Inflation

Economics 12.1

Assignment

- Review Consumer Price Index / Unemployment

Inflation

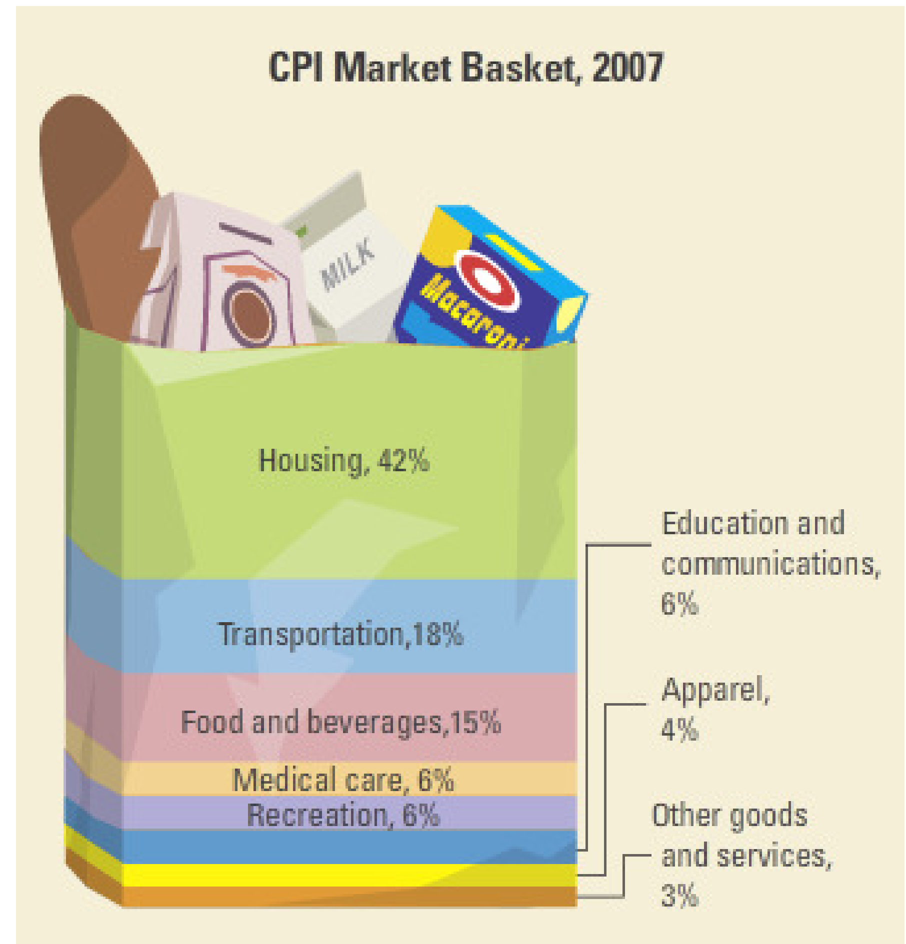
- is an increase in the price level, or the average level of prices.

Deflation

- Deflation is the opposite of inflation.
- **Deflation** is a decrease in the price level, or the average level of prices.
  - A downward change in the CPI indicates deflation.

How is inflation calculated?

- **<u>By using the Consumer Price Index (CPI)!</u>**
  - **400 goods and services are calculated in the “Market Basket”**
  - **Each group of items is weighted to reflect how much consumers spend on it**
  - **Re-calculated yearly to find the difference**
  - **Growth of the price index = inflation!**



Types of Inflation

Normal

- A certain amount of inflation is normal and expected.
- The normal ("creeping") rate of inflation is 3.4% per year.

Abnormal

- HYPERINFLATION: Inflation goes into overdrive!
  - Germany in the 1920's (Loaf of bread: 1 mark in 1920, 2 billion marks in 1923)
- DEFLATION: Prices go down over time
  - Good for consumers, savers, & lenders
  - Bad for borrowers & businesses
- STAGFLATION: Prices go up and high unemployment

What causes inflation?

- **Quantity Theory:**
  - **Too much money circulating!!!**
- **Demand-Pull Theory:**
  - **Demand for goods exceeds supply & causes a shortage…"Pulls" prices upwards**
- **Cost-Push Theory:**
  - **Costs of production increase, so prices are "pushed" upwards**
  - **Result of the Wage-Price Spiral**