# The price changes behind inflation

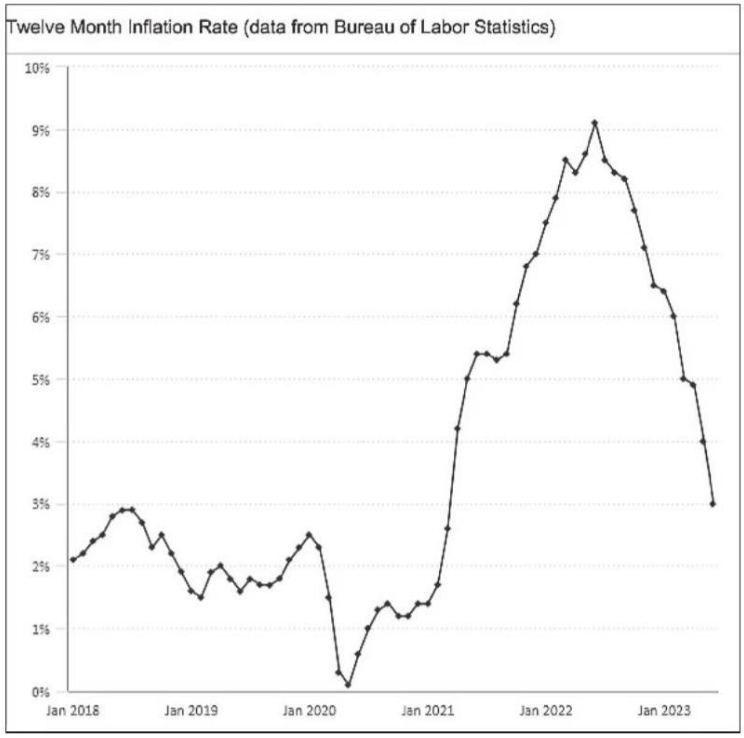
Joe McGarrity

During the last two years, inflation has been much higher than normal. Inflation started its rapid rise in February 2021 and peaked a year ago at 9.1 percent. A 9.1 percent inflation rate can be devastating. Since inflation measures the increase in the average price level, it also measures the erosion of the purchasing power of money. In effect, a person who did not get a raise would feel about the same amount of economic pain from a 9.1 percent inflation rate that she would feel from a 9.1 percent pay cut.

As you can imagine, given the amount of economic pain that inflation can cause, the Federal Reserve has been focused on bringing it down. Thankfully, the Fed has been successful. Now the 12-month inflation rate is 3 percent, which is not as low as the 2 percent rate the Fed desires, but which is a lot better than the 9.1 percent rate we had a year ago.

So what did this rapidly decreasing inflation rate look like to consumers? A year ago, they certainly did not see all prices increasing at a rate of 9.1 percent and now they don't see them all increasing at a 3 percent rate. Inflation never looks like that because the inflation rate is merely the percentage increase in the average price level. In any year, an increase in the average price level reflects the prices of many products: some increase rapidly, others increase slowly, and still others decrease.

As the graph shows, since 2021, inflation looks like a wave that increases rapidly and then falls just as rapidly. Some of these increases were caused by extraordinarily large increases in energy prices. From June 2021 to June 2022, gasoline prices increased 60 percent; and natural gas prices increased 38.4 percent. During the same time, new car prices increased 11.4 percent; and food prices increased by 10.4 percent. All of these prices increased at a faster rate than the overall inflation rate. These large price increases helped pull up the inflation rate to 9.1 percent.




**Twelve-month inflation rate (data from Bureau of Labor Statistics).**

Many of the products that saw large price increases leading up to June 2022 have become cheaper in the last year. Overall, energy prices have declined by 16.7 percent. The price of gasoline decreased by 26.5 percent and the price of natural gas decreased by 18.6 percent. The price of used cars has decreased by 5.2 percent. These lower prices, quite obviously, brought down the average price level and helped tame inflation.

Food and new car prices are still higher than the inflation rate and thus pulling up the inflation rate. However, food and new car prices have only increased by 5.7 percent and 4.1 percent, respectively, over the last twelve months. As a result, they contribute less to an increasing average price level than they did a year ago – when their prices were increasing by 10.4 percent and 11.4 percent over 12 months.

The Fed seems determined to bring the inflation rate down to its 2 percent target rate. It will be interesting to see which prices decrease or grow slowly to achieve this goal. My guess is that it will be the prices of goods that continued to increase rapidly over the last 12 months. My guess includes the price of shelter, which increased by 7.8 percent; the price of transportation services (like car repairs), which increased by 8.2 percent; and the price of food, which increased by 5.7 percent. All of these price increases were significantly higher than the 3 percent inflation rate. If recent history is a guide, we can expect the prices of these products to begin to decrease or at least grow at a much slower rate.

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