FRIDAY, AUGUST 15, 2025

Hello and welcome to this Friday edition of the Dividend Cafe. Hi, I am your host, David Bahnsen. And we are going to today talk about inflation, which as I'm sure is just never, ever talked about at all these days. What I've done here the last couple weeks is very much on purpose.

Two weeks ago I wanted to give an assessment of the tariff impact. On the economy into the future, how to think about it, how to look at it over a longer term period of time, and what our concerns are, not so much in what it does this week or next month. But what it will mean into the six, 12 and 18 months further out.

Last week we wanted to do a assessment of the overall economy and where things stand with a heavy emphasis in the labor market. The labor market being the sort of foundation to where a lot of other things can be expected to go around income savings, consumption, production, and so forth. The, if you're gonna talk right now about tariffs and you're gonna talk right now about the economy, then you are gonna inevitably end up talking about the impact on prices for one thing, because that is the subject that everyone wants to have.

When I say everyone, I do mean everyone. There are people who want the tariff policy to be proven victorious. They will want to use a low impact to prices as some sort of validation of a success story. And I've made the 0.2 weeks ago that there's a lot more to this than first order effect on prices.

And then of course, there's some that want the tariff policies to fail or anything else that the Trump administration might be doing. And they would understandably wanna look to higher prices as proof that they are indeed failing. My problem is not that I want anything to succeed or fail, and it is also not that I am viewing what tariffs do to prices as that criteria.

My issue is I'm looking to the bigger impact on economic growth as a more substantive story. Yeah, and I believe there's a lot of misunderstandings in what inflation is and how to be thinking about inflation that many people are okay being a misunderstanding because they're not really looking at it for the purposes of economic analysis, let alone what it could mean in markets.

They're looking at it from the vantage point of a very short term political report card, and I want to encourage us in the Dividend Cafe to do better. So this is not to say that the short term issues in price impact, whether it's tariff related or not, whether it's lower inflation or higher inflation, it's not to say they don't matter, but it is to say perhaps this whole entire subject, how we view where the economy's going, where we think the price level is, where we think economic growth and productivity are going is maybe all, and what all that means for markets.

Maybe all of that will benefit from a little refresher in what exactly we're talking about with inflation to begin with. And I think you will find that a proper understanding of the inflation discussion will not lead one to be looking at a monthly impact from coffee prices in tariffs, but rather a much bigger story that I want to rehash for us today.

There's a chart in Dividend Cafe dot com that I'm not sure if it's up in the video right now or not, but I do know this. It tells a story about the truth of prices over the last 25 years, and the truth in prices is not. That everything went up a little or everything didn't go up a little or everything went up a lot.

The truth is that some things went up a lot in price and some things went down and that the blended level of inflation annualized for 25 years, about 2.5%, and that includes the higher inflation that we had post COVID. So that's 87% in in price move over 25 years, which again, is a big number. Over 25 years.

Something that was a hundred dollars, it's now $187. That's a big gain, but that's 2.5% a year. Reasonably moderate, especially because that number was actually much lower than that for many of those 25 years. However, the story doesn't end there because as you can see, there's a disproportionately high amount of price increase in some things that kind of matter a great deal like housing.

Like healthcare and like higher education, college expense, tuition, textbooks, et cetera. And then of course there were big disinflationary forces on a lot of things that mattered as well. The amount of one's paycheck that one has to spend on food and energy is weighed down. That's all a good thing. I also believe that it highlights the probably most important piece over a 25 year period.

Which is that real wages grew more than prices. So the problem, of course, is in trying to draw one conclusion from this data, I have an obligation to draw several conclusions. First of all, just to get the important parts out of the way. Inflation has been mild for 25 years. Number two. Wages have grown more than prices for 25 years.

Those are two good sentences. But number three, when you say, well, but there's been malignant price increase in housing, healthcare, and higher education, that is more than just an economic sentence because it has, it not only has, but really has verifiably had tremendous impact in the culture. The social reality of there being people that have certain goods that have decreased in price.

And their wages have grown more than the price level. That's all positive. But if they are price constricted from accessing a home 'cause of housing affordability or unable to attend college 'cause of the big increase in higher education, then it does create various rifts in society that are no longer hypothetical or theoretical.

And I believe are a byproduct of the price escalations in housing, healthcare, home higher education. And those things, to me, represent the easiest causation to identify of anything in the in the price level. They're the only three things in our economy that are federally subsidized. They're the three major components of what people buy.

