



# The Investor's Journal

Summer 2019



Yusufov Wealth Management  
of RBC Dominion Securities

**Emin Yusufov, CFA**  
Associate Portfolio Manager  
& Investment Advisor  
emin.yusufov@rbc.com  
416-733-5302

**Yashar Yusufov, PFP, CIM**  
Associate Advisor  
& Financial Planner  
yashar.yusufov@rbc.com  
416-733-5304

5140 Yonge St. Suite 1100  
North York, ON M2N 6L7  
www.yusufowealthmanagement.com  
1-888-894-0596

## Why do we need inflation?

When one hears the word inflation, they immediately associate it with something negative. They think inflation is 'bad' because it causes prices to go up and the value of their money to go down. It's rational thinking and seems true on the surface, but let's dig a little deeper to get a better understanding of it.

Why do we need some inflation for a healthy economy? It's better than the alternatives. Let's start with deflation first. Deflation is defined as a decrease in the general price level of goods and services. Picture a scenario where food, rent, cars, and all goods and services would go down in price every single year. Sounds wonderful, doesn't it? In theory it does. In reality, it creates a negative feedback loop (also known as a deflationary spiral). If prices are dropping, individuals will start to realize that a dollar saved today will have more purchasing power in the future because goods and services will be cheaper. The longer you wait, the more you can buy. Using real estate as an example, would you buy a house today if you think prices were to drop by over 10% in the next 12 months? Probably not.

Now, if you stop making purchases today, demand for goods and services drop, which leads to overall company profits decreasing and ultimately unemployment rising. If unemployment rises, there is even less money to spend on goods and services creating an even further deflationary spiral as consumers lose confidence in the economy. We saw this spiral occur leading up to the Great Depression. Prices dropped by over 10% in 12 months!

Deflation wreaks havoc on an economy while runaway inflation causes a different type of harm. If inflation is high, it reduces the purchasing power of your money. If the same dollar today will buy you less in the future, you are more inclined to make purchases today in order to avoid tomorrow's higher prices. This fuels demand to a point where suppliers potentially cannot keep up. A big issue in this scenario is that wages typically don't keep up with the price increases. As a result, the consumer is priced out from some goods and services. Using real estate as an example again, if inflation was initially high and you can afford to purchase a house today, you most likely do it because prices are expected to move higher. Let's look at another situation. Suppose with your current income, you will be able to save enough money over the next two years and purchase a house. If runaway inflation occurs during the next two years, you will be priced out of the market because home prices are going up, yet your income isn't keeping up with it. This is why, at some point, inflation dampens consumer confidence and spending (because you cannot afford the same lifestyle), which reduces overall demand.

Low or mild inflation can actually help the economy. It creates an environment of price stability which is positive for both spenders and savers. Price stability has a positive effect on consumer confidence, which in turn increases the demand for goods in the short term. As a result, company sales tend to increase, and companies hire more workers to keep up with the demand. This creates a positive feedback loop and boosts economic growth.

Inflation is such an important driver of the economy, which is the reason central banks focus heavily upon it. If inflation increases to the point where the economy starts to heat up, the central bank will raise interest rates to combat it. On the other hand, if the economy slows down and inflation decreases substantially, the central bank will usually decrease interest rates to help stimulate the economy. Deflation is much scarier for an economy than inflation, and central banks will do everything in their power to avoid such a situation.

Feel free to contact us if you would like to discuss inflation at more depth.

## Team update

Ella is now two months old and what a journey it has been so far. They really do grow quickly! Yashar and Mery just celebrated their one-year anniversary with a trip to Vietnam and Indonesia.



**Wealth Management**  
Dominion Securities