Inflation - Student Notes

Directions:
Fill in the blanks.

Factors Influencing Inflation Segment

1. Inflation

- Accounts for an economy's increase in price level
  - this is the result of an increase in _____ supply or demand
- Results in a reduction in the value of money
- Is usually measured _____
- Most countries try to maintain a rate of two to three percent per year

Aggregate: the sum or whole amount of something

2. Expected Inflation

- Is the predicted rate of _____
- Allows employers and workers to approximate how much they should _____wages and hours worked
- Is not always accurate

Example: You agree to work for a wage which is four percent higher than your current salary because inflation is expected to rise at a three percent level. However, if inflation rises at a four percent level, your purchasing power would be less than originally expected.

3. Unexpected Inflation

- Accounts for the unexpected changes in inflation
- Interferes with a company's ability to plan for the future
- Affects _____companies the worst as they must predict future inflation in order to calculate _____rates

4. Aggregate Supply

- Is also known as total _____
- Accounts for the total amount of goods and services produced in an _____during a specified period

Example: If a car manufacturer produced 25,000 cars last year, the aggregate supply of the first quarter could have been 7,000, 7,500 the next quarter, 4,500 the next quarter, and 6,000 the last quarter

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5. The Aggregate Supply Curve

- Demonstrates how much output _____are willing and able to supply at various price levels
  - displays a _____relationship between price level and total quantity of output producers supply

Positive Relationship: a relationship between two variables in which they both increase or decrease

6. The Aggregate Supply Curve

- Assumes the following constants:
  - resource _____
  - state of technology
  - rules providing production _____ (patents, copyright laws, etc.)

Constant: an unchanging quantity

7. Aggregate Demand

- Explains the relationship between the _____price of aggregate supply and the _____demanded
  - example: If 100 mp3 players are produced and the price per mp3 player was $800, there may be only 30 sold, but if the price changed to $150 per mp3 player, there may be 90 sold

8. The Aggregate Demand Curve

- Shows the economy's price level with the real GDP demanded
  - these two factors are _____related; as one goes up, the other goes down
  - the price level creates the vertical axis while the real _____is the horizontal axis
- Assumes all things constant, including other countries' price levels and exchange rates

Gross Domestic Product (GDP): the total market value of all goods and services provided within a country

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9. Price Level

- Is the weighted average of the prices paid for all goods and services produced within the economy
- Can be seen as an _____number
- Comparisons between the index number of one year to a _____year give you the rate of inflation

Weighted Average: an average derived using some factors which may count more than others

Index Number: a set number used to measure rate of change

10. Price Level Example

- Supposing a soda cost $1.00 in _____, and $1.85 in _____, this shows an 85 percent rate of inflation over 20 years

Equation:

((1.85-1)/1)x100 = 85

11. Producer Price Index

- Is often referred to as the _____
- Looks at the price change from the producers' standpoint, including the following considerations:
  - labor
  - materials
  - rent/utilities
  - shipping/_____
  - marketing/advertising

12. Producer Price Index

- Measures the average change in _____selling prices over a given period of time
- Considers three areas of production: industry based, _____based and stage of processing based companies

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13. Producer Price Index Example

The last time you purchased a couch was in 1990, and it cost $550. You go to replace it in 2008, and a couch of the same make costs $1120. Looking at the PPI of the furniture maker, you can understand why the price rose so much.

Factor	1990	2008
Labor (Minimum Wage)	$3.80/hour	$6.55/hour
Materials per Couch	$127	
Rent/Utilities	$372	$765
Shipping/Packaging	$186	$321
Marketing/Advertising	$316	

14. Consumer Price Index

- Considers the _____averages of a group of consumer goods and services
  - example: transportation, food and medical expenses
- Can be _____through averaging the price changes in each item in the predetermined group of goods
  - each good is weighted on its importance
- Is important as it examines price changes associated with the cost of living

15. Consumer Price Index Example

The percent change in CPI can be determined by finding a year's average CPI for a category and comparing it to another year's CPI for that same category. This shows how inflation affects the cost of living.

	Food	Housing	Medical Care
1988 Average*	118.20	118.50	138.60
2008 Average*	214.23	216.26	364.07
Change in Index Points	96.03	97.76	225.47
Percent Change		82%	

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16. Gross Domestic Product

- Is the total _____value of all goods and services produced within the borders of a country during a specific time period
- Can be calculated using the following equation:

  GDP = Consumption + _____+ Government Spending + (Exports - Imports)

Consumption: the economic amount of goods and services utilized in a given period of time

17. GDP Example

- GDP = Consumption + Investments + Government Spending + (Exports – Imports)
- _____: $8.7 trillion
- Investments: $2.1 trillion
- Government Spending: $2.4 trillion
- _____: $1.2 trillion
- Imports: $1.9 trillion

8.7 + 2.1 + 2.4 + (1.2 – 1.9) = $12.5 trillion

18. Gross Domestic Product

- Is used in the following ways:
  - allows people to see how fast the economy is growing or shrinking by comparing the current _____to previous years' GDP
  - aids government agencies in making policy decisions, such as the Federal Reserve's stance on interest rates
  - provides information on other _____, letting the US determine an approximate amount to lend in aid

Concepts Related to Inflation Segment

1. Inflation

- Occurs in the following forms:
  - _____
  - disinflation
  - deflation
  - stagflation

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2. Hyperinflation

- Is extremely high inflation
- Means people often cannot make even small purchases since they cannot _____carry enough money
- Creates a difficult market to _____with, both in and out of the country

Between August 1922 and November 1923, inflation in Germany increased at an average rate of 322 percent per month.