That have federal price imposition and then their affectation, so therefore price escalation, it would take a certain level of coincidence that is almost indescribable to believe that the price increase in housing educa higher education and healthcare is not correlated to government subsidy. So therefore what we see is that the biggest impact in the price level that has created upward movement in certain things, even as the overall price level has been mild and wages have grown well, but nevertheless created certain sociological and cultural separations is a byproduct of federal subsidy.

Then you look to. More recent times and you start to say how that 25 year picture where there's been the disruptions from impact in housing and college and whatnot into a shorter term period, let's call it post COVID, and this is the second chart I have at Dividend Cafe dot com shows you how, actually over the last several years, if you just look at the prices.

Of food, energy, shelter, utilities, insurance, regular expenses. Almost everybody has relative to real wages that in fact wages have not grown with the level of those particular expenditures. Our friends Strategas research refer that, refer to that as common man, CPI. So what I believe you have is all at once a big picture story that is indisputably true.

How did inflation and aggregate get tamed in the eighties and nineties? Because there was high supply of goods and services and a constrained growth of money supply. And how did housing higher education. Healthcare buck that trend because of government subsidy. And what was the impact into the culture?

Those were just with real wages growing more prices were mostly okay, but noticing that they were being more and more excluded from certain parts of economic living, college and housing. And then that really came to a head when the common man, CPI, if you will. Went upside down relative to wages that it created a much larger degree of societal rift, angst tension, et cetera.

So I, I think that it's hard to summarize 25 years of complex sociological and economic developments in 10, 15 minutes, but I think that that is a pretty accurate assessment of how a lot of these things broke down. Now what, when I say there was a good production of goods and services that was taming inflation, constrained money supply, why are those things the pertinent factor in inflation?

People have heard so many different explanations over the last few years of what caused the inflation in 2022 or what we're looking to month by month. Now with tariffs what effectively really is inflation? And this is where the economist in me comes out. The political junkie in me goes away because I can't stand trying to use a discussion of inflation as a political tagline, divorced from economic, cogency, economic explanation.

The economic eq, let's call it the equation exchange in the quantity theory of money. Irving Fisher that I've talked about in Dividend Cafe for years now is MV equals pt, which is that money supply times velocity equals the price level times the total supply of goods. And that when you reorg, when you rework the algebra.

The equation to simply say the price level equals money, supply times velocity divided by total supply. In other words. There are good reasons inflations can go down and there are bad reasons inflation could go down, and we have lived through both in my lifetime. The good reasons for disinflationary forces are money supply growth being constrained combined with total supply growing, and that's sort of the Reagan Volcker.

Model. It was to some degree to prove my bipartisanship here or nonpartisanship. Pretty aligned with the Gingrich Clinton. Model in the nineties and what Greenspan reen set out to do. There's focus in how they got there was a little different, but the Greenspan Reen model versus Volcker. But money supply growth was constrained.

Reen was particularly fond of a strong dollar and downward pressure on interest rates via fiscal deficit control, which was a priority of ging. Speaker Gingrich a priority of President Clinton, but all these things led to. Two decades of moderating inflation for a good reason. 'cause you had ri high real GDP growth and low inflation, but you also had very low inflation post-financial crisis, but for a totally different reason.

And in that case, you had higher money supply, but lower total supply of goods and services. However, up against a very low velocity caused by declining loan demand. Caused by crowding out of private sector caused by low confidence in the future and so forth. That's the ification theme, the low slow, no growth theme that I have dedicated so much of the last several years to talking about writing about and better understanding.

You can get lower inflation out of it, but for the wrong reasons, because it leads to low growth. What pushes inflation up. Is money supply growth in excess of total supply goods and services. And that's what the issue was out of 2022, where we had a very low supply of goods and services in the COD moment, and yet, of course an increase in money supply.

And now we have sorted through that well, a discussion of money supply, what the moderat ISTs are focused on. To supply goods and services. What a supply sider is focused on are very important to a real understanding, an economic understanding of inflation, an economic way of thinking, if you will.

They're not very helpful for a 32nd political tagline, a meme on social media. Something that is intended to say, ha ha, gotcha. Tariffs are inflationary, or Ha ha, gotcha. Tariffs are not creating inflation. And the reason is because one is kind of stupid and the way I'm wanting you to understand inflation is the way inflation actually works.

Now you go, David, are you trying to say that tariffs can't push prices up? I'm most certainly not saying that because I believe the exact opposite. I actually believe most tariffs do put most prices higher in the first order effect of the tariff. But as I wrote about two weeks ago. Our friend Dr. Lacey Hunt refers to the elasticity of demand here being a key factor.

