Inflation Essay

Inflation is a rise in the general level of prices. It is measured as the change in RPIX, the Retail Price Index (excluding housing costs). This index is often referred to as "the headline rate of inflation", by the press.

The chart shows inflation in the UK from 1949 to 2001. In 1949, inflation was about 2.5%, before rising to about 2.7% in 1950. Then, it rose quite sharply to about 9.7% in 1951 and was stable at this level in 1052, before falling down quite rapidly to about 2% in 1954. Between 1954 and 1970, the rate of inflation had a series of 3 peaks and 3 troughs. It the started rising in 1972 and rose dramatically to about 24% in 1975 before falling down rapidly to about 8.5% by 1978.

The rate of inflation then rose again to about 18% by 1980 and fell down to 5% by 1983. It then rose to 9.7% by 1990 before falling to 2% in 1993. From 1993 to 2001, inflation has been quite stable – between 2% and 4%. The inflation in the UK was quite volatile during the first 4 decades of the second part of the 20th century. It was contrastingly stable in the last decade of the 20th century – indicating that the UK economy has been performing quite well lately.

Most economists consider inflation to be a problem. The UK experienced periods of high inflation in 1975 and 1980. There were some serious consequences on its economy as a result. Some of the general consequences of high inflation include, shoe-leather costs, menu costs, psychological & political costs, redistribution costs, unemployment & lower growth and as a result of many of these, a negative effect on the stock market.

During periods of high inflation, individuals and firms would be unclear about a reasonable price for goods. As a result, they will shop around more to find the best deals on commodities. This involves the cost of time. Firms are also faced with menu costs, which are basically changing/altering price lists and price tags to keep in line with volatile prices. Even more costly are changes to fixed capital, such as vending machines and parking metres, to take account of price increases.

Price rises are deeply unpopular. People feel gloomy and that they are worse off even if their incomes rise by more than the rate of inflation. As a result, people's social lives and, society in general develop negative sentiment. Revolution and change in the past have often accompanied periods of high inflation, proving to be political costs.

When prices rise, people's purchasing power drops if they are on a fixed income. People feel this way even if their incomes have gone up by more than the rise in inflation. As a result, people try to conserve their purchasing power by putting their money in high interest accounts. The transfer of money costs money and time.