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Deflation Alarm Bells Ringing Across Europe

for every Major World Market

Economics / Deflation Apr 21, 2009 - 01:21 AM By: Mike_Shedlock



The New York Times is reporting Spain's Falling Prices Fuel Deflation Fears in Europe.

Faced with plunging orders, merchants across this recession-wracked country are starting to do something that many of them have never done: cut retail prices.

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Prices dipped everywhere, from restaurants and fashion retailers to pharmacies and supermarkets in March. Hoping to increase sales, Fernando Maestre reduced prices by a third on the video intercoms his company makes for homes and apartment buildings. But that has not helped, so, along with many other Spanish employers, he is continuing to fire workers.

The nation's jobless rate, already a painful 15.5 percent, could soon reach 20 percent, a troubling number for a major industrialized country.

With the combination of rising unemployment and falling prices, economists fear Spain may be in the early grip of deflation, a hallmark of both the Great Depression and Japan's lost decade of the 1990s, and a major concern since the financial crisis went global last year.

"Alarm bells are going off," said Lorenzo Amor, president of the Association of Autonomous Workers, which represents small businesses and self-employed people. "Economies can recover from deceleration, but it's harder to recover from a deflationary situation. This could be a catastrophe for the Spanish economy."

Deflation is not just a Spanish concern. Luxembourg, Portugal and Ireland have reported price drops, too. While the declines have been slight — and prices rose modestly after factoring out food and energy prices, which can fluctuate widely — other figures released this month suggest the risk of deflation is growing.

When Spain had its own currency, the peseta, the central bank could have simply devalued it, or cut interest rates to zero. But that is not an option in the era of the euro, when monetary policy is controlled from the European Central Bank's headquarters in Frankfurt, said Santiago Carbó, a professor of economics at the University of Granada.

"If we enter into a deflationary period, we won't have the monetary tools to sort it out," Mr. Carbó said. I have news for Santiago Carbó: Bernanke does not have the tools either. If Bernanke had tools the US would not be in deflation now, which it clearly is.

And if Central Banks properly treated housing as a consumer good, scores more countries would be in "price deflation" which by the way is a natural state of affairs (as a result of massive productivity improvements over time) and a good thing as well.

Regardless of how you see it, Deflation Has Gone Global and there is little Central Banks can do about it. If you disagree, please consider Bernanke's Deflation Preventing Scorecard.

By Mike "Mish" Shedlock http://globaleconomicanalysis.blogspot.com

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Mike Shedlock / Mish is a registered investment advisor representative for <u>SitkaPacific Capital Management</u>. Sitka Pacific is an asset management firm whose goal is strong performance and low volatility, regardless of market direction.

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When not writing about stocks or the economy I spends a great deal of time on photography and in the garden. I have over 80 magazine and book cover credits. Some of my Wisconsin and gardening images can be seen at MichaelShedlock.com.

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