THE FEDERAL RESERVE BANK OF ATLANTA

Price Stability

How does the Fed measure price level changes?

MACROECONOMICS

Understanding Price Stability

Price stability occurs when the Rate Of Inflation is kept low and stable over an extended time period. The Price Level is the average of the Current Prices of Everything Sold in our Economy.

How does inflation affect your purchasing power?

Year 1

Ice Cream .... 50¢
Hot Dog $1.00
French Fries .... 75¢
Soda Pop .... 50¢

$ $ .25¢ .25¢ .25¢

It takes 88% more money to buy the same basket of goods in Year 2.

Year 2

Ice Cream $1.00
Hot Dog $2.00
French Fries $1.50
Soda Pop .... 67¢

$ $ $ $ $ .05¢ .05¢ .05¢ .01¢ .01¢

Who gains and who loses from unanticipated inflation?

Borrowers gain

Borrowers with fixed interest rate loans repay their loans with money that has less purchasing power.

Lenders lose

Lenders who sell loans at fixed rates are repaid with money that has less purchasing power.

What inflation indices are used?

Inflation Indices are measures of the prices paid by consumers for goods and services.

CPI

Consumer Price Index from the U.S. Bureau of Labor Statistics

Average change over time in the prices paid by urban consumers for a market basket of consumer goods and services.

- Reflects expenditures of urban consumers only
- Derived from household surveys
- Uses a fixed basket of goods and services

Source: U.S. Bureau of Labor Statistics: The most recent reweighting was in December 2015. Businessinsider.com/pce-vs-cpi-weight-comparisons-2014-6; BLS.gov

PCE

Personal Consumption Expenditures Index from the U.S. Bureau of Economic Analysis

Captures the changes in the prices for the personal consumption component of gross domestic product. The Federal Open Market Committee ties its explicit target rate of 2% inflation to the PCE index.

Core vs. Headline Inflation Rates

CORE

Excludes volatile prices of

Food Energy

Excluding these components may provide a better picture of the underlying short-term inflation trends.

HEADLINE

Includes volatile prices of

Food Energy

Including food and energy more accurately represents people's actual expenses.

Calculating the Inflation Rate

Inflation rate

$$\left(\frac{\text{Price index this period} - \text{Price index previous period}}{\text{Price index previous period}}\right) \times 100$$

Inflation rate example

$$\left(\frac{243 - 237}{237}\right) \times 100 = 2.5\%$$

Source-: BLS.gov

The Federal Reserve's mission is to conduct the nation's monetary policy by influencing monetary and credit conditions in the economy in pursuit of maximum employment, stable prices, and moderate long-term interest rates.