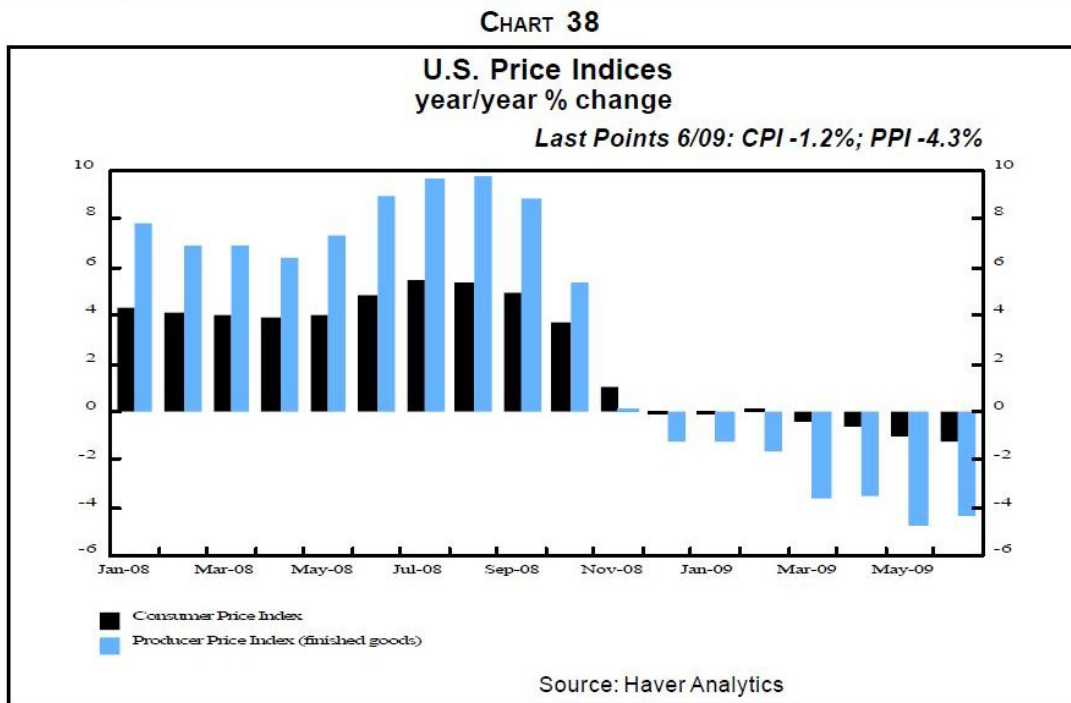


# ISN'T DEFLATION HERE?

## WEB BUZZ 2009.08.24

It seems as if the most deniable economic condition in the world is deflation (aggregate price level decline). Inflation seems to be the only thing along these lines that commands any print. The reason, we imagine, is that those who report the business news in the U.S. have never seen anything other than inflation. The Federal Reserve, whose stated purpose is to protect the dollar through price stability and to foster full employment, is in the process of destroying both of these mandates due to their creation of inflation for all these years with a too liberal monetary policy. Therefore, hardly a man is still alive who has witnessed deflation. Please note the following chart, which traces the U.S. price indices on a year-over-year basis.



Adapted from *A. Gary Schilling's Insight*

An update to this chart reflects that the CPI through July is -2.1% and the PPI is -6.8%. That's eight months in a row that the numbers were negative. Other nations also have reported deflation, most notably Germany, Japan, and now Canada.

As this is being written, the 30-year U.S. government bond is selling at 4.30%. If one adds 2.5% to that to account for deflation, you have a real yield of 6.80%. Historically, bond market participants have required a 2.5% premium to offset potential inflation for long dated government bonds. That being the case, shouldn't the long 30 year bond be selling at a yield of 0.4% (2.50% minus 2.10%)? Think about it!

For a look at why inflation is unlikely, please read the recent Northern Trust commentary found at:

[http://www.northerntrust.com/popups/popup\\_noprint.html?http://web-xp2a-pws.ntfs.com/content//media/attachment/data/econ\\_research/0908/docume nt/dd081909.pdf](http://www.northerntrust.com/popups/popup_noprint.html?http://web-xp2a-pws.ntfs.com/content//media/attachment/data/econ_research/0908/docume nt/dd081909.pdf)