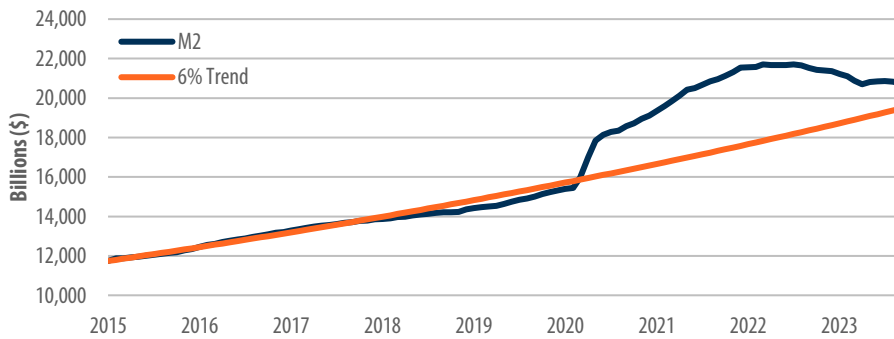


Starting in mid-2020, we began worrying about and forecasting higher inflation. The reason behind this was our belief in Milton Friedman and his view that inflation is “too much money chasing too few goods.” Not only did the Federal Reserve (Fed) allow the M2 measure of money to soar by roughly 40% in 2020/21, but COVID policy disrupted supply chains while pandemic benefits stimulated demand. In this week’s edition of “Three on Thursday,” we examine this surge in inflation to 40-year highs. The Fed (and, in fact, most economists) downplayed this inflation, characterizing it as transitory or short-lived. However, despite these initial reassurances, inflation in the US has proven far from transitory. The growth in the Consumer Price Index (CPI) has now exceeded the Fed’s preferred target of 2% year-over-year inflation for almost three years. We believe the underlying cause of this persistent inflation is growth in the money supply. Without that, we believe the purchasing power of the dollar would not have fallen so dramatically.

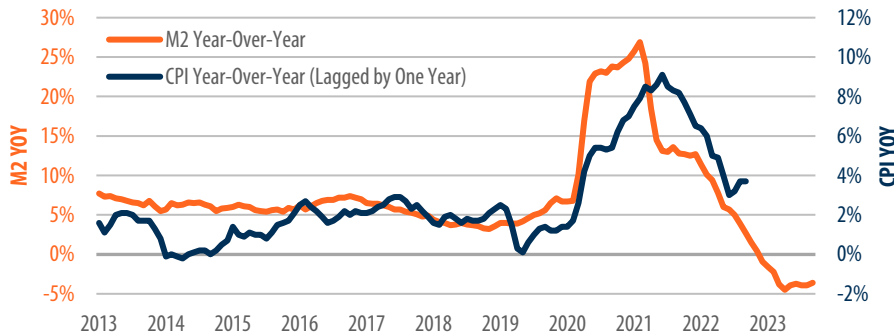
### M2 Money Supply vs. Past Decades’ 6% Trend Growth



Source: Federal Reserve Board, First Trust Advisors. Monthly data 1/2015 – 9/2023.

In contrast to the Quantitative Easing of 2008-2014, it appears to us that during COVID the Fed “monetized” debt issuance from the US Treasury, and along with it, the Paycheck Protection Program (PPP) loans and pandemic unemployment benefits. This newly created cash was directly deposited into people’s bank accounts as stimulus payments, resulting in a rapid surge of the money supply. This boosted growth in M2 well above trend. And, even though growth in M2 has slowed, and even gone negative in the past year, it is still above the trend that had existed in the previous decade.

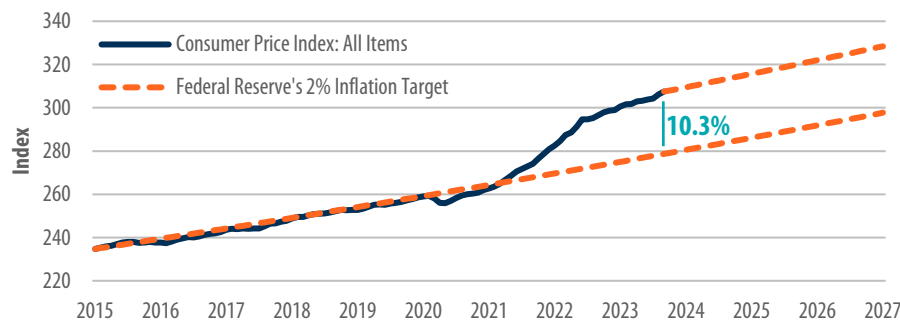
### M2 Money Supply vs. CPI



Source: Federal Reserve Board, Bureau of Labor Statistics, First Trust Advisors. Monthly data 1/2013 – 9/2023.

As Friedman observed, there is a lag in the impact of money on inflation and the surge in the money supply took about a year to noticeably affect prices. Recently, the M2 money supply has started to decline. The level of M2 remains comfortably above the long-term trend, which alleviates deflation concerns, but if this trend persists, the growth rate of inflation should continue to come down.

### Prices Permanently Adjusted Higher



Source: Bureau of Labor Statistics, First Trust Advisors. Monthly data 1/2015 – 9/2023. There is no guarantee that past trends will continue or projections will be realized.

It’s common for the average person to mix up the terms “deflation” and “disinflation.” What we’re currently witnessing is disinflation, which means a decrease in the inflation rate. Deflation, on the other hand, occurs when the actual price level declines. Lately, prices are still on the rise, but at a slower rate compared to previous years. In fact, prices are now 10.3% higher through September than they would have been if inflation had continued growing at the Fed’s preferred 2% target. Even when the 2% target is eventually reached, prices will remain permanently adjusted, more than 10% higher than they would have been, owing to the significant money creation over the past few years.