

*Dan Hamilton*  
*July 18, 2010*

Producer price growth has been declining for six months. It reached negative territory, deflation territory, three months ago, in April. This is extraordinarily unusual for the United States. What does it mean?

Most of the June PPI deflation was due to declining food prices. Producer prices are up from a year ago, where of course a year ago, prices were at record lows after being pummeled by the Great Recession.

Monthly consumer price growth has also been negative since April, while year-on-year CORE consumer price growth has been falling since December of 2009 and is at a 49-year low.

These price changes are occurring against the backdrop of contracting Retail spending and slowing manufacturing growth, according to the latest (June) data.

We teach our students about multiple-equilibria, especially in the context of macro and international models. The typical cause of multiple equilibria, as opposed to a unique equilibrium, is alternate expectation possibilities. In certain situations, agents' expectations might easily change from one possibility to another.

Think of an over-simplified condition where three equilibria are possible. The best equilibrium is one that would be difficult for the United States economy to achieve at this time, one where job growth was 1.5 percent, GDP growth was 3.5 percent and inflation was 2.0 percent.

Another possible equilibrium could be one where deflation strangles the economy, where debt-laden and cash-strapped consumers decide to hold off on purchases thus causing a large fall in the 71% component of GDP that is consumer spending. This is the worst of our three possible equilibria, and the one that causes economists to lose sleep at night.

A third possible equilibrium, an intermediate one, is where consumers see low price growth as helpful in maintaining moderate spending in a jobless economy, producers see low price growth as helpful in maintaining costs, and the FED is able to maintain historically low interest rates without worrying about inflation.

The third possible equilibrium is, in part at least, a result of technological improvement. Any \$1,000 dollars spent today on a personal computer, or any \$100 dollars spent on a cell phone

purchases the consumer a product that is dramatically more functional than what was available just a few years ago.

I believe that, at the moment, we are in a situation that is essentially the third equilibrium. Absent some unforeseen event, the possibility of achieving the first equilibrium seems remote for now. The possibility of achieving the second equilibrium is unfortunately all too high.

My hope is that we stay in this relatively desirable intermediate equilibrium, but of course there is no guarantee of this. The factors that drive an equilibrium shift, including today's lower consumer confidence data, will be the topic of another blog.