



What's the Difference Between Inflation and Reflation?

Sam Snyder, CFA®, Senior Research Analyst, Equities

While there are similarities, their differences mean different things for the markets.

In early 2019, we were intrigued when we saw that the cover story of a *Bloomberg Businessweek* issue was titled “Is Inflation Dead?” We became interested in a topic when the media began making bold claims, as it can be a sign of a crowded trade. In fact, we saved a physical copy of the issue, thinking it would make for a nice reminder if Bloomberg happened to “top tick” the secular disinflation narrative.

Fast forward to today, and the media seem to have changed their tack and are now sounding the alarm on inflation. Many are now feeling it is inevitable, given the impressive fiscal firepower deployed over the past 12 months by several world governments. But before investors wring their hands over inflation, we think it is worth explaining the distinction between inflation and reflation. These terms are often confused with each other, but they mean very different things for markets.

The fact is that the terms reflation and inflation are similar but distinctly different in their outcome and origin. In short, for the average consumer, inflation is bad, and reflation is good. Inflation is what we blame when your dollar buys less today than it did yesterday, which can result in a reduced standard of living or purchasing power. On the other hand, reflation is good for wages, profits, and risk assets, as demand drives prices and profits higher. Both result in price increases, but for very different reasons and with very different outcomes for investors.

When we think about demand driving prices higher, we may think of things like homes, vacations, and appliances — goods and services that get bid up by consumers who benefit from a growing economy. We also think it is essential to consider the demand for money, or capital. If we dust off our macroeconomics textbook, we will recall that the price of money — the economy’s cost of capital — is expressed every day in the form of interest rates in the fixed income markets. We also can recall from our microeconomics textbook that supply and demand drive prices. Therefore, it is logical that if the demand for goods, services, and capital rises, all else being equal, the prices for these things also rise, as seen in the recent increase in interest rates from historically low levels. This is reflation, and it is healthy in a growing economy.

On the flip side, if there is an increase in the cost of goods, services, and capital that is not driven by increased demand for capital and goods but rather by an increased supply of money that grows faster than real economic output, we observe more dollars being needed to buy the same goods and services. This is inflation, resulting in lowered living standards for consumers depending on the distribution of the increased money supply.

Further, as inflation expectations rise, many investors begin to sell fixed income instruments to avoid their devaluation in real terms, which lowers demand for bonds and drives up bond yields. This raises the cost of capital for the economy without the benefit of higher overall demand. And that reduces economic growth.

What's the Difference Between Inflation and Reflation?

In closing, when being stewards of capital, we do our best to avoid crowded trades. Of course, the consensus is not always wrong, and we do not intend to ever be contrarian for the sake of being contrarian. However, we recognize that being a contrarian can, at times, point us in the right direction of opportunity that others do not see. For us, that is the name of the game.

Altogether, this begs two questions: How do we know whether we are in a reflation or inflation scenario? And what should we do about it, if anything?

At this moment, we believe much of the recent movement in the market has occurred in response to reflationary trends. Still, as my colleagues recently alluded to in our previous Key Questions article¹, we should be on the lookout for a reemergence of inflation as the economic recovery continues to unfold. As such, it is worth remembering that remaining diversified is a prudent path forward for wealth accumulation and preservation.

For more information, [please contact your Key Private Bank Advisor.](#)

Key Private Bank



Page 2 of 2

Publish Date: March 15, 2021

Source: i - Key Questions: How Much Stimulus Is Too Much? -<https://www.key.com/kpb/our-insights/articles/how-much-stimulus.jsp>

Any opinions, projections, or recommendations contained herein are subject to change without notice and are not intended as individual investment advice. This material is presented for informational purposes only and should not be construed as individual tax or financial advice. KeyBank does not provide legal advice.

Investment products are:

NOT FDIC INSURED • NOT BANK GUARANTEED • MAY LOSE VALUE • NOT A DEPOSIT • NOT INSURED BY ANY FEDERAL OR STATE GOVERNMENT AGENCY

© 2021 KeyCorp. Member FDIC. 210113-937992-1197738432