And price elasticity is really related to you. Take something like coffee. It's very unlikely that people are gonna drink less coffee if there's a tariff of 30% pushing prices up 20 to 30%. People don't, can't substitute the coffee very easily. They want the coffee. So what happens is prices go up and you go, isn't that called inflation?

But in theory, if there's no other increase of money supply, if there's no other increase of production, then no it isn't. Prices of coffee went up, but prices of something else had to have gone down. But there are a lot of things that won't have that inelasticity and so therefore, what you really end up getting is a different effect on different products, and I think that that's where our conversation is right now around tariffs.

And as I wrote about two weeks ago, all of this is somewhat unhelpful because what ultimately will matter is if you see the demand curve go down and then that will lead to out of declining profits. Out of either people seeing prices go up, which should be bad, or trying to protect market share and they forfeit profit margins, then you see lower investment, lower hirings, all of the kind of economically productive activities that we want for growth.

The data right now, I don't care what anybody says is not telling you which way this is going. I mean, we could point to look, toy prices this holiday season will go higher if they do, or look, this other thing didn't go higher if it doesn't this week. We got a microcosm of it in one calendar week where the CPI number on Wednesday was not higher than expected.

There wasn't a big increase and a lot of the pro tariff people start doing this little silly victory lap. And then the very next day, producer prices had skyrocketed and you had a bunch of silly people doing a silly victory lap the other way, and the producer prices went up 0.9% for the month. Both core and headline, meaning with food and energy, and without food and energy.

Now it's one month in CPI, it was one month in PPI the producer or wholesale prices for goods have been very tame and, and in fact, the beginning of the year were 0% year over year. It's creeped higher, but up until this month had not been up a lot. Services inflation is up and some people go that's less likely impacted from tariffs.

But remember, we are a net exporter of tariffs and there's been, excuse me, of services and there's been retaliatory tariffs that have impacted it. And then there are of course, 1.6% year over year in PPI move higher in goods that had been at zero. So are tariffs driving some of this? Perhaps we want more months data.

But what if tariffs move it higher and then they stop? Is that inflation? And my point is, it's prices moving higher. Either in a good, either in a way that people are gonna like or not like, but who's gonna like the higher prices? But that's not the monetary inflation that we have to be focused on. And so this is the reason I'm bringing it up, is not to have a big economic semantics conversation.

With those who listen or read Dividend Cafe, it's to make the very important economic point that inflation matters. Because money supply, as a matter, public policy matters, and because production of goods and services matter, and prices matter because when prices grow more than wages, it's a declining standard of living for the society.

That's not what we want. It's the textbook definition of a poor economic outcome. At the end of the day we have to understand this vocabulary, what inflation is, why we talk about over a 25 year period, what coffee prices going higher. Is what VCR prices going lower? Was there, there are terms being used there's an equivocation going on.

How some of the terms are being used that I think is very unhelpful. What I would suggest. Is that the real inflation picture, not over a month or a week over a coffee item or a tared item. The big picture tariff issue. If you wanna have a conversation about real inflation of prices that affect a lot of people and cause a rift in society, then that real policy focus is actually on housing, healthcare, and higher education.

And if you want to ensure that the total macro level of prices is not going higher than wage growth, then what you want is money supply to be responsibly constrained relative to the production of goods and services. I believe money supply needs to grow, but I believe it needs to grow, not more than production of goods and services than total supply.

And so it's not ever gonna be perfectly linear and there's always gonna be a certain unevenness in the distribution impact, but ultimately these are broad policy topics that matter a great deal to ensuring that real wages grow more than prices, and ensuring that those areas that are most sensitive that we address at a policy level how to stop the insanity.

But if you are looking to month over month prices, then what I wanna say is the tariff impact in many items is likely to have a first order inflationary effect. That then leads to very likely something worse than inflation, which would be a decline in capital investment, as I wrote about already.

So this is the compartmentalization, the definitions, the categorizations that I think matter. To put things in the right economic buckets so we can address from a policy standpoint, so we can think about the right way so we can understand. And then so that macro view could be aligned in our outlook on markets.

What we think is really going on, not going on. So much of this is made is the worst thing for a long-term investor because people are trying to say. Look at this PPI number, The Fed should do this. Look at this tariff thing. They should do that. The reality is, what is the big impact to real growth along the categories of these bigger picture issues?

And I would suggest that none of those things are being captured in any of this weekly data whatsoever. I have given you a lot of economic stuff this week in a short period of time. I welcome your questions. I would love to unpack this even further, but I do hope that there's some clarity in this inflation conversation in this week's Dividend Cafe.

'cause that was most certainly my intent, and I appreciate you listening, watching, and reading the Dividend Cafe. We'll see you on Monday.