The Stock Market Game™
Week In Review

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Written By: Elizabeth Reidel, SIFMA Foundation for Investor Education

Dear Stock Market Game Teachers and Participants:

While much of the country has battled nasty cold weather again this week, Wall Street is experiencing something it hasn’t seen in years: deflation. According to the Labor Department, prices for goods actually declined 0.1% in January which means it costs less to buy things in the U.S. than it did in January 2014. It is the first time since October 2009 that the U.S. economy has experienced annual deflation.

What is the main driver of this trend? It appears to be cheap gas. Softer global demand and increased shale oil production in the United States have caused an oil surplus, causing crude prices to plummet. According to the Commerce Department, domestic gasoline prices plunged 18.7 percent in January, the biggest drop since December 2008, after falling 9.2 percent in the prior month. If gas prices rebound more, then the total inflation figure should start heading up again.

While most Americans pay attention to the prices of food and energy, economists also look at so-called core inflation that excludes those two items. Core inflation actually rose 1.6% from a year ago, another sign that gas is the key swing factor. January's deflation could cause the Federal Reserve to hesitate on raising interest rates, which many expect them to do later this year. Federal Reserve Chair Janet Yellen and her fellow board members do not want to raise interest rates until the economy shows real momentum. Yellen told lawmakers this week that the central bank's policy-setting committee "needs to be reasonably confident that over the medium-term inflation will move up toward its 2-percent objective" before it starts to raise interest rates.

Those new to investing and The Stock Market Game program may be curious about the concepts of inflation and deflation and how they affect one’s investments. Inflation is much more widely known and is the rate at which prices rise, and over time can erode the purchasing power of your money. For example, you can buy somewhat less with a dollar today than you could have bought five years ago, and significantly less than you could have bought fifty years ago. So if you have the same amount of income each year, your purchasing power gradually shrinks. Investing can help you offset the eroding effect of inflation by providing a rate of return on your money that is higher than the rate of inflation. If you expect your portfolio to be worth more tomorrow than it is today in terms of buying power, you'll need to invest in securities that have a good chance of outpacing inflation, but picking them is easier said than done.

Deflation is a widespread decline in the prices of goods and services. But instead of stimulating employment and production, deflation has the potential to undermine them. As the economy contracts and people are out of work, they cannot afford to buy even at cheaper prices.

To expand this discussion with your students, be sure to check out the first issue of In The News for the Spring 2015 semester. “Crude Awakening” examines the causes behind the drop in gasoline prices and the impact it has on the market. You may also be interested in Level Headed, issue of In the News. It explains inflation and deflation, shows their history over the last 80 or so years, and describes their impact on the stock market over those years. You can access both editions by logging into the Teacher Support Center, Clicking the “Publications” link under In The Classroom, and Selecting “Show All Publications Listed by Name.” In the News is the first link on the page.

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Econ Illinois, Northern Illinois University, DeKalb IL 60115
P: 815.753.0356; W: www.econed-il.org