



# The inflation rate is falling, but prices are not

Mary Clare Peate

# Disclaimer

- The opinions expressed here do not necessarily reflect those of the Federal Reserve System or the FRB of St. Louis
- Any comments, questions, feedback from participants must be appropriate & professional



# Introduction

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Has someone in your life  
recently asked you:



Has someone in your life recently  
asked you:

The inflation rate has fallen.  
So why are \_\_\_\_\_ prices still so high?

# Inflation in an intro course

1. SR vs LR AS curves
2. Inflation is bad because curbing it leads to unemployment/lowered output
3. PCE vs CPI



Would your students answer  
this question correctly?

**Scenario:** In 1965, the inflation rate is 12% and in 1966, the inflation rate is 9% .

From 1965 to 1966,

The Inflation rate is....	The price level is...
Increasing Decreasing Staying the same	Increasing Decreasing Staying the same





The **inflation rate** is falling  
but (the average level of)  
**prices** are not

# Goals

1. Become aware of the **common misunderstanding** between **deflation** and **disinflation**
2. Review how textbooks currently cover disinflation



# Basics

# Inflation, Deflation

- Inflation
  - **Average** level of prices in an economy is increasing (usually measured with a price index)
- Deflation
  - **Average** level of prices in an economy is decreasing



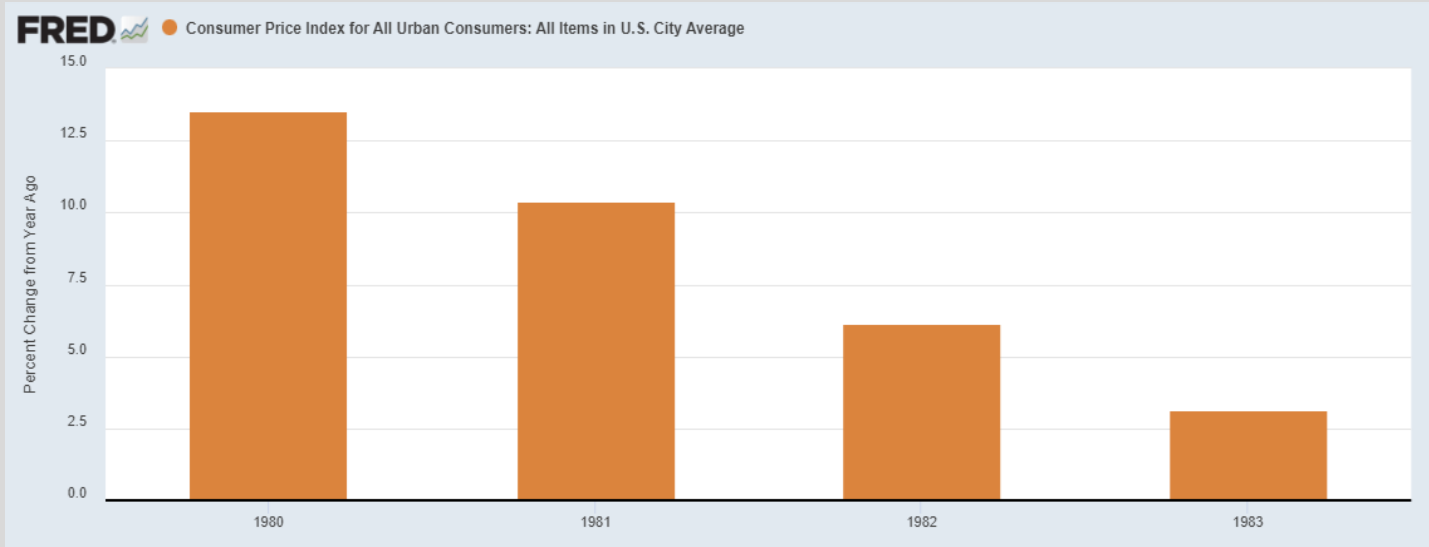
# Average Level of Prices

# Inflation Rate, Price Level

- Inflation rate
  - Percentage change in the average level of prices over a given time
- Price level (e.g., Consumer Price Index)
  - A weighted average of the prices of goods and services in the economy

