Macroeconomics: **Inflation**

Inflation: the rate at which prices for goods and services are rising.
In inflation, the speed at which the money supply is increasing is higher than the rate of production of goods and services is increasing.
Note: If money supplies are very big then prices rise and the value of money decreases.

Inflation in the country :

- Rise in price
- income, including wages, rise
- Amount of money in the circulation rise

Deflation: The rate at which prices, incomes, wages, and money supply are falling. This can develop into a dramatic decrease in falling prices, incomes and employment leading to an economic recession.

Disinflation: The rate at which price inflation is slowing down, often the result of government policies to reduce inflation.

Measuring Inflation with CPI:

Consumer Price Index (CPI) is used to measure the difference in inflation compared to different countries. Measures changes in prices of large shopping baskets of commonly consumed household goods and services.
The content of the 'basket' is changed every 12 months to reflect changes in shopping habits. Each item in the index is given a 'weight' or quantity to reflect its importance in the budget of a typical household.

Calculating CPI:

1. Expenditure must be allocated a weight, which is found by calculating the proportion of total expenditure spent on each product.

   Eg: if £500 out of a total expenditure of £2,000 is spent on food, then food would receive a weighting of ¼

1. The weight is multiplied by the percentage price change to give the weighted price change. (Percentage change in Price is second-year price - first-year price/first-year price x 100).

Limitations of The CPI:

- A rise in the price of 1 good and service in the basket can lead to a rise in the total, which assumes that everyone is affected by it. Eg: the price of oil/ petrol increases and total inflation increases, only people using cars and other vehicles will be affected.
- Excludes buying habits of the rural population (who uses less fuel/oil).
- People switch between expensive to cheaper alternatives, but the CPI doesn't consider this.
- It does not consider the price increase as a result of improvement of quality. Eg: A Tv in 2015 costs lower than in 2018 because the 2018 model has a better quality screen and more features.
- Chooses a limited number of products and follows some movement in their price.