





1 Gallon of
Gasoline

1 Bag of
Apples

$\text{Price}_{\text{gas}} = \text{Price}_{\text{apples}} = \2

\$1

$$P_{\text{gas}} = 3 P_{\text{apples}} = 1$$

Prices Change

\$2

\$2

\$3



1 Gallon of
Gasoline

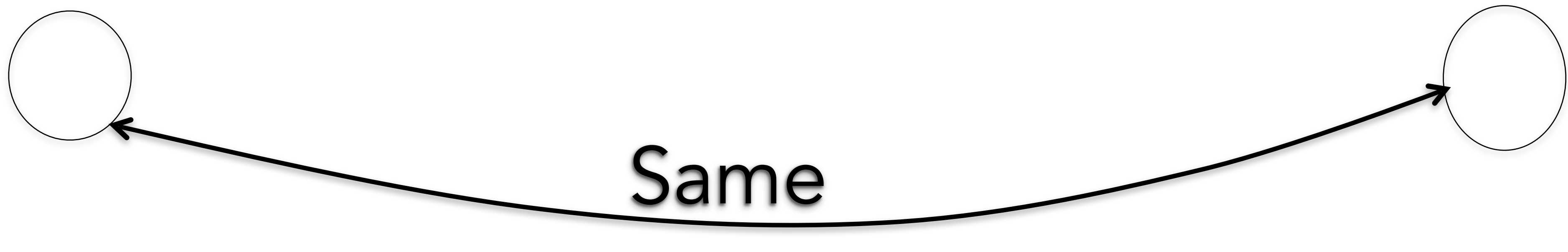
1 Bag of
Apples

Cost of Basket

$$(1 \times \$2) + (1 \times \$2) = \$4$$

Cost of Basket

$$(1 \times \$3) + (1 \times \$1) = \$4$$

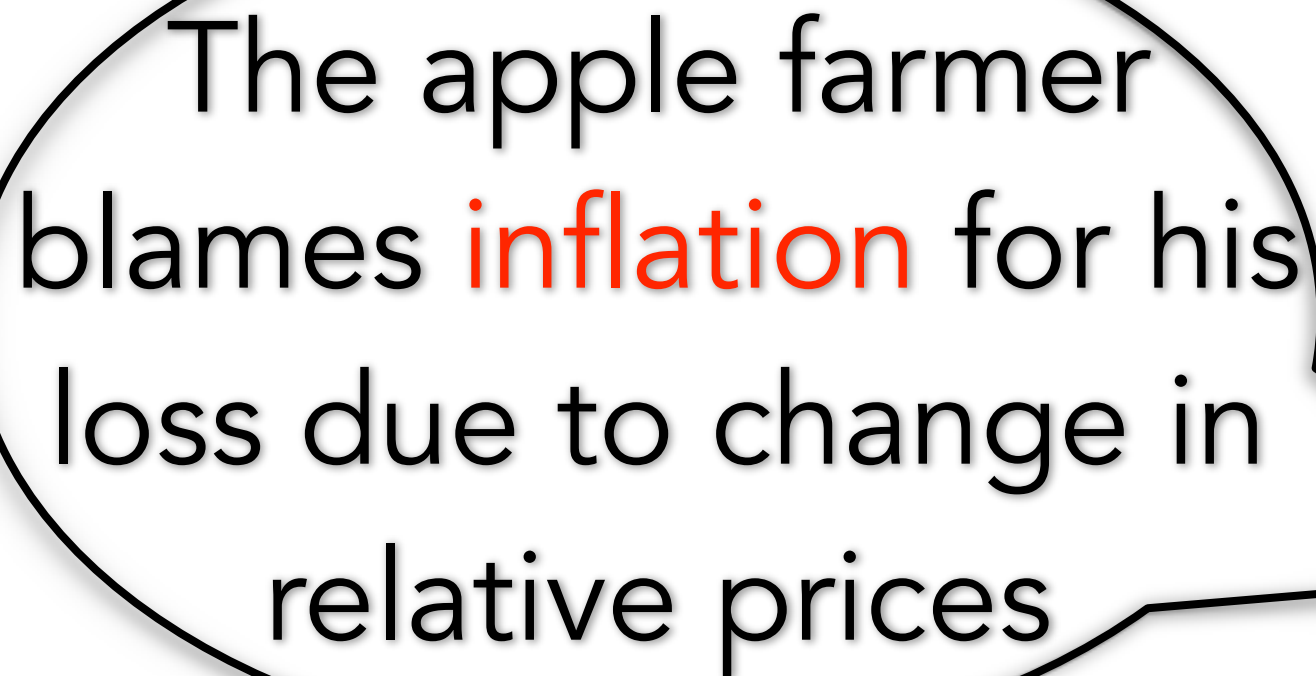


Zero Inflation

1 gallon of gas costs now 3 bags of apples

Relative Prices change:

