February 22, 2021

FUSCO FINANCIAL ASSOCIATES

Market Commentary

The Global Financial Crisis of 2007-2009 ushered in an era of ultra-low and even negative interest rates from central banks around the world. The lower rates and quantitative easing, a process which includes central bank purchases of assets such as government bonds, were designed to improve credit conditions. The intention of these policies is to boost economic activity by providing liquidity to the financial system.

One of the concerns about such policies was that it would lead to an increase in inflation as the effective money supply was increased. The Oxford Dictionary defines the economic version of inflation as a general increase in prices and a fall in the purchasing value of money. Controlling inflation is of such importance, that it is part of the Federal Reserve's Open Market Committee dual mandate (the other part being to lower unemployment). One of the Federal Reserve's primary tools in controlling inflation is the setting of interest rates through the Federal Funds Rate. In March 2020, the Federal Reserve effectively lowered the Federal Funds rate to 0% (with a range of 0% - 0.25%).

Inflation, as measured by the Consumer Price Index (CPI), has been remarkably muted over the last decade. January's CPI was up 0.3% from the previous month, however over the last 12 months CPI has only risen 1.4%. Over the past few years, the Federal Reserve has targeted a 2% inflation rate as indicator of when to increase interest rates. In August 2020, the Federal Reserve signaled that it may allow inflation to increase past a single reading of 2%, by announcing that they shift to "average inflation targeting". This has been interpreted as the Federal Reserve being inclined to allow inflation to run higher than 2% before beginning to increase interest rates.

The primary reason policies such as quantitative easing have not led to rampant inflation is due to the velocity of money. Velocity of money is a measure of the number of times that the average unit of currency is used to purchase goods and services. So while money supply has increased significantly, those same dollars are actually being saved and not used to purchase additional goods and services. Personal savings rates have been increasing while the velocity of money as actually been decreasing since mid -2005.

Please continue to stay safe, and as always, if you have any questions, or if we can help in any way, please don't hesitate to give our office a call.

With My Best Regards,

Kevin

With my best regards,

Kevin Fusco

Registered Principal, RJFS

[1] Oxford University Press

[2] Bureau of Labor Statistics

[3] Federal Reserve Bank of St. Louis

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