Inflation

- Definition
  - Increase in general price levels of goods and services in an economy over time.
- Causes
  - Demand-Pull Inflation
    - Occurs when aggregate demand exceeds aggregate supply.
  - Cost-Push Inflation
    - Results from increased production costs passed on to consumers.
  - Monetary Inflation
    - Caused by an increase in the money supply exceeding economic growth.
  - Built-In Inflation
    - Results from expectations of future price increases leading to higher wages and prices.
- Types
  - Moderate Inflation
    - Low and steady increase in prices, usually manageable by central banks.
  - Hyperinflation
    - Extremely rapid and out-of-control price increases, often leading to economic instability.
  - Stagflation
    - Simultaneous occurrence of high inflation and stagnant economic growth.
- Measurement
  - Consumer Price Index (CPI)
    - Measures changes in the price level of a basket of consumer goods and services.
  - Producer Price Index (PPI)
    - Measures changes in the selling prices received by domestic producers.
- Effects
  - Purchasing Power
    - Decreases as the value of money declines, leading to reduced buying capacity.
  - Interest Rates
    - Often rise to combat inflation, affecting borrowing costs and investment decisions.
  - Cost of Living
    - Increases, impacting individuals' budgets and standard of living.
  - Savings and Investments
    - Real returns diminish as inflation erodes the value of savings and investments.
- Impacts on Businesses
  - Production Costs
    - Increase due to higher input prices such as raw materials and labor.
  - Pricing Strategies
    - Companies may raise prices to maintain profit margins, affecting consumer behavior.
  - Wage Pressures
    - Workers may demand higher wages to keep up with rising living costs, impacting labor markets.
- Global Implications
  - Exchange Rates
    - Inflation differentials between countries can impact currency values and trade balances.
  - International Trade
    - Inflation rates influence competitiveness and pricing of exported goods and services.
- Government Response
  - Monetary Policy
    - Central banks adjust interest rates and money supply to control inflation.
  - Fiscal Policy
    - Governments may use taxation and spending policies to influence economic activity and inflation.
- Strategies for Individuals
  - Diversification
    - Spread investments across different asset classes to hedge against inflation risk.
  - Inflation-Indexed Securities
    - Invest in bonds or assets whose returns adjust with inflation rates.
  - Real Assets
    - Invest in tangible assets like real estate or commodities that may retain value during inflationary periods.

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