drive the economy forward, even as we are seeing the headwinds with inflation and interest rates. It's likely that the Federal Reserve needs to keep raising interest rates as they aren't going to reduce inflation.

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With interest rates at 3% when inflation is over eight. Historically, we've seen that it takes a lot more to break inflation. Depending on where you are in your career, your lifestyle, and how you've prepared will determine your concerns regarding inflation. I'll start with the youngest workers and progress to the older generations. Recent graduates both high school and college and others in their twenties, are facing a lot of headwinds when it comes to inflation.

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Collectively, they own the least and as they haven't had much time to establish themselves yet, they're typically in entry level positions which don't command the same salaries as more experienced workers. However, they do stand to benefit from higher wages as the labor market remains competitive. This group is the most susceptible to layoffs in the event we do have a recession.

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Mid-career workers, those that are in their thirties, forties, fifties, who are established and who purchased their homes before the pandemic, are benefiting from the growth and property values. This is created in large part between the millennial generation buying houses for the first time and the baby boomer generation retiring and relocating. This mid-career worker group has had the time to build a cushion of savings and investments and therefore has the capacity to absorb these higher costs.

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Speaker 1

However, some costs, namely around raising a family, have increased considerably. Specifically, the costs of childcare services and higher education can squeeze even affluent families. Retirees and those approaching retirement have had the same benefits as the younger generations that own assets and had seen their increase in value, except perhaps on a grander scale, since they're likely to have owned their home for some time.

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The consideration for this group is that spending after retiring is different than spending while you're still working. You have to rely on outside forces providing for a cost of living increase versus when you were working and you could negotiate for more money or change employers for wage growth. Retirees must rely on increases from Social Security and their portfolio growth from their assets to accommodate their lifestyles.

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To recap, younger, less established workers without assets will need to seek higher wages to offset higher costs. This group needs to be prepared for recession, however, and should build savings where they can. High income earners and established workers can, for the most part, handle inflation by reducing their spending on wants to supplement the rising cost of the products they need.

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Retirees will need to rely on increasing asset prices and cost of living adjustment benefit increases to programs like Social Security so that they can keep pace with the rising inflation costs. Additionally, if we end up in a recession by its very nature, this will reduce demand and get a check on inflation. So to answer the question, should I worry about inflation? Well, it depends!

*Speaker 1 = Andrew Baron, CFP®, Enrolled Agent, Associate Advisor