TRANSITIONS

WHAT IS BEHIND THIS INFLATION?

Inflation is now running at 7.5%. How did we get here? Our economy has been grappling with massive supply chain problems, labor shortages, and higher energy prices. By themselves, these issues create inflation through higher prices as we experience a lack of supply to meet consumer demand. At the same time, both the Trump and Biden administrations spent trillions to stimulate a recovering economy that did not need stimulus. Although this fiscal policy added to inflationary pressures, the main culprit is the Federal Reserve, which runs monetary policy.

In March 2020, the Fed wisely took emergency actions during the temporary government shutdown of our economy. To stimulate the economy, they cut interest rates to near zero. Then to provide substantial liquidity to the markets, they began purchasing massive amounts of bonds each month, a monetary policy known as quantitative easing. What is unfathomable is even though the economy has been recovering, the Fed continues these inflationary, emergency actions nearly two years after the Pandemic began.

In 2020, the Fed's \$4.1 trillion balance sheet was considered elevated when compared to their \$2 billion amount of a decade earlier. Yet by the end of 2021, their balance sheet more than doubled to \$8.8 trillion. Even today, as the Fed has announced a policy of quantitative tightening, which is the opposite of easing, they continue to purchase bonds and add substantial liquidity to the markets.

Over the last decade, inflation was averaging 1.7%. Now we are experiencing the highest inflation rate since 1982. Even though the Fed's inflation target of 2% was passed many months ago, they continued to further inflate the economy with quantitative easing. The Fed, which hires numerous economists, provided excuses that inflation was "transitory", and it was attributed to the Covid Pandemic and was therefore "impossible to measure". Yet anyone who went shopping or put gas in their cars could easily measure inflation. Once inflation begins, it is never temporary or transitory. When everyone can feel the impact of material sustained inflation except the Fed, then they are too slow to act and are behind the

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curve in tackling inflation.

Also, with artificially low interest rates, the Fed is encouraging the mis-allocation of capital. It does not make sense to invest in a 10-year treasury bond paying a taxable 2.0% with an inflation rate of 7.5%. What is even more absurd is that investing in a 30-year treasury bond pays only a ¼% greater return. To motivate me to invest your money into fixed income securities, we need to see a normalization of interest rates that are set by the marketplace.

Part of the reason for this major monetary policy error is the Fed has lost much of its independence. Since its inception in 1913, the Fed operated monetary policy independent of the political pressures of the White House. There was a noticeable change when the current Federal Reserve Chairman began having daily conversations with the Treasury Secretary in the Trump White House. The current Treasury Secretary in the Biden White House was the former Federal Reserve Chair. Now, these ongoing conversations promote the appearance of Fed monetary policy being influenced by the politicians who run fiscal policy. As every President wants a strong economy as part of their legacy, it is critical that the Fed remains independent of politics to conduct monetary policy that best serves the economy. We look forward to a rapid change in monetary policy that will tackle the problem of inflation.

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