

Effects of Inflation

INFLATION: RISE IN THE GENERAL PRICE LEVEL (% RATE OF CHANGE IN THE RPI OR CPI PER ANNUM)



DEFLATION

Danger of vicious cycle of slow growth (consumption is postponed as price cuts are expected)

e.g. Japan 1990s

LOW INFLATION

Bank of England MPC target (1%-3%)

Gentle inflation favours borrowing & spending is buoyant

e.g. UK 1992-2007
Inflation below 4%

HIGH INFLATION

Domestic industry gets uncompetitive; jobs lost

Fixed income earners suffer

Savers suffer

'Menu' costs

e.g. UK early 1970s
Inflation 6-8%

ACCELERATING INFLATION

Wage-price spiral takes off (expected inflation rises)

'Shoe leather' costs

e.g. UK 1972-1975
Inflation rose from 7.1% to 24.2%

HYPERINFLATION

Money ceases to facilitate exchange; trade collapses

e.g. Germany 1923
Zimbabwe inflation over 100,000% in 2008