3. Disinflation

- Is a decrease in the rate of inflation
- Usually occurs during a recession as this is when _____drop and retailers cannot place higher prices on customers
- Cannot be confused with _____, which actually experiences a drop in prices

The United States experienced an era of disinflation throughout the 1980s and 1990s, having average inflation rates around 9 percent in the early 1980s and reducing to 2 percent at the beginning of 2000.

4. Deflation

- Refers to the decrease in price level
- Is often caused by a _____in the supply of money
- May also be prompted by a decrease in government, personal or investment spending
- Is the opposite of inflation and may lead to an increase in _____due to a lower demand of goods and services from the economy

From 1930 to 1933, the United States experienced approximately 10 percent deflation a year, due in part to retiring paper money printed during the Civil War as well as the economy sliding into the Great Depression.

5. Stagflation

- Occurs in the economy when unemployment and _____are both high
- Occurs when the economy fails to _____, but prices continue to rise
- Often increases the rate of inflation within a country

In the 1970s, the price of oil sky rocketed while America's economy remained unchanged and sluggish, resulting in one of the worst periods of stagflation in American history.

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6. Causes of Inflation

- Have been tied to the following two concepts:
  - _____-pull inflation
  - _____-push inflation

7. Demand-Pull Inflation

- Results from increases in _____demand
- Increases price levels
- Leads to a rightward shift of the aggregate demand _____
- Is often described as “too much money chasing too few goods”

During the late 1980s in the United Kingdom, the number of people wanting to buy houses and the price of houses both grew at sharp rates. There was a high amount of money being used in the economy, resulting in higher demand of products for the next few years

8. Cost-Push Inflation

- Results from a _____in aggregate supply
- Increases price levels
- Leads to a _____shift of the aggregate supply curve

The oil crisis in the 1970s demonstrates this idea as there was a necessary item (oil) which experienced high prices, shifting the supply curve left while the demand curve remained in the same place, raising the demand.

9. Reflation

- Is one of the actions the government can take to counter inflation
- Involves the government using _____stimuli to increase the country’s output, including the following:
  - tax _____
  - adjusting interest rates
  - changing the money supply

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10. Effects of Inflation

- Include the following:
  - value of the dollar _____
    - the following is an example of exchange rates

	Food	Housing	Medical Care
1988 Average*	118.20	118.50	138.60
2008 Average*	214.23	216.26	364.07
Change in Index Points	96.03	97.76	225.47
Percent Change	81%	82%	163%

  - _____power is lowered
    - as illustrated above, in Mexico in 1990, the dollar was able to buy 554 sodas priced at 5 pesos. In 2009, however, a dollar could only have bought two sodas priced at 5 pesos.

11. Effects of Inflation

- Include the following:
  - lowers competition of _____products if inflation rates are higher than in other countries
    - if a domestic brand television is priced at $300, and a comparable foreign brand is priced at $250, which would you purchase?
  - lowers the standard of living for those on _____income, such as retirees
    - if you are receiving a monthly allowance of $500, your money will buy less and less as inflation increases

12. Inflation

- Often has a _____with the unemployment rate
  - in most periods of strong economic growth and falling _____, there is a rise in inflation

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13. Inflation

- Can cause unemployment when:
  - products or services are no longer _____
    - which reduces the need for production
  - inflationary growth is unsustainable, leading to a boom-and-bust economic cycle
    - rapid economic growth and inflation, (boom) followed by a period of economic _____and rising unemployment (bust)

14. Interest Rates

- Are the rates charged to _____money
- Are largely affected by inflation but can be helped
  - nominal interest rates
  - real interest rates
- Are more accurately represented through real _____rates and therefore these are the ones which should be consulted

15. Nominal Interest Rates

- Do not account for inflation
- Are expressed in terms of current dollars as the percentage of the amount _____
- Are the rates which appear on the borrowing agreement
- Are typically the rates discussed by the media
  - for example, home _____rate of 7 percent

16. Real Interest Rates

- Takes inflation into consideration
- Equal nominal interest rates when there is no inflation
- Concern lenders and _____more than nominal interest rates
- Can be calculated using the following equation:
  - Real Interest Rate = Nominal Interest Rate – _____Rate

17. Interest Rate Example

- If you borrowed $1,000 with a 7 percent interest rate, then:
  - the nominal interest would be $70
  - however, if there is a 4 percent inflation rate, the real interest rate would be 3 percent
    (7 – 4 = 3)