With the new year upon us, one of the top concerns for the national and local economy is inflation. You may have noticed that some inflation is already occurring, and you can feel it when you get gas, go to the grocery store or dine out at a restaurant. Until November, many believed inflation was "transitory," mainly due to the pandemic-driven supply chain constraints. However, now some think that this inflation is more than that. The surge in the consumer price index last month shocked the system. A 6.8% increase was the most significant 12-month rise in almost 40 years. So, given we will likely experience some degree of inflation in the coming years, what does that mean, and how will it impact us here?

**Is inflation really coming?** There are several reasons to believe that inflation will continue in the years ahead. The first is the expected increase in the Fed Rates; three or more increases are projected in 2022. There are also fears of what is known as a wage-price spiral, in which rising pay feeds rising prices. If you have a business or see all the "Help Wanted" signs, you will agree that wages are on the rise. "A wage-price spiral has started," wrote Sung Won Sohn, professor of finance and economics at Loyola Marymount University and head of SS Economics. In a period when businesses have no problem hiking prices, "the spiral, once it begins, is hard to stop," he wrote. Here locally, the inflation in wages, housing costs, energy, and food is already apparent.

**What does inflation mean to consumers?** The Fed rate directly impacts anything to do with borrowing money. Home mortgage rates, for example, are at record lows, but already creeping up. From a low of 2.7% a year ago, we are now over 3% and could reach 4% by the end of next year, based on the expected Fed rate hikes. 4% is still not bad, considering the historical average is 8%. However, given our local average home price of $500,000, just a one percent increase in the mortgage rate adds over $250 a month to the payment and almost $100,000 to the total interest paid on the loan. It also makes single-family housing even less affordable and causes increases in rental rates. Consumers will have to also pay more for gas, food, credit cards, and nearly everything else. Even with rising income, the erosion of their purchasing power will force families to reduce consumption. With consumer spending at 70% of our economic activity as a nation, even a minor pullback in consumption can severely impact the economy.

**What does inflation mean to businesses?** Businesses are in a tough spot as inflation increases. If they want to borrow money to expand or automate their operations, the cost of that capital increases. Many other costs increase, including utilities, rent, and employee wages. We are already experiencing this increase in employee costs as the available national labor pool continues to decline. The labor force participation rate has dropped almost 4% in the past ten years, nearly six million fewer employees, and down one percent since the pandemic's start. Fewer available employees result in higher wages as employers compete for talent. To pay for this, employers raise the cost of their goods and services, which contributes to inflation. Locally, our small businesses and retail organizations bear the brunt of this inflation. It is tough to fill an entry-level job here for less than $20 an hour.

**What can we expect in the years ahead?** With increases in government expenditures (which increase the money supply) and the Fed rate increases, we will likely continue to see inflation in 2022 and beyond. In the past, inflation has pushed the economy into a recession as consumers pull back on their non-essential expenditures. Discretionary spending is the first to feel the impacts, which is why during past recessions, our tourism-based economy was hit so hard, resulting in job losses, high unemployment, and the inability to pay mortgages and other essential expenses. Fortunately, with the diversification of our economy and the influx of higher-paying jobs, we are in a good position as a region, to weather this storm. In fact, with savings rates going up, some (especially seniors) may even benefit from it.

**So, even with the potential for inflation on the horizon, our economy is postured for success.** That said, our greatest community challenge remains affordable housing. Inflation will make that even tougher to address. Given our critical need for affordable housing, we must identify solutions and work together to make this a priority in the new year!
Inflation is coming – So what does that mean?  

The key to Fed rate hikes? It may be the 2022 paychecks of Americans (cnbc.com)