

Gregory E. Cater CWS® CRC® AIF®
Certified Wealth Strategist®
Certified Retirement Counselor®
Accredited Investment Fiduciary®

32731 Egypt Lane, STE 202
Magnolia, Texas 77354

936-321-1542
gcater@1stallied.com
caterwealthmanagement.com

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Greg Cate Sr. & Greg Cater Jr.

Does High Inflation Lead to High Interest Rates?

(Part Two)

We hit another record; the Consumer Price Index Year-Over-Year inflation rate (CPIYOY) reported last week hit 7.5%. The “experts” are still comparing today’s high inflation with rates 30 and 40 years ago. In our note dated 12/13/2021 we showed you how quickly inflation dropped from those high levels.

The root causes of the recent spike in inflation are very different from what we experienced in 1982 and 1990. To us it more closely resembles April of 1947 when CPIYOY hit 19.7% or June of 1920 when CPIYOY hit 23.7%. The highest inflation rates in the history of our country occurred after both WWI and WWII.

In Jun’1982 CPIYOY hit 7.1% and dropped to 2.5% in 14 months!

In Nov’1990 CPIYOY hit 6.3% and dropped to 2.6% in 14 months!

In Apr’1947 CPIYOY hit 19.7% and dropped to 0% in 26 months!

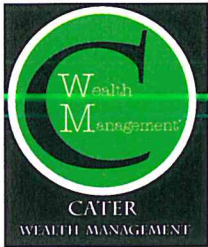
In Jun’1920 CPIYOY hit 23.7% and dropped to -15.8% in 12 months!!!!

Consumer Price Index YOY 1910-2022



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When our country is at war, industrial production “converts” from civilian goods to war goods (guns vs butter). Unemployment is low and wages are high. Civilian wages increased 65% during WWII. People had money, but there was little to spend it on. In 1944 the unemployment rate dipped to 1.2% of the civilian labor force, a record low in American economic history. Not to mention the 15 million soldiers (WWII) making a paycheck while being provided food and board (so to speak). When wars end factories must switch back to the production of consumer goods. This takes time, but eventually the shortages ease and prices drop. Supply-Demand imbalances caused the high inflation after both WWI and WWII. In both cases the high inflation didn’t last long.

COVID-19 shut down a lot of the production of goods worldwide. Things to buy became scarce. Closed factories need to be re-opened. Re-establishing supply chains takes time. During a time of shortages various government policies have attempted to maintain incomes which helped maintain demand. High demand and low supply leads to high prices (inflation).

We believe the root cause of today’s inflation mirrors the inflation spikes following both WWI and WWII.

If left alone the private sector will reverse the current supply-demand imbalances and bring inflation under control.

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