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Slowing Down a Fast Economy
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The US economy has been expanding too fast since the recent pandemic period stimulus measures were put in place. President Trump and Congress came to the rescue in providing numerous aid programs that grew the national debt by 22% from $22.7 trillion in 2019 to $27.8 trillion in 2020 (Bureau of Economic Analysis), and the figure was over $30 trillion as of July 11, 2022.

Individuals and businesses received over $1 trillion of stimulus, split between the Paycheck Protection Program (PPP) and individual deposits. The PPP loans were forgiven if properly documented. The Federal Reserve Bank weighed in during the 2020-2021 period by spending $4.0 trillion to keep mortgage and bond yields low through open market operations. The result was a massive $9 trillion balance sheet from asset purchases that doubled in 24 months. Meanwhile, the Fed Funds rate remained near zero. With every means available, a war-like approach was set in motion to save the US and the major global economies from a depression, and the unintended consequence of these simulus measures was the super heating of aggregate demand and inflation.

With so much money in the hands of eager consumers, the demand for goods and services has grossly outstripped supply at twice the rate as in Europe (WSJ). The result was an 8.6% annual inflation rate by May 2022 (Bureau of Labor Statistics). For the past 40 years, we have relied upon an average inflation rate of 2.0% and a real Gross Domestic Product (GDP) economic growth rate of 2.7% (4.7% nominal). Today, the nominal GDP is runnung at a 6.5% annual rate, up from 5.7% in Q4 (BEA). **The world's largest economy was growing at a 6.5% GDP nominal rate that is 1.4 times faster than the 40-year average. The pulses of stimulus to accomplish this came from the fiscal and monetary measures put in place since March 2020.**

Getting back to normal will require a period of economic deceleration, meaning negative growth. Think about piloting a super tanker and slowing it down. Inflation is already slowing down the US economy, since real purchasing power is being diminished each day. The Federal Reserve has begun shifting to a neutral policy, by allowing interest rates to naturally move higher and resetting policy rates closer to a lower targeted inflation rate. This means slower US economic growth over the next 12 months, but not a protracted recession. Getting the inflation rate down to 3.5% from 8.6% could take several years (Federal Reserve survey). The objective is to reduce inflation while avoiding the choking off of real economic growth.

As the US economy enters into a slower growth rate, inflation is expected to respond favorably. The dollar should rise further against major foreign currencies, as the Federal Reserve allows interest rates to rise further. This eases inflation as imports become cheaper.

If the US economy slows down too quickly during the current deceleration phase, the Federal Reserve has the option to reverse course and bring down interst rates. In fact, this reversal may take place in late 2023 or early 2024. This would be positve news for stock, bond and real estate investors and may be the start of another bull market cycle.

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