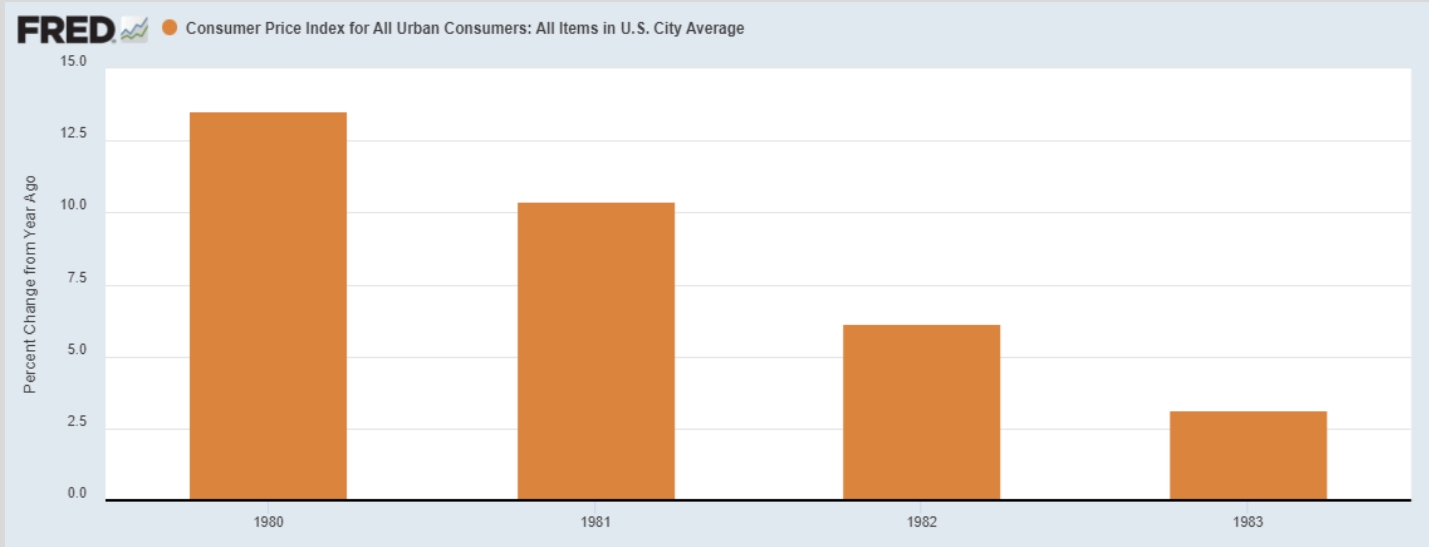
# 1980-1983

## Inflation Rate

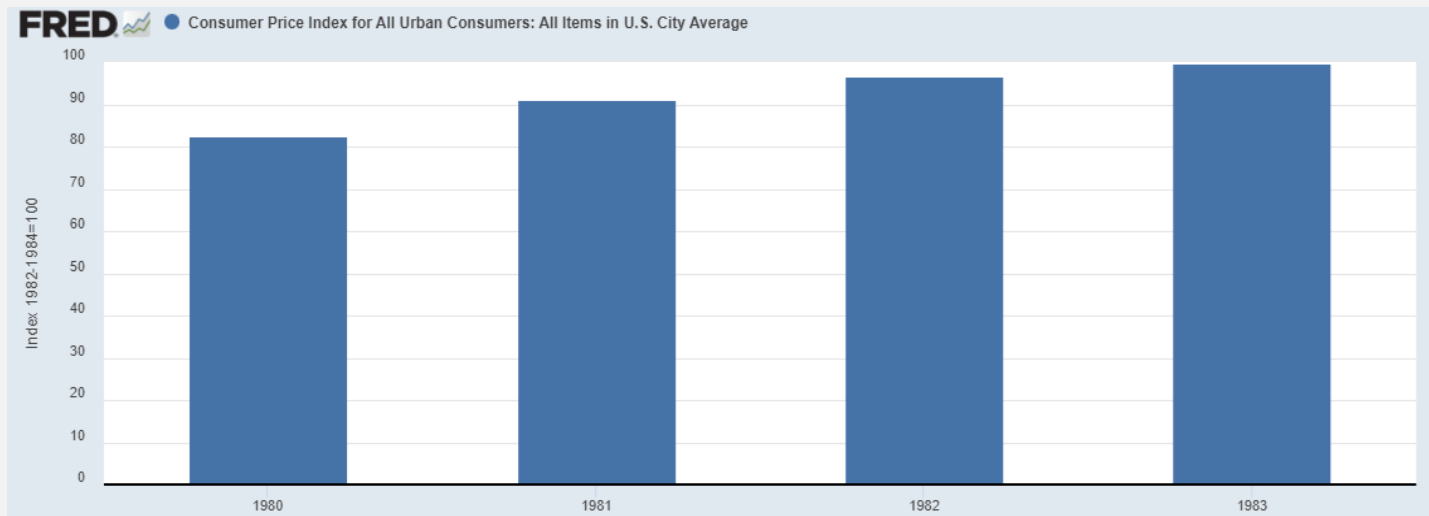


