

Car prices

My colleague, Jacob Bundrick, tells the story of when he visited a shoe store with his dad. His dad had his eye on an expensive pair of dress shoes. Seeing those shoes, Jacob said that he could buy nine pairs of tennis shoes for the price of just one pair of the expensive dress shoes. To put Jacob's comment another way, the relative price of the pair of dress shoes was nine pairs of inexpensive sneakers. The relative price of one good is what you could buy instead with the same amount of money. Relative prices can help economists make good decisions. For instance, they wouldn't buy the expensive shoes if they would rather have nine pairs of sneakers.

Relative prices can also give insight into how prices will settle after the economy completely recovers from its recent bout of high inflation. Inflation is the erosion of the purchasing power of money. When there is inflation, the general price level increases. That is, the prices of goods increase but their relative prices remain the same. In Jacob's example, inflation causes the prices of the dress shoes and sneakers to increase, but the relative price of the dress shoes will remain nine pairs of sneakers. But, one of the problems

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It is difficult to get automobile price data from previous years, so I won't calculate a relative price of a new car. Instead, let's assume that in September 2019 the relative price of a new car was in equilibrium. That is, the number of used cars one could buy for the purchase price of a new car remained stable. Then, during the pandemic, the general price level rose rapidly. The inflation rate between September 2019 and September 2024 was 22.8 percent. Some prices increased by more than 22.8 percent, some price increased by less.

In fact, new car prices rose 21.6 percent – just a little less than the general rise in the price level. Used car prices, on the other hand, rose 28.4 percent during this time. As used cars got so much more expensive, the amount of money it took to

with inflation is that initially some prices skyrocket and others move just a little. It takes a while for prices to become stable again, but when they do, the relative prices should return to their previous levels.

purchase a new car could buy fewer used cars. Or, put differently, the relative price of a new car decreased. One would give up fewer used cars to buy a new car.

As the economy moves toward a new equilibrium, we can expect the old relative price of new cars to emerge again. To get to this new equilibrium, new car prices won't adjust much since they rose at about the rate of inflation. To get to the old relative price, used car prices will have to come down.

This has already begun to happen. In the past year, from September 2023 to September 2024, both new and used car prices have decreased. But while new car prices have only declined by 1.3 percent, used car prices have decreased by 5.1 percent (all data for this column came from the Bureau of Labor Statistics).

I expect this trend to continue. Used car prices will decrease until the old relative prices (between new and used cars) get established again. What does this mean for most people? If they are thinking about buying a used car, they might want to wait.

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