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LETTERS TO THE EDITOR: Deflation threat can be beaten

By Bernard Munk
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From Mr Bernard E. Munk.

Sir, Many economists have recently despaired that the threat of deflation is beyond the power of a central bank to deal with, or, to put it differently, that while inflation is fundamentally a monetary matter, deflation is not.

The Japanese experience is being used to assert that the US cannot combat deflation by monetary measures. But, just as in the great hyperinflationary experiences, the public's expectations - particularly expectations about central banking behaviour and its impact on prices - do count.

The key is to avoid creating a substantial amount of risk aversion and the fear that the central bank will in fact back off from its duty to create stable prices and maximum employment. It is tempting for central bankers to find fault with politicians with regard to their tax and expenditure measures and to shrink from their central banking tasks.

The Japanese experience should tell the Fed not to fall into that trap, even if its colleagues at the European Central Bank seem to have shrunk from their own responsibilities on this issue. Central banks have a powerful weapon with which to fight inflation (the printing press) and an unlimited amount of ammunition.

They need only the will to use it in a timely and consistent manner. They also need to expect that, when a great deal of damage has been done through a less than timely and forceful action, they will have to offset the deflationary expectations that earlier inaction has caused to develop.

Bernard E. Munk, Munk Advisory Services, Villanova, PA 19085, US