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Deflation may be the biggest threat to U.S. economy

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If I could know one single data point from the future, it would be whether deflation or inflation won the economic battle of this decade. It is the ultimate question that will decide the future price of almost every single asset: real estate, gold, equities, bonds, etc.

The decisions made by those in power will profoundly impact whether we slip into a deflationary morass or inflate our way to another day. While a thin line defines these two outcomes, in an inflationary environment, cash is trash. In a deflationary environment, it is king.

One of the reasons investors are stymied right now is the uncertainty about which is the more likely outcome. Waves of inflation and deflation can last for decades.

Since 2002, the Federal Reserve has let the U.S. dollar devalue with hopes that a legitimate economic recovery would supplant the credit expansion that dominated this decade.

As it stands, we're still waiting. The greenback has declined 33 percent since 2002, while everything measured in dollars

reacted in kind. Although that slipped by U.S. investors largely unnoticed, it's been a steady source of stress for foreign holders of dollar denominated assets.

No matter how obscure deflation may be, it is apparently the biggest threat to our country right now, according to some. A full-blown monetary deflation would truly put the U.S. economy in ruin. In a general deflation, everything falls -- prices, profits, output and wages. Unchecked, this can lead to another depression politicians claim we have avoided.



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