How Deflation Develops and What It Does - Inflation Overview

A gradual devaluation or decline in overall asset prices is known as deflation, which leads to lower prices on most goods and services. This eventually creates an unfavorable environment for companies to raise prices and maintain already elevated profit margins. Ironically, what has led to this environment are the lingering effects of inflation. As the pandemic diminished and consumers spent more, companies raised prices as demand increased, eventually bringing about inflation. Now, as demand dissipates and consumers spend less, prices head lower.

Economists suggest that long-term yields can directly portray deflation. As the 10-year Treasury bond yield has fallen since its peak in October, nominal GDP along with inflation has slowly fallen. Real wages have also contracted, leading consumers to refuse to pay higher prices but demand more lower-priced goods. Retail stores have resorted to discounting in order to increase sales and reduce unwanted inventories.

Commodities across the globe are also reflecting deflationary characteristics as prices have pulled back from the highs of 2021 and 2022, including lumber, natural gas, aluminum, copper, and wheat. The International Energy Association (IEA) for the first time predicted that global demand for oil will reach a peak this decade, indicative of possibly lower oil and gasoline prices in the future.

Fed Chair Jerome Powell mentioned that elevated long-term bond yields lessen the pressure for tighter monetary policy, meaning that the Fed may not need to raise rates further, thus allowing rising bond yields to slow economic activity.

Sources: Treasury Dept., Federal Reserve, IEA