

## Lecture 17: Price Changes

1. Why important: so you can see how much your salary must change to keep pace with rising prices
2. Measures how an *average* of prices are changing – not every individual price, but an average of prices
3. Three categories of price change
  - a) inflation: the average of prices is rising
  - b) disinflation: the average of prices is rising, but the rise is smaller in each future year
  - c) deflation: the average of prices is falling
4. Three measures of average prices
  - a) Consumer Price Index (CPI): retail prices
  - b) Producer Price Index (PPI): business input prices
  - c) Implicit Price Deflator (IPD): both retail and input prices
5. Problems in measuring inflation
  - a) CPI and PPI are based on fixed buying habits, and it takes time for those to be updated
  - b) also takes time to incorporate new products and new stores
  - c) problem of incorporating quality changes – a price increase isn't counted if related to a quality improvement in a product
6. Is there a “best” inflation rate?
  - a) rapidly rising inflation can reduce the value of fixed debt and fixed debt payments
  - b) conversely, deflation can increase the real value of debt and cause salaries to fall
  - c) most economists think a “little inflation” is good, maybe 1% to 3%