

## OTHERS ON DEFLATION

### WEB BUZZ 2009.09.21

Janet Yellen, president of the Federal Reserve Bank of San Francisco, recently made an address in which she compared the current situation to the 1980s. The major difference, she said, was that inflation was then very high and moving downward, whereas now it is non-existent and moving lower. This, of course, means deflation. To our memory, she is the only Fed President to discuss the real possibility of deflation. She was careful not to mention that word, preferring instead the term disinflation.

We believe she is right on, except that we believe the proper comparison would be to the 1930s rather than the 1980s. The following is an excerpt from her speech:

*"The slow recovery I expect means that it could still take several years to return to full employment. The same is true for capacity utilization in manufacturing. It will take a long time before these human and capital resources are put to full use.*

*My personal belief is that the more significant threat to price stability over the next several years stems from the disinflationary forces unleashed by the enormous slack in the economy. The 1980s provides a useful historical comparison. During that period, fears about burgeoning federal deficits and an unsustainable fiscal situation were widespread, as they are today. Moreover, the Fed was under significant political pressure, and some worried whether it would be able to safeguard its independence. But those circumstances didn't ignite a renewed bout of inflation . . .*

*. . . Of course, that period differed from ours in one critical respect. Then, inflation was coming down from unacceptably high levels. Monetary policy was*

*designed to be tight enough to bring inflation down to price stability, a goal we accomplished and have maintained for two-and-a-half decades. Today, we are starting with very low inflation. Core PCE price inflation has averaged just under 1½ percent over the past twelve months, which is already below the 2 percent rate that I and most of my FOMC colleagues consider an appropriate long-term price stability objective. With slack likely to persist for years, it seems likely that core inflation will move even lower, departing yet farther from our price stability objective . . .”*