



# Measuring Economic Growth

## Inflation

# Inflation and Deflation

- **Inflation**

- A sustained increase in the average of all prices of goods and services in an economy

- **Deflation**

- A sustained decrease in the average of all prices of goods and services in an economy

# Inflation and Deflation

- **Purchasing Power**

- The value of money for buying goods and services
- Varies with prices and income

# Inflation and Deflation

- Nominal value
  - Price expressed in today's dollars
- Real value
  - Value expressed in purchasing power, adjusted for inflation

# Inflation and Deflation

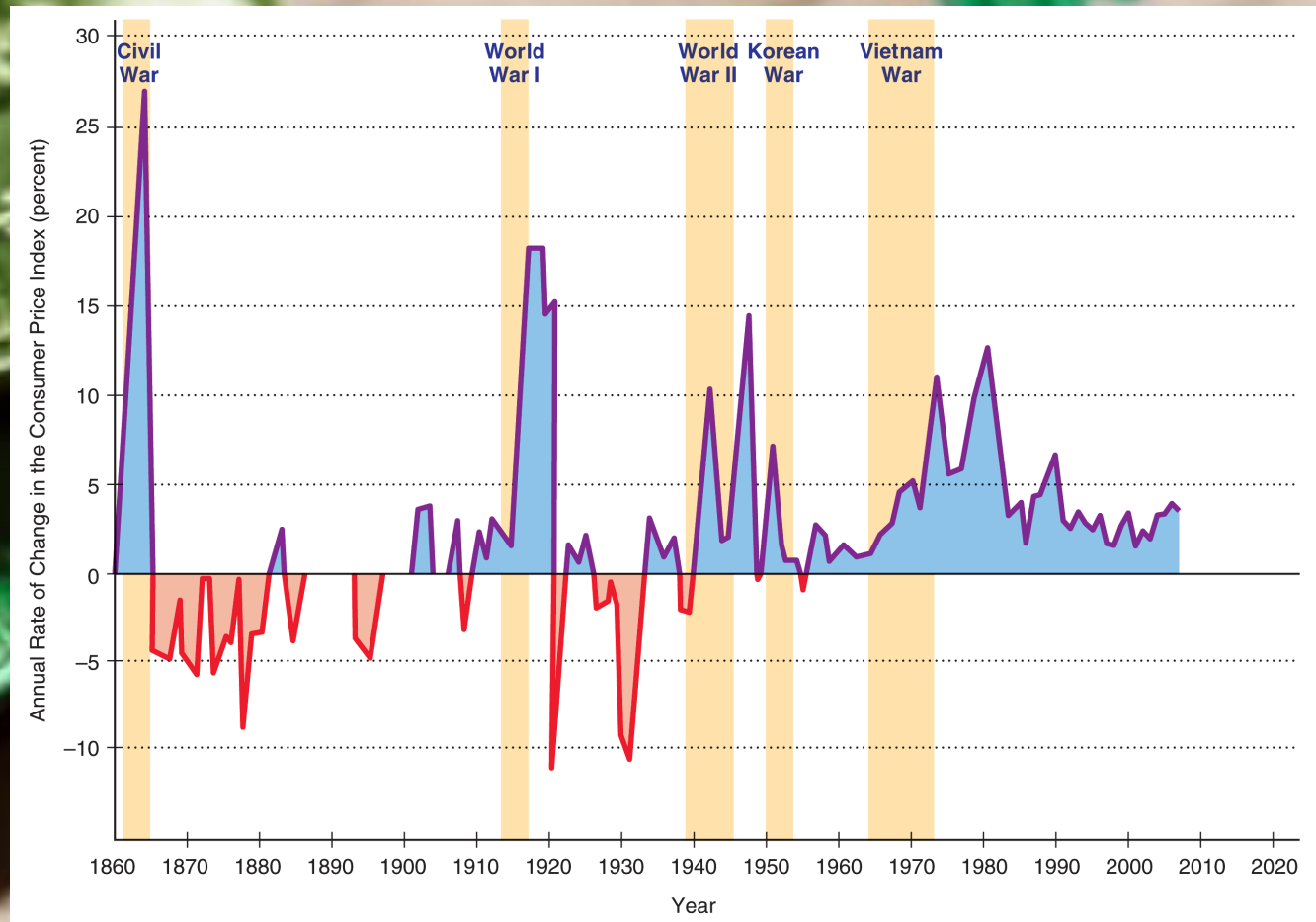
- Measuring the rate of inflation

- Price Index

- The cost of today's market basket of goods expressed as a percentage of the cost of the same market basket during a base year

$$\text{Price index} = \frac{\text{Cost today of market basket}}{\text{Cost of market basket in base year}} \times 100$$

# Figure 7-4 Inflation and Deflation in U.S. History



Source: U.S. Department of Labor, Bureau of Labor Statistics

# Causes of Inflation

- Cost Push
  - Results when businesses raise prices due to shortages
    - Forces associated businesses to raise prices creating ripple effect
- Example: OPEC raises price on Oil -> All products using oil become more expensive -> Companies raise prices-> Companies forced to pay workers more due to more money coming in and to attract worker.

# Causes of Inflation

- Demand Pull
  - Demand raises and companies/consumers suddenly have increase of more expendable income
    - Causes –
      - Increased supply in amount of money coming into a country
      - Decreased taxes
      - Consumer confidence goes up
      - Dip in currency exchange



# Anticipated versus Unanticipated Inflation

- Anticipated versus unanticipated inflation
  - To determine who is hurt by inflation we distinguish between the two types.
  - The effects of inflation on individuals depend upon which type of inflation exists.

# Anticipated versus Unanticipated Inflation (cont'd)

- **Anticipated Inflation**
  - The inflation rate that we believe will occur
- **Unanticipated Inflation**
  - Inflation at a rate that comes as a surprise

# Anticipated versus Unanticipated Inflation

- Does inflation necessarily hurt everyone?
  - Inflation affects people differently
- Unanticipated inflation
  - Creditors lose
  - Debtors gain