



Inflation

Lecture 16

Definition

Inflation reduces the purchasing power of each unit of currency, which leads to increases in the prices of goods and services over time. It's an economics term that means you have to spend more to fill your gas tank, buy a gallon of milk, or get a haircut. In other words, it increases your cost of living.



Inflation rate

- ▶ The inflation rate is the percentage increase or decrease in prices during a specified period, usually a month or a year. The percentage tells you how quickly prices rose during the period.
- ▶ If the inflation rate is more than 50% in a month, that's hyperinflation.





Walking Inflation
prices rise 3-10% a year

Creeping/Mild Inflation
prices rise 3% a year or less



THE FOUR MAIN TYPES OF **INFLATION**



Galloping Inflation
prices rise >10%



Hyperinflation
prices rise >50% a month

Causes of inflation

► Demand-Pull Effect

Demand-pull inflation occurs when the overall demand for goods and services in an economy increases more rapidly than the economy's production capacity. It creates a demand-supply gap with higher demand and lower supply, which results in higher prices.

► Cost-Push Effect

Cost-push inflation is a result of the increase in the prices of production process inputs. Examples include an increase in labor costs to manufacture a good or offer a service or increase in the cost of raw material. These developments lead to higher cost for the finished product or service and contribute to inflation.

► Built-In Inflation

Built-in inflation is the third cause that links to adaptive expectations. As the price of goods and services rises, labor expects and demands more costs/wages to maintain their cost of living. Their increased wages result in higher cost of goods and services

How Does Inflation Work?

Inflation represents the rate at which the cost of goods and services increase over a period of time.

Demand-Pull



When demand for goods/service exceeds production capacity.

Cost-Push



When production costs increase prices.

Built-In



When prices rise, wages rise too, in order to maintain living costs.

Internal causes of inflation



A large surge in property prices



Higher wages / labour costs



Boom in credit / money supply



Rise in business taxes e.g. VAT

External causes of inflation



Increase in world oil / gas prices



Inflation in global commodity prices



Depreciation of the exchange rate



Higher inflation in other countries

Inflation Indexes

► Consumer Price Index

The CPI is a measure that examines the weighted average of prices of a basket of goods and services which are of primary consumer needs. They include transportation, food, and medical care. In Pakistan, the CPI covers the retail prices of 374 items in 35 major cities and reflects roughly changes in the cost of living of urban people



Inflation Indexes

- ▶ Wholesale Price Index

Designed for those items which are mostly consumable in daily life on the primary and secondary level. Their prices are collected from wholesale markets as well as from mills at organized wholesale market level. It covers the wholesale price of 106 commodities prevailing in 18 major cities of Pakistan.

- GDP deflator

The GDP deflator is also measure of the level of prices of all new, domestically produced, final goods and services in an economy. It is a price index that measures price inflation or deflation.

- Sensitive Price Index

The weekly change of price of 53 selected items of daily use consumed by those households. It is usually informs about the actual position of supply: whether the commodity is available in market or not.

Effects of inflation

- Decreased the purchasing power of rupee.
- Depreciation is especially hard on retired people with fixed incomes ,
 - as spending power decreases each month.
- Alters the distribution of income.
- Inflation weakens the function of money as storage of value.
- Producers will not able to control the cost of raw material and labor and hence the price of the final product , which results in less profit or in some cases no profit, forcing them out of business.
- When the balance between supply and demand goes out of control , consumers could change their buying habits , forcing manufacturers to cut down production.
- Manufactures will not have an incentive to invest in new equipment and technology.

Inflation rate compared to previous year

Year	Inflation Rate (%)	Annual Change
2019	6.74	1.67
2018	5.0781	0.99
2017	4.0854	0.32
2016	3.7651	1.24
2015	2.5293	-4.66
2014	7.1894	-0.5
2013	7.6922	-1.99
2012	9.6824	-2.23
2011	11.9168	-1.96
2010	13.8811	0.23

How inflation is threat to Pakistan economy?

- Inflation measured through the Consumer Price Index (CPI) had touched 12 years highest level of 14.56 per cent in January this year. However, with the emergence of coronavirus, the entire economic scenario was turned upside down as demand contraction lowered inflation forcing the SBP to cut down interest rates to 5.25% within just three months.
- The rate cut announcement came as inflation slowed down, falling to 8.2% in May.
- The government has slashed petroleum prices thrice during the two months, which drastically reduced the cost of production, transportation and finally reduced inflation. (Dawn 7may20)



What Causes Hyperinflation?

Hyperinflation is when the prices of goods and services rise more than 50% in a month



It starts when a country's government begins printing money to pay for its spending



As the government increases the money supply, prices rise as in regular inflation

Instead of tightening the money supply to stop inflation...



With too much currency sloshing around, prices skyrocket



A purple rectangular tag with a hole on the left side is placed on a light-colored wooden surface. The tag has the words "Thank you!" written in a black, cursive script. Three white daisies with yellow centers are scattered around the tag: one to the left, one to the right, and one in the background. A thin, light-colored string is looped around the tag and extends towards the top left corner.

Thank
you!