



Written by [Bob Adelman](#) on November 7, 2011

Deflation: Good and Bad

The one form of deflation that the Federal Reserve is most concerned about, according to Shilling, is that the general price level will experience sharp declines which will turn into a self-perpetuating downward spiral as buyers delay making purchases in the hopes of paying even lower prices in the future. But there are six other forms of deflation, and five of them “are already in place in the United States,” say Shilling.

There is deflation in the price of *financial assets* such as bond prices and bank shares. With the U.S. economy refusing to respond to continued stimulus from the Fed, the increasingly likelihood of a “hard landing” in China, and the continuing unraveling of the European Union, Shilling sees nothing but lower prices ahead.



There is deflation of *commodity prices*, which is soon to show up in retail prices consumers pay. He notes that copper prices have declined 28 percent since February while cotton is off 53 percent since March. And with the visible slowing of the Chinese economy, their demand for commodities is already declining.

There is deflation in *wages*, which Shilling says is “already firmly established,” and with unemployment remaining high there is little pressure to reverse that trend in the near future. He notes that real wages, adjusted for inflation, has declined by 7.1 percent between 1999 and 2010, and fell another 2.3 percent last year.

There is deflation in *currencies* especially as uncertainty over the Eurozone continues and safe-haven seekers move to the U.S. dollar.

There remain two other forms of deflation, according to Shilling: deflation by *government decree*, which could happen after the next election that, he says, “might spawn tax simplification” and substantial reductions in government spending, and “*goods and services*” deflation, which can’t be far behind the declines already seen in commodities.

It’s that “goods and services” deflation that, so far, has proven elusive. When the Bureau of Labor Statistics [published](#) its reading on the Consumer Price Index for September, it noted that its “all items index” increased by 3.9 percent over the last 12 months, with energy prices increasing by 19.3 percent overall, which included gasoline prices which increased by 33.3 percent over that period. And the [daily online “billion prices” index](#) published by the Massachusetts Institute of Technology confirms the BLS results with that index increasing by 4.2 percent.

The recent rally on Wall Street that has pushed equity prices up by 15 percent or more since early October is deceptive and upon closer analysis, supports Shilling’s view that there is deflation there as



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well. According to the [CPI Inflation Calculator](#), the S&P 500 Index would have to be at 1,470 in order to reflect the purchasing power that the index had on December 31, 2001, when it was at 1,148. Recent market action is pricing that index about 1,240, which means that an investor holding equities over the last 10 years has lost 15 percent of his purchasing power.

Professor Joseph Salerno, vice president of the Mises Institute, explained that in a free-market economy, deflation is actually a normal and welcome effect of improvements in manufacturing efficiency. [In his testimony](#) before the House Financial Services Subcommittee back in March, Salerno said, "Falling prices are, under most circumstances, absolutely benign and the natural outcome of a prosperous and growing economy." He noted that even in the mixed economy in the United States prices have declined sharply especially in the consumer electronics and high-tech industries. He noted:

This is not merely abstract theoretical speculation; it is precisely the process that occurred in the past four decades with respect to the products of the consumer electronics and high-tech industries. Thus, for example, a mainframe computer sold for \$4.7 million in 1970, while today one can purchase a PC that is 20 times faster for less than \$1,000. The first hand calculator was introduced in 1971 and was priced at \$240 (which is roughly \$1,400 in terms of today's inflated dollar). By 1980, similar hand calculators were selling for \$10 despite the fact that the 1970s was the most inflationary peacetime decade in U.S. history. The first HDTV was introduced in 1990 and sold for \$36,000. When HDTVs began to be sold widely in the United States in 2003 their prices ranged between \$3,000 and \$5,000. Today you can purchase one of much higher quality for as little as \$500. In the medical field, the price of Lasik eye surgery dropped from \$4,000 per eye in 1998, when it was first approved by the FDA, to as little as \$300 per eye today.

So it appears that Shilling is calling for deflation as a result of a slowdown in the economy (bad), whereas Salerno explains that a general reduction in the price level due to technical and manufacturing innovations is benign and beneficial (good).



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