<u>Inflation: Why You Aren't Earning More at the Bank</u>

Tom Mullooly: In episode 63 we're going to answer the question why you're not getting more at the bank.

Welcome to the Mullooly Asset Show. This is episode number 63. I've run out of fingers and toes so I can't show you what episode it is but we're at 63. Today we are recording this on October 19, 2017.

30 years ago I was a babe in the woods just watching the stock market melt before my eyes. I know that's not what we're going to talk about today but I just wanted to get that in there.

So when we get these questions, these topics that we talk about on the video or in our podcasts, and hopefully you're listening to them, we get them from our listeners and our viewers. So if you've got a question that you're really jonesin' to get an answer for, get in touch with us so you can email us or just pick up the phone and call us.

But we love getting questions from our clients and our viewers and our listeners because we know that you're not the only ones out there with these kind of things that you want to talk about, so bring it on, let's hear it.

Tim, what are we going to be talking about today?

Tim: If the Fed is raising interest rates, how come I'm not getting more at the bank?

Tom Mullooly: You know, this is a question that we get a lot and I'm surprised that we haven't been asked more and more this year, but it's important to understand, of course banks are in it for a profit, but they some other factors at work that you need to know about.

I'm going to talk primarily about inflation. This is really important because it's kind of a mysterious thing. It's an economic concept more than anything else.

So 'inflation' is the measure of the rate of change in the general price level of goods, of anything in the economy. The opposite of inflation is 'deflation'. Deflation would be a negative rate of change in the general price levels.

Now, there's a third term that we need to know called 'disinflation' and disinflation is a, I guess the way to put it would be a decline in inflation rates. You still have inflation but you have less than you had in the past. So there's inflation, deflation and then disinflation.

So inflation affects the total output and it also affects economic efficiency. The higher the inflation rate, the higher you're going to see a change in relative prices. So how does the government measure, how does the Federal Reserve measure inflation?

The two main guides that they use are the CPI which is the Consumer Price Index and also GDP which is the Gross Domestic Product. They measure how much prices are rising and how much the economy is growing or shrinking, and then they can assess how much inflation is in the system.

Now, after 2008 the Fed Chairman at the time, Ben Bernanke, decided that the best course of action to get the economy moving again was to re-inflate the economy, or basically a way to bring inflation into the system almost artificially.

So they started this program of quantitative easing where, and we talked about this in a previous episode where if the Fed is buying bonds, they're actually taking bonds in. That means cash is going out of the Fed's balance sheet and the money is going back into the banks. So, by putting more cash into the system, their idea was to create more inflation.

Good idea. Sounded good on paper, hasn't really worked. Let's talk about this. So the original question that started this video was: Hey, the Fed's raising rates. How come I'm not making more money at the bank? That's a great question. Shouldn't that trickle down? The Fed's been raising rates all year. We should be seeing higher rates on CDs but we're not. So what's going on with this?

One of the things that I used to show clients is if you are looking for a CD and say, let's go back 20 years and the CD was paying 8% interest. I'm going to bet without even looking at a newspaper that inflation on a one-year CD if the interest rates 8%, inflation's going to be 6 1/2, maybe 7%. Because your net real rate of return on a one-year CD should be under 2%. It should be 1 1/2, it should be 1%. It should be a really low number.

One day my Dad came home in 1979 and he showed me a certificate from Marine Midland Bank, not around anymore, and he had a 20% CD for the next three months. Can you imagine 20% CD? It's too bad it was only good for three months. It was only good for 90 days. But inflation at the time was way into the teens, so this is what you need to keep in mind when you're looking at CD rates. They're going to give you the net rate of return after inflation.

Let me go through the math again. If you have a CD that's paying, say, 8%. I know we haven't seen them in 20 years. You have a one-year CD paying 8%. Inflation has got to be around 6 1/2, 6 3/4, maybe 7%. Your real net rate of return after inflation is going to be about 1%. Inflation is going to eat away at your purchasing power. I mean let's face it, the newspaper cost $.25 10 years ago, today it's a dollar, more of your purchasing power is being spent on the same stuff. You're not buying more.

If you're earning 1 1/2% on a CD today, inflation's got to be around zero and you'd be right because your net real rate of return is going to be that 1 or 1 1/2%. Fantastic question. I could probably talk for another hour about this but you don't want to sit here and listen to it.

Thanks for watching episode 63 and we will see you on the next video, number 64.