

## What's a mystery is why they think low inflation is a mystery

When the editor of the Journal of Economic Perspectives writes "[Mysteries of Modern Inflation](#)":

The theory of inflation that I learned long ago suggested that inflation should creep up when an economy is running near full employment, but will come back down during a recession. However, for almost two decades now, the rate of core inflation (that is, inflation not counting the volatile movements in oil and food prices) has stayed low and hasn't budged by very much.

At one level, low and stable is clearly good news. But at another level, it raises a question of whether we **really understand the causes of inflation. And if we don't understand it, how much confidence can we have that it will remain low and stable.**

Something must be very wrong in the Kingdom of Denmark.

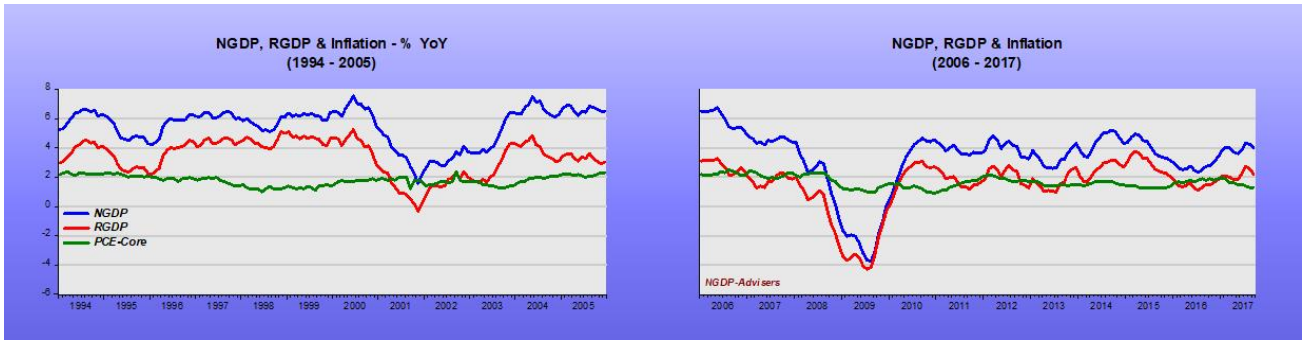
Just a few years ago, we had the "reverse mystery" or the mystery of the [missing disinflation](#):

What's at stake: The missing disinflation – or even deflation – in the Great Recession has generated a large literature, which proposes a set of possible tweaks to the traditional Phillips curve.

The fact is that for more than 20 years, since 1994, core PCE inflation has averaged 1.7%. In the last seven years, the average has been 1.6%! Headline inflation, jostled by supply shocks, has averaged 1.8% and 1.5%, respectively.

In the past, no one cared that inflation was below 2%, simply because there was no specified numerical target. Now, with inflation remaining below the specified 2% target, it's a "mystery", with the Fed risking losing credibility.

The chart illustrates.



Before and after 2006, inflation has remained indistinguishable. Before and after 2006, nominal spending (NGDP) growth has, excluding 2008-09, remained stable, but at a lower level after 2010. That explains inflation remaining stable.

The “victim” of the lower stable NGDP growth has been the growth of real output, which has dropped from an average of 3.4% in 1994-05, to 2.1% since 2010.