STABLE: Supermarket prices on many items aren't moving. **Photo: Attila Csaszar**

1.3%
5-YEAR PROJECTED ANNUAL US INFLATION

Conflicting views on inflation conundrum

Deflationary pressures are causing concern for central bankers worldwide.

BYSTANDER
Tim Treadgold
tim.treadgold@businessnews.com.au

IS it a good thing that the price of Woolworths home brand pasta, or a 20-roll bulk pack of Sorbent toilet paper for that matter, have not risen for the past 18 months, or is it a sign of a fundamental shift in the Australian economy?

That might sound like an odd question but the unchanged $1 price of Select Pasta and $10 for the loo paper is a local example of the global phenomenon of minimal inflation, and even a dash of deflation – a time when future prices are expected to be lower than current prices.

A knee-jerk reaction to the prospect of falling prices is that such an event sounds too good to be true.

A more rational reaction is that it might be true, but it's certainly not a good thing.

The debate about low (or absent) inflation has become one of the hot topics among central bankers around the world, and a small group of economic boffins, who have spent most of their working lives fighting inflation but now find themselves trying to resurrect their demon.

The price of pasta and loo paper at Woolies is a small example of what it means to have no upward price movement of a commodity for more than a year.

Other examples of low or falling prices can be found across the economic spectrum, starting with Perth property prices and rolling on to the price of iron ore and oil, and even including the cost of money – bank interest rates on both what they pay depositors and what they charge borrowers.

Until recently most economists assumed that low (or falling) prices would be a short-lived phenomenon, with a quick return to the more conventional situation of higher inflation and rising prices. That view is changing as a new slogan gains popularity – 'lower for longer'.

In commodity markets, which are the lifeblood of the economy in Western Australia, lower for longer is definitely a bad thing, with tumbling prices for most of the state's exports, and a collapse in project development, traced directly to falling property prices.

The lifespan of the lower for longer trend is unknown but it is certainly starting to worry business and government leaders, because if everyone believes they can buy cheaper tomorrow why would they buy today?

The answer to that question is that a lot of people are not buying today, which is why the number of unsold properties on the market continues to rise and why seasoned property executives such as Nigel Satterley can see another two years of recession-like trading.

Mr Satterley's observations count, because he's been in the business for decades and has seen more booms, and ridden out more busts, than anyone else in the property game, with the possible exception of Peet's boss, Tony Lennon.

Interesting as the local property market is, and important as the price of pasta and loo paper are, the deeper question of flat-or-falling prices is one in need of closer consideration, which is what some of the world's top financial thinkers are doing.

One of those thinkers keeping an eye on inflation, interest rates and the stultifying effect flat-lining has on an economy is US Federal Reserve vice-chairman Stanley Fischer.

In an academic paper presented to a gathering of economists, Mr Fischer argued that the world had entered a period of sustained low interest rates due to the glut of money sloshing around the world combined with the fact that fast-growing new technology-based companies (Google, Amazon and Facebook) did not require much capital to fund their growth.

Strange as it might seem, the world could be entering a long-term period of exceptionally low inflation, low interest rates and flat prices for everything from pasta and loo paper to property and share prices.

Rather than assume we might soon bounce back to a time when banks paid 6 per cent on deposits and charged 9 per cent on housing loans, we could be in for years of 2 per cent on deposits and 5 per cent (or less) on housing loans.

Another study into where we might be heading is based on an analysis of US inflation rates over the next five years, with the result being that inflation is likely to be stuck at around 1.3 per cent a year, below the Federal Reserve's target of 2 per cent.

Meanwhile Japan, China, Britain and the European Union are also expecting inflation to be below their central bank target levels.

What happens next is the important question, but one on which there is widespread disagreement.

One view is that inflation is simply being kept at bay courtesy of the lingering European recession, China's slowdown, and sharply lower commodity prices, especially for oil.

Another view is that the world is shifting from a time of building things and consuming commodities to one with a greater emphasis on technology and tertiary services, which require less capital and fewer consumables such as minerals and metals.

Whatever the correct answer, the repercussions for everyone, whatever happens to inflation, are substantial.

Low inflation for longer means limited growth in demand, thin returns on investments, and stagnant property prices; and if that's the case then welcome back to the 19th century, a time when property prices barely moved for the best part of 100 years.

Now that's serious food for thought – pasta anyone? Cheap today and cheap tomorrow.