Introduction

Inflation and Deflation, in economics, terms used to describe, respectively, a decline or an increase in the value of money, in relation to the goods and services it will buy.

Inflation is the pervasive and sustained rise in the aggregate level of prices measured by an index of the cost of various goods and services. Repetitive price increases erode the purchasing power of money and other financial assets with fixed values, creating serious economic distortions and uncertainty. Inflation results when actual economic pressures and anticipation of future developments cause the demand for goods and services to exceed the supply available at existing prices or when available output is restricted by faltering productivity and market constraints. Sustained price increases were historically directly linked to wars, poor harvests, political upheavals, or other unique events.

Examples of inflation and deflation have occurred throughout history, but detailed records are not available to measure trends before the Middle Ages. Economic historians have identified the 16th to early 17th centuries in Europe as a period of long-term inflation, although the average annual rate of 1 to 2 per cent was modest by modern standards. Major changes occurred during the American War of Independence, when prices in the United States rose an average of 8.5 per cent per month, and during the French Revolution, when prices in France rose at a rate of 10 per cent per month. These relatively brief flurries were followed by long periods of alternating international inflations and deflations linked to specific political and economic events.

By historical standards, the post World War II era has been characterised by relatively high levels of inflation in many countries, and by the mid-1960s a chronic inflationary trend began in most industrial nations. For example, from 1965 to 1978 American consumer prices increased at an average annual rate of 5.7 per cent, including a peak of 12.2 per cent in 1974. In Great Britain, inflation also peaked in 1974, following the quadrupling of world oil prices, at over 25 per cent. Several other industrial nations suffered a similar acceleration of price increases, but some countries, such as West Germany (now part of the united Federal Republic of Germany), avoided chronic inflation. Given the integrated status of most nations in the world economy, these disparate results reflected the relative effectiveness of national economic policies.

This unfavourable inflationary trend was reversed in most industrial nations during the mid-1980s. Austere government fiscal policies and monetary policies begun in the early part of the decade combined with sharp declines in world oil and commodity prices to return the average inflation rate to about 4 per cent.

The layout of my investigation is simple. There are 5 categories that all items fall into; Food & Drink, Travel & Leisure, Household, Personal and Alcohol & Tobacco. These 5 categories are what my whole research will be based on and will show how inflation affects my family.

Prediction

I predict that my family will not suffer to harshly from inflation and may even see examples of deflation. This is because my family usually buy things as soon as they come out, when demand is high for these items. Once th e "hype" has fallen on such items we see a price drop to regain interest in it or offers and sales occur. The rate of inflation is 2.7% but I don't see this affecting us too greatly in comparison to some other families. Food & Drink is the only category my prediction doesn't comply with. I believe that this is the only category that my family may be hit by the hardest of our inflation. This category has a lot of monopolistic products with companies who may decide to rise their prices knowing that their cost umers will keep buying the product. Things that were bought in sales and multi saves may also not comply with my predictions.

Research

Desk

Kinds of Inflation

When the upward trend of prices is gradual and irregular, ave raging only a few percentage points each year, such creeping inflation is not considered a serious threat to economic and social progress. It may even stimulate economic activity: the illusion of personal income growth beyond actual productivity may encour age consumption; housing investment may increase in anticipation of future price appreciation; business investment in plants and equipment may accelerate as prices rise more rapidly than costs, and personal, business, and government borrowers realize that loans will be repaid with money that has potentially less purchasing power.

A greater concern is the growing pattern of chronic inflation characterized by much higher price increases, at annual rates of 10 to 30 per cent in some industrial nations and even 100 per cent or more in a few developing countries. Chronic inflation tends to become permanent and ratchets upwards to even higher levels as economic distortions and negative expectations accumulate. To accommodate chronic inflation, normal economic acti vities are disrupted: consumers buy goods and services to avoid even higher prices; property speculation increases; businesses concentrate on short-term investments; incentives to acquire savings, insurance policies, pensions, and long-term bonds are reduced because inflation erodes their future purchasing power; governments rapidly expand spending in anticipation of inflated revenues; and exporting nations suffer competitive trade disadvantages forcing them to turn to protectionism and arbitrary currency controls.

In the most extreme form, chronic price increases become hyperinflation, causing the entire economic system to break down. The hyperinflation that occurred in Germany following World War I, for example, caused the volume of currency in circulation to expand more than 7 billion times and prices to jump 10 billion times during a 16 -month period before November 1923. Other hyperinflations occurred in the United States and France in the late 1700s; in the Union of Soviet Socialist Republics (USSR) and Austria after World War I; in Hungary, China, and Greece after World War II; and in a few developing nations in recent years. During a hyperinflation the growth of money and credit becomes explosive, destroying any links to real assets and forcing a relian ce on complex barter arrangements. As governments try to pay for increased spending programmes by rapidly expanding the money supply, the inflationary financing of budget deficits disrupts economic, social, and political stability.

A historically important form of inflation in the days of bimetallism or the gold standard was currency debasement, when a ruler reduced the amount of precious specie metal in coins. This secured short -term profits for the state, which could use the same amount of precious metal to mint more coin, but drove up prices in the long term, under Gresham's law whereby “bad money

drives out good". Such debasements frequently funded government war efforts, partly explaining the correlation of inflation with political upheaval. The flow of silver from the New World into Europe from the 16th century has also been linked with the gradual rise in inflation from that time, as the value of the precious metal tended to diminish, but this view is not universally accepted. Modern governments effectively perform similar debasement when they print more money or otherwise modify its value

Causes

Demand-pull inflation occurs when aggregate demand exceeds existing supplies, forcing price increases and pulling up wages, materials, and operating and financing costs. Cost-push inflation occurs when prices rise to cover total expenses and preserve profit margins. A pervasive cost-price spiral eventually develops as groups and institutions respond to each new round of increases.

