FRASER® Quick Look

Inflation

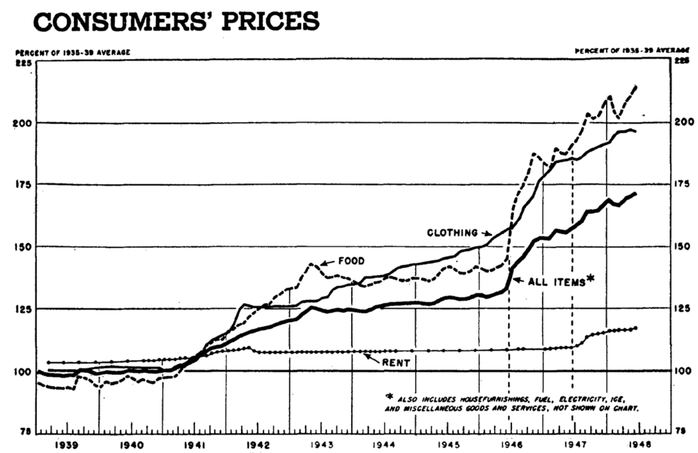
Inflation is a general, sustained upward movement of prices for goods and services in an economy. This means most things cost more as time goes by. But is inflation bad?

Inflation reduces the purchasing power of money. With high inflation, cash tomorrow is worth less than the same amount of cash today. This means that the number of goods and services you can buy with a set amount of money becomes smaller over time. When inflation rises too high, some consumers may react to a loss of purchasing power and make unwise purchases for fear that prices will go up even more.

Negative inflation over a sustained period of time is called "deflation." Very high inflation is called "hyper-inflation." Both deflation and hyperinflation can cause people to lose jobs, make it extremely difficult for consumers to buy things, and hurt the whole economy.

In the United States, the most common measure of inflation is the consumer price index (CPI), put out by the Bureau of Labor Statistics (BLS). The BLS checks the prices of the same items every month; these items are known as the "market basket" and represent the kinds of things that consumers want to buy. The prices of different items change at varied rates and in different amounts, so it's important that the BLS looks at lots of items. The CPI is then calculated from those price changes to give a number that represents inflation in the economy.

Central banks watch inflation as one sign of whether the economy is healthy. In 1978, Congress passed the Full Employment and Balanced Growth Act (known as the Humphrey-Hawkins Act) requiring the Federal Reserve to focus on price stability and full employment. Price stability is a low and stable rate of inflation maintained over an extended period of time. But what is considered "low" inflation? In 2012, to improve transparency and promote price stability, the Fed established a 2 percent annual inflation rate as its goal. In other words, when the Fed achieves price stability, the U.S. dollar will lose purchasing power at 2 percent per year. ■



This chart excerpted from 1948 U.S. Senate hearings on "Inflation Control," digitized for FRASER. The left and right axes are labeled "percent of 1935-39 average"

Inquiry Questions

- Why do people want to know if there is inflation?
- What amount of inflation is acceptable?
- How does inflation affect regular people?

For more about inflation, check out this *Page One Economics®* article.

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