# 1980-1983

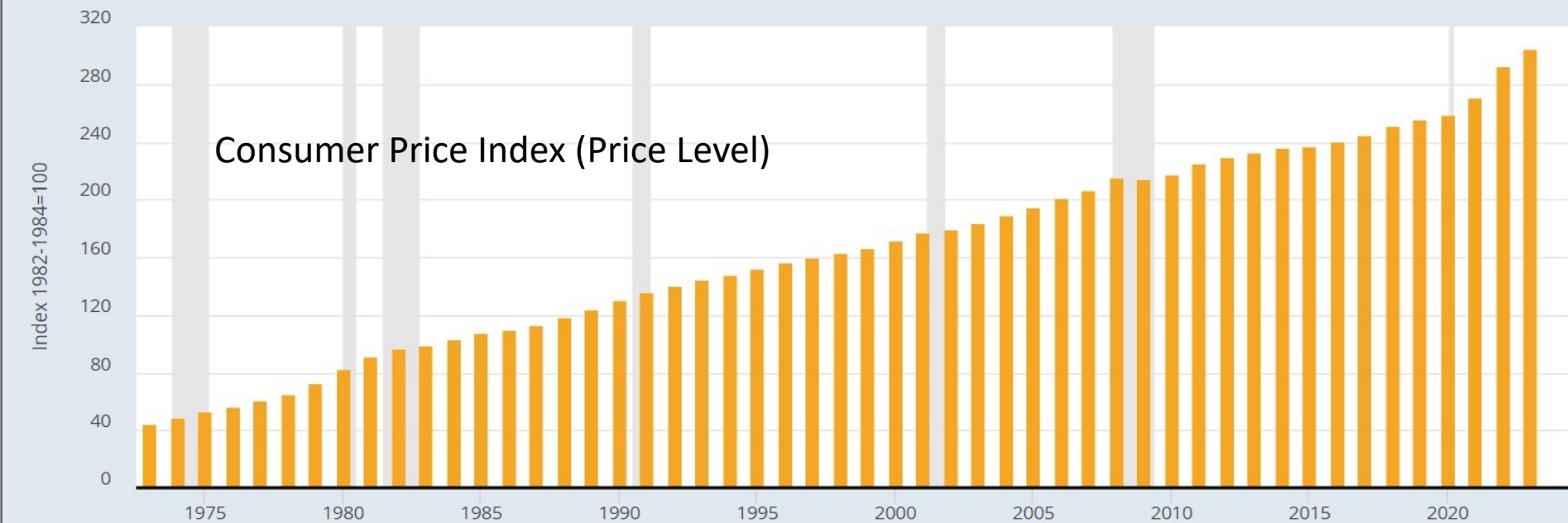
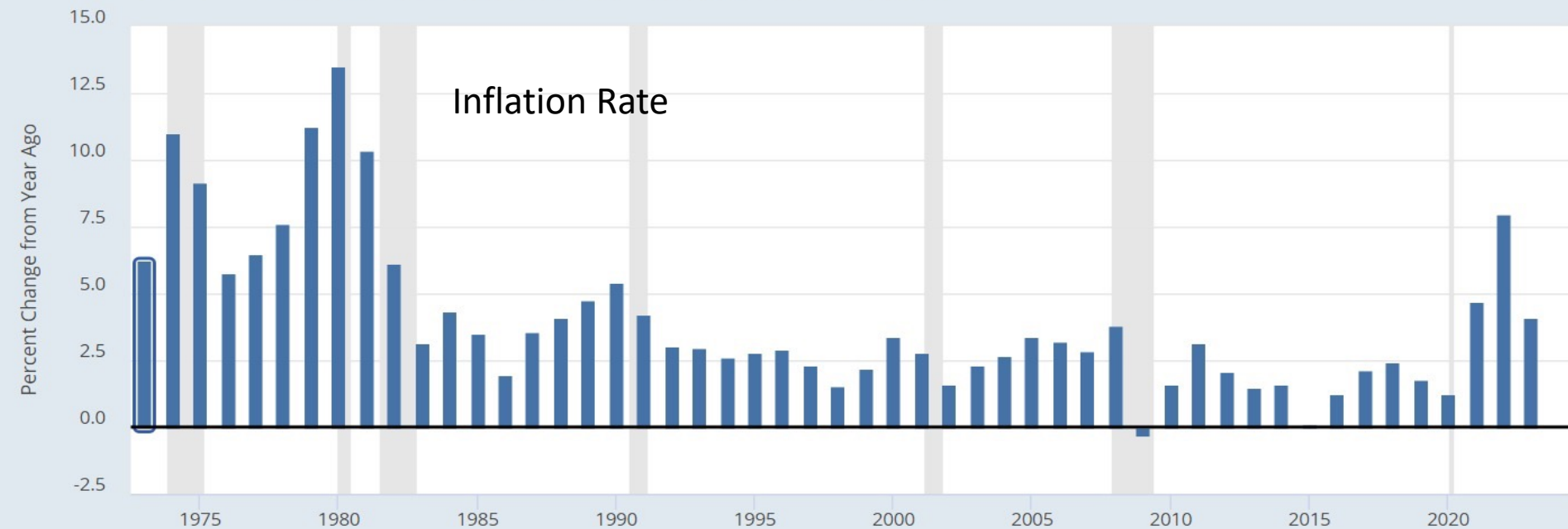
## Inflation Rate