To explain why the basic supply and demand elements change, economists have suggested three substantive theories: the available quantity of money; the aggregate level of incomes; and supply-side productivity and cost variables. Proponents of monetarism believe that changes in price levels reflect fluctuating volumes of money available, usually defined as currency and demand deposits. They argue that, to create stable prices, the money supply should increase at a stable rate commensurate with the economy's real output capacity. Critics of this theory claim that changes in the money supply are a response to, rather than the cause of, price-level adjustments.

The aggregate level of income theory is based on the work of the British economist John Maynard Keynes, published during the 1930s. According to this approach, Keynesianism, changes in the national income determine consumption and investment rates; thus, government fiscal spending and taxation policies should be used to maintain full output and employment levels. The money supply, then, should be adjusted to finance the desired level of economic growth while avoiding financial crises and high interest rates that discourage consumption and investment. Government spending and tax policies can be used to offset inflation and deflation by adjusting supply and demand according to this theory.

The third theory concentrates on supply-side elements that are related to the significant erosion of productivity. These elements include the long-term pace of capital investment and technological development; changes in the composition and age of the labour force; the shift away from manufacturing activities; the rapid proliferation of government regulations; the diversion of capital investment into non-productive uses; the growing scarcity of certain raw materials; social and political developments that have reduced work incentives; and various economic shocks such as international monetary and trade problems, large oil price increases, and sporadic worldwide crop disasters. These supply-side issues may be important in developing monetary and fiscal policies.

Effects

The specific effects of inflation are mixed and fluctuate over time. Inflation initially increases business profits, as wages and other costs lag behind price increases, leading to more capital investment and payments of dividends and interest. Personal spending may increase because of "buy now, it will cost more later" attitudes; potential property price appreciation may attract buyers. Domestic inflation may temporarily improve the balance of trade if the same volume of exports can be sold at higher prices. Government spending rises because many programmes are explicitly, or informally, indexed to inflation rates to preserve the real value of government services and transfers of income. Officials may also anticipate paying larger budgets with tax revenues from inflated incomes.

Despite these temporary gains, however, inflation eventually disrupts normal economic activities, particularly if the pace fluctuates. Interest rates typically include the anticipated pace of inflation that increases business costs, discourages consumer spending, and depresses the value of stocks and bonds. Higher mortgage interest rates and rapidly escalating prices for homes discourage housing construction. Inflation erodes the real purchasing power of current incomes and accumulated financial assets, resulting in reduced consumption, particularly if consumers are unable, or unwilling, to draw on their savings and increase personal debts. Business investment suffers as overall economic activity declines, and profits are restricted as employees demand immediate relief from chronic inflation through automatic cost-of-living escalator clauses. Most raw materials and operating costs respond quickly to inflationary signals. Higher export prices eventually restrict foreign sales, creating deficits in trade and services and international currency-exchange problems. Inflation is a major element in the prevailing business cycles of booms and recessions that cause unwanted price and employment distortions and widespread economic uncertainty.

The impact of inflation on individuals depends on many variables. People with relatively fixed incomes, particularly those in low-income groups, suffer during accelerating inflation, while those with flexible bargaining power may keep pace with or even benefit from inflation. Those dependent on assets with fixed nominal values, such as savings accounts, pensions, insurance policies, and long-term debt instruments, suffer erosion of real wealth; other assets with flexible values, such as property, art, raw materials, and durable goods, may keep pace with or exceed the average inflation rate. Workers in the private sector strive for cost-of-living adjustments in wage contracts. Borrowers usually benefit while lenders suffer, because mortgage, personal, business, and government loans are paid with money that loses purchasing power over time and interest rates tend to lag behind the average rate of price increases. A pervasive "inflationary psychology" eventually dominates private and public economic decisions.

Field

My Basic research for my family follows on the next page –

As I said in my introductory method, I have put all items into their respective category. The categories follow on the next page –

With a couple of simple calculations I can fine the number of items in the category, the percentages, amount spent and the weighting.

2002

	No. items	% items	amount spent	% spent
Food & Drink	37	71.15%	£66.28	29.24%
Travel & Leisure	1	1.92%	£26.00	11.47%
Household Goods	3	5.77%	£69.98	30.88%
Personal Goods	8	15.38%	£44.94	19.83%
Alcohol & Tobacoo	3	5.77%	£19.45	8.58%
	52	100.00%	£226.65	100.00%

2003

	No. items	% items	amount spent	% spent
Food & Drink	37	71.15%	£62.28	30.81%
Travel & Leisure	1	1.92%	£26.00	12.86%
Household Goods	3	5.77%	£49.98	24.72%
Personal Goods	8	15.38%	£44.45	21.99%
Alcohol & Tobacoo	3	5.77%	£19.45	9.62%
	52	100.00%	£202.16	100.00%

The category with the most items in is obviously Food & Drink but strangely in 2002 it wasn't the most expensive. You can see there are noticeable changes between 2002 and 2003 . Inflation has occurred and even deflation.

The weighting graphs follows -

The Weighting can be used with the price change to work out the weighted price change and following on from this the inflation rate can be found. The Weighting is just a way to measure the inflation simply to see the effect on the average person. The weighting can help to work out how the average person is effected by inflation by using percentages of things. Therefore averages obviously have to used. This is how I will work out my family's price change.

I need to find the category average and inflation. I do this by working out the inflation or deflation for each of the selected items in the category, adding them up and this leaves me with the category average.