What is Inflation?

Inflation refers to the increase in the general price level of goods and services in an economy over a period of time. When inflation occurs, each unit of currency buys fewer goods or services than it did previously. It's essentially a decrease in the purchasing power of money.

Inflation can happen for various reasons:

Demand-Pull: This occurs when demand for goods and services surpasses their supply. When demand outpaces supply, prices tend to rise as sellers can charge more due to increased demand.

Cost-Push: When the cost of production for goods and services increases, companies often pass those increased costs to consumers, resulting in higher prices. Factors such as rising wages, increased raw material costs, or taxes can contribute to cost-push inflation.

Monetary Factors: Changes in the money supply within an economy can influence inflation. If there is an excessive increase in the money supply relative to the production of goods and services, it can lead to inflationary pressure as more money chases the same amount of goods, driving prices up.

Expectations: If people expect prices to rise in the future, they may buy more now, causing an increase in demand and subsequently leading to inflation.

Inflation is typically measured using various indices, such as the Consumer Price Index (CPI) or the Producer Price Index (PPI), which track the average change over time in the prices paid by consumers and producers for a basket of goods and services.

Central banks often aim to maintain stable inflation rates, usually within a target range, as moderate inflation can encourage spending and investment. However, high or unpredictable inflation can erode purchasing power, disrupt economic stability, and affect savings and investment decisions.