## Consumer Price Index







# Disinflation vs Deflation

## Disinflation

- **Inflation rate** decreases
- “the rate at which inflation is occurring has slowed”
- **Price index** is still increasing
- The growth rate of the price index has decreased
- Inflation is still occurring

## Deflation

- **Inflation rate** is negative
- **Price index** is falling
- The growth rate of the price index is negative
- Deflation is occurring



# Check for understanding!

**Scenario 1:** In 1979, the inflation rate is 12% and in 1980 it 15%.

From 1979 to 1980,

The Inflation rate is....	The price level is...
Increasing Decreasing Staying the same	Increasing Decreasing Staying the same

**Scenario 1:** In 1979, the inflation rate is 12% and in 1980 it 15%.

From 1979 to 1980,

The Inflation rate is....	The price level is...
Increasing Decreasing Staying the same	Increasing Decreasing Staying the same

**Scenario 2:** In 1965, the inflation rate is 12% and in 1966, the inflation rate is 9%.

From 1965 to 1966,

The Inflation rate is....	The price level is...
Increasing Decreasing Staying the same	Increasing Decreasing Staying the same

**Scenario 2:** In 1965, the inflation rate is 12% and in 1966, the inflation rate is 9%.

From 1965 to 1966,

The Inflation rate is....	The price level is...
Increasing Decreasing Staying the same	Increasing Decreasing Staying the same

**Scenario 3:** In 1953, the inflation rate is 8%, and in 1954, the inflation rate is 8%.

From 1953 to 1954,

The Inflation rate is....	The price level is...
Increasing Decreasing Staying the same	Increasing Decreasing Staying the same



**Scenario 3:** In 1953, the inflation rate is 8%, and in 1954, the inflation rate is 8%.

From 1953 to 1954,

The Inflation rate is....	The price level is...
Increasing Decreasing Staying the same	Increasing Decreasing Staying the same

**Scenario 4:** In 1991, the inflation rate is 3%, and in 1992, the inflation rate is 0%.

From 1991 to 1992,

The Inflation rate is....	The price level is...
Increasing Decreasing Staying the same	Increasing Decreasing Staying the same



**Scenario 4:** In 1991, the inflation rate is 3%, and in 1992, the inflation rate is 0%.

From 1991 to 1992,

The Inflation rate is....	The price level is...
Increasing Decreasing Staying the same	Increasing Decreasing Staying the same

# What about the textbooks?

- How do they define disinflation?
- Do they explicitly mention that disinflation still results in an increase in prices?

