

## **The dangers of deflation**

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What our economy really needs is a healthy dose of inflation, but there is no sign of this materialising with the Bank of England stating that the current bank rate at 0.5 per cent will stay well into next year. Well, this of course produces winners and losers but for the time being, there appears to be very little alternative.

There is, of course, the threat of higher inflation as a result of the current spurt of economic growth, oil prices have slipped back, and wages are enduring the longest squeeze in living memory, while sterling is enjoying a spate of strength. There does seem to be more danger of deflation rather than inflation which is something we have not seen in the UK for the best part of a century.

Deflation ultimately means that consumers become even less willing to spend and the value of debts goes up in real terms and makes debt harder to service and pay off. Therefore, households reduce their spending thereby weakening the economy. So, rates must stay low so the economy can be supported, even as both the government and households continue the job of paying down the debts accumulated in the boom a decade ago.

A substantial proportion of the billions pumped into the British economy seem to have been funnelled into things that have not exactly stimulated the real economy such as residential property, classic cars and, until recently, equities. Consumption and wages have not felt any benefit and as a result though strong has been an awful long time coming to fruition.

The long-term answer lies way beyond the control of central banks. Low productivity and skill levels, and lower wages, may have to be sorted by fundamental reforms. Looser labour markets, freed-up retail sectors, a more enlightened approach to foreigners investing and freer trade have all been on the agenda for years.

As the emerging problems in China's property market and banking system often remind us, the global imbalance have barely improved since. Until all these structural issues are acted upon, the West will remain hinged between a sustainable long-term revival and another decade of near-stagnation.