Mistake #2: Confusing Inflation with changes in Relative Prices



The apple farmer
blames **inflation** for his
loss due to change in
relative prices

Mistake # 2: Confusing Inflation with changes in Relative Prices

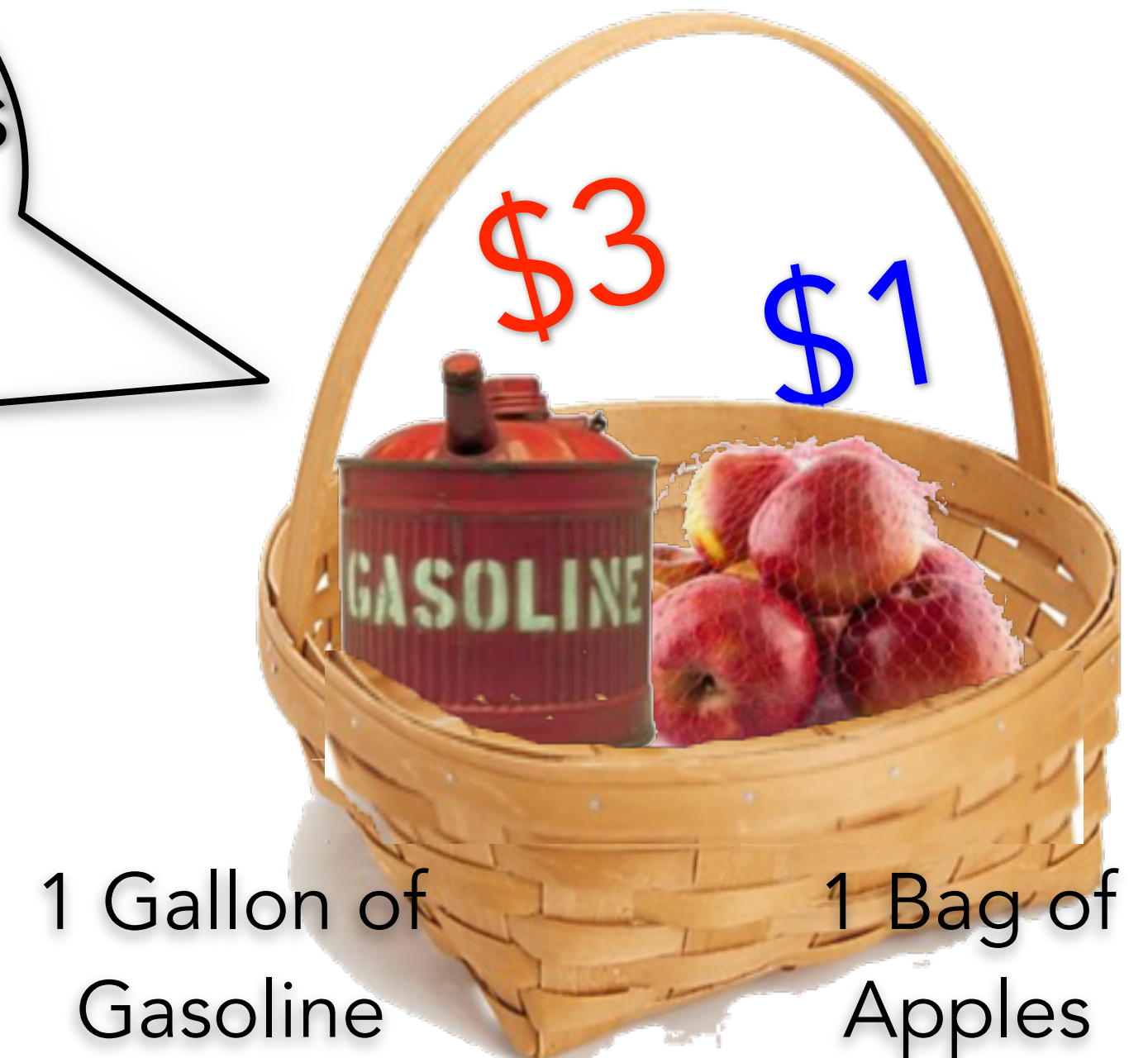
$$\text{Price}_{\text{gas}} = \text{Price}_{\text{apples}} = \$2$$

$$P_{\text{gas}} = 3 \quad P_{\text{apples}} = 1$$

The apple farmer blames **inflation** for his loss due to change in relative prices



Zero Inflation



Relative Prices **change**:

1 gallon of gas costs now 3 bags of apples