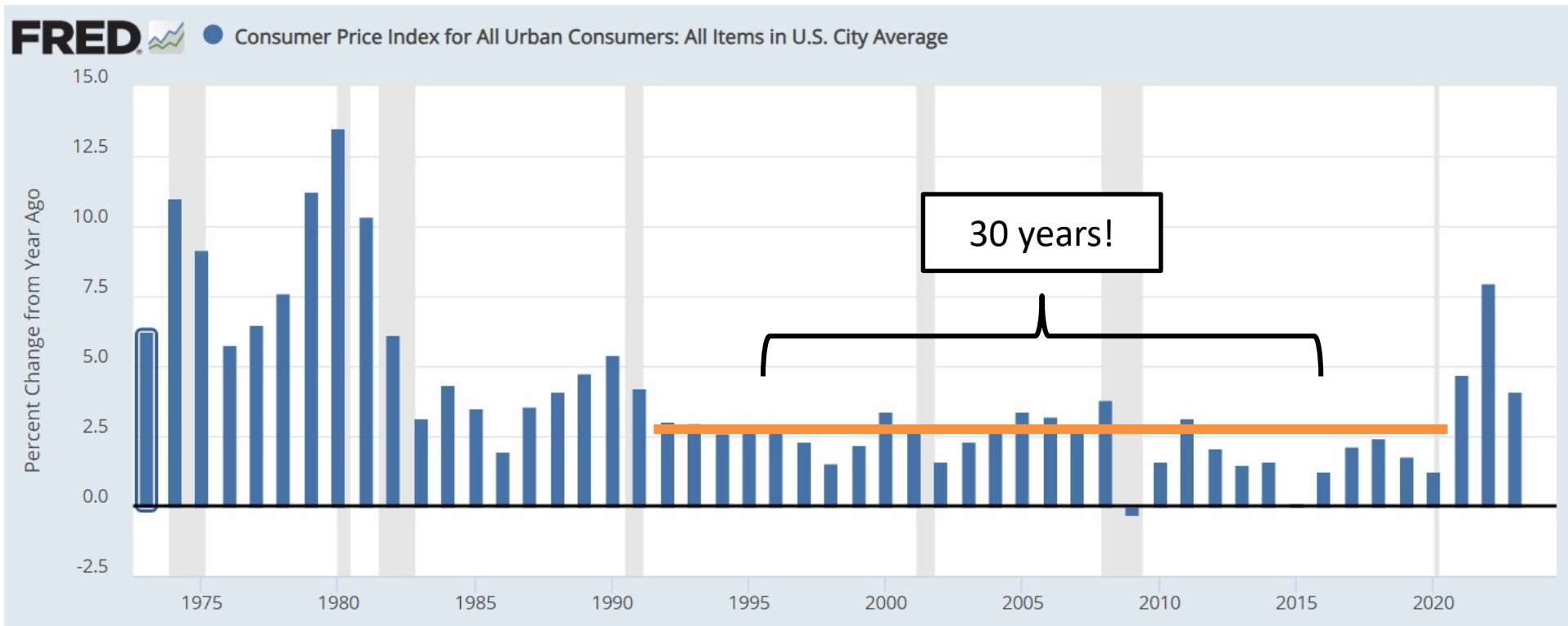
Author	Disinflation Definition	Is disinflation connected to increasing prices?
Krugman 5 <sup>th</sup> edition	“the process of bringing the inflation rate down”	No. Connects disinflation to unemployment/lowered output
Wolfers/ Stevenson 2 <sup>nd</sup> edition	Not defined	NA
Frank et al 8 <sup>th</sup> edition	“a substantial reduction in the rate of inflation”	No. Connects disinflation to unemployment/lowered output
Colander 12 <sup>th</sup> edition	Not defined	NA
McConnell et al	“A reduction in the rate of inflation”	No. As a distinction between LR and SR Phillips curve (not in main chapter about inflation)



# Why is this not covered?



# Why is this not covered?



# Recommendations

- Define disinflation: (A decrease in the inflation rate *or a slowdown in the upward movement of prices for goods and services in the economy.*)
- Explicitly teach that disinflation still means that prices are increasing (rates vs levels)
- Check for understanding with simple questions



# Reading Q&A

## PAGE ONE Economics®



### The Inflation Rate Is Falling, but Prices Are Not

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Thank you!!!  
**Questions?**

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