



Still Think We Have Inflation Coming?

As you have no doubt noticed, Americans are worried about inflation. You need only to watch TV for an hour to gauge the mentality: the airwaves are full of infomercial ads about the need to protect yourself from the coming inflationary collapse by buying gold coins—NOW.

The good news is that the dire forecasts of inflation are likely to be wrong. The bad news is that what is coming could be worse—deflation, the condition of falling consumer prices.

Given recent events, this view might seem preposterous. Didn't the Federal Reserve double the monetary base, and doesn't the Federal Government continue to spend record amounts of money it doesn't have? The answers, unfortunately, are "yes" and "yes." All else equal, these factors would cause inflation, but there is more to the economy than government actions.

The deflationary forces of the private sector—the paying back or nullification of loans by consumers and businesses and the slowdown of what economists call the "velocity of money"—are more than offsetting the inflationary actions of the Fed and Congress.

For a case in point, take a trip to your local Wal-Mart. If you want a gauge of where the prices of real, everyday items are going, Wal-Mart is a good barometer. And the "Wal-Mart indicator" still points to lower prices.

Consider this Associated Press headline from the end of May: **"Wal-Mart makes splashy price cuts to get mojo back"**

Wal-Mart has dropped the price of ketchup bottles to \$1 and the price of cases of Coke to less than \$4, among other cuts. And when Wal-Mart makes a move, its competitors have no choice but to follow. As the Associated Press continues, "The sharp cuts at its U.S. Wal-Mart stores, which came ahead of Memorial Day weekend, have already pushed rivals such as Target into price wars. And the markdowns are expected to keep coming throughout the summer."

Price wars among major retailers can mean only one thing: lower prices for consumers. This is great, of course, if your income is secure and you have no risk of job loss. The problem is that most people do not have that kind of security. And as economic reality forces companies to keep prices low, they must also keep their own costs low—including labor costs.

This means that we should expect unemployment to remain elevated for years. It may improve slightly from its current levels around 10%, but our days of 4% unemployment are almost certainly gone for the foreseeable future. High unemployment in turn means weak consumer demand and thus weaker consumer prices, causing the cycle to continue.

It is important to avoid getting too pessimistic; we will indeed see good economic times again, even if it is years from now. In the meantime, we will have to navigate some rather difficult waters.

Sincerely,

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