IOSR Journal of Economics and Finance (IOSR-JEF)
e-ISSN: 2321-5933,p-ISSN: 2321-5925.Volume 14, Issue 4 Ser. I (July. – August. 2023),PP 19-21
www.iosrjournals.org

Causes Of Rising Inflation In The West

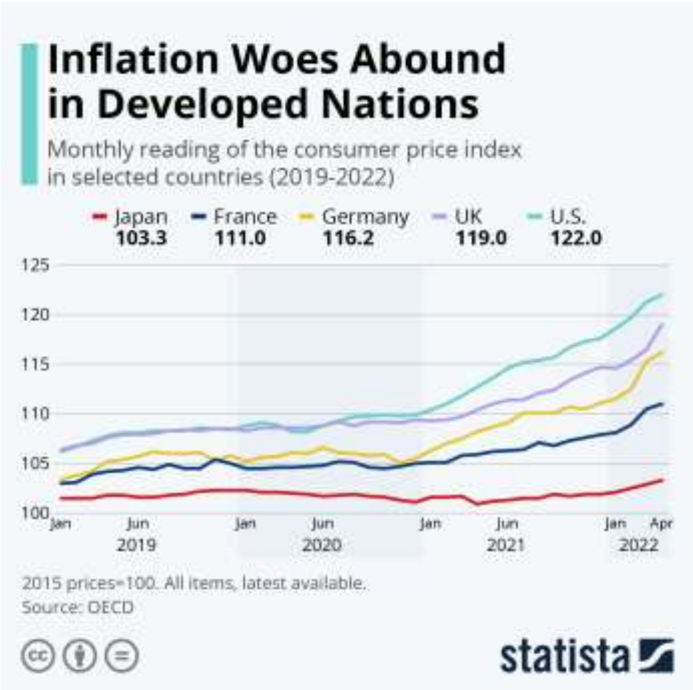
Shreya Gupta

Date of Submission: 02-07-2023 Date of Acceptance: 12-07-2023

Abu who lives in the States was confused why his ten dollar bill won't buy as many candies as it used to before the Covid-19 pandemic. Unfortunately for Abu, his favourite candy brand was nowhere to be seen as well . Did nobody tell him the factories in China stopped producing those candies? Why were these factories suddenly shut down, and how many consumers like Abu were affected? Why won't Abu get as many candies for the same amount? and What is the government doing to help Abu?

Abu lives in a world where Inflation is prevalent. Inflation is the rise in prices of goods and services which leads to reduction in the purchasing power of a currency. The average inflation rate of the European Union is 9.8%, the highest it has been in 25 years. While the United States has a current inflation rate of 4.7%.

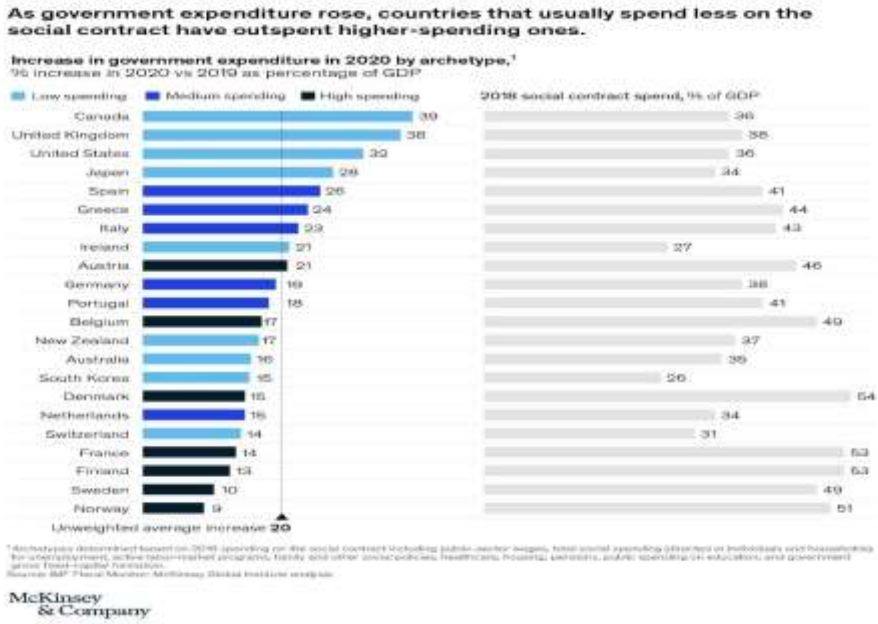
The graph below represents the growing Inflation during the period of 2020-22 in various developed Western countries.



The hike in Inflation can be attributed to two major factors- 1) The Covid 19 pandemic and 2) The Russia-Ukraine War.

The Covid 19 Pandemic left a brutal impact on economies everywhere. When Covid-19 struck, countries around the world were forced into lockdowns: factories shut down, workplaces closed and many businesses stopped trading altogether. During this time, most governments stepped in to provide massive investments and support to keep people out of poverty and to keep the economy alive. In Britain, current estimates of the cost of government measures announced so far range from about £310 to £410 billion. This is the equivalent of about £4,600 to £6,100 per person in the UK. This was about £167 billion higher than had been planned before the pandemic for that year. For example, in the UK, the biggest source of support was the furlough scheme through which the government started paying many workers' wages.

In 2020 alone, governments in the European Union are expected to spend an additional $2,343 per person compared to 2019, while in the United States, spending will be $6,572 higher. The chart below shows the increased spending in various countries due to changes in fiscal policies.



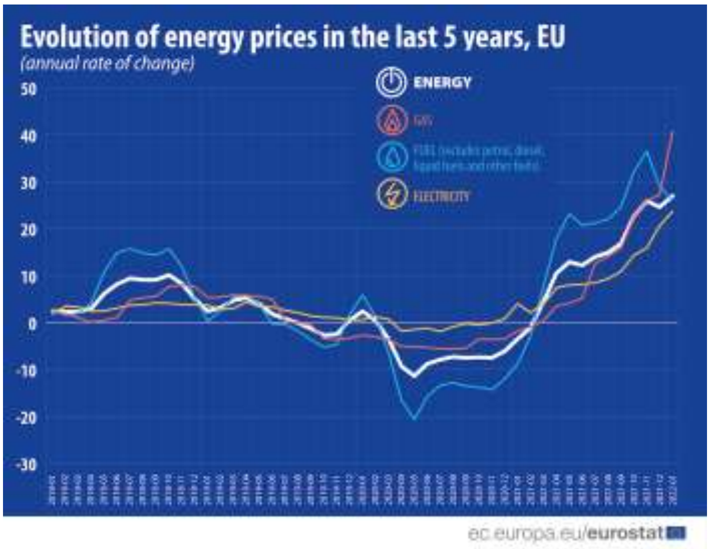
Many households built up unexpected savings as a result of having fewer opportunities to spend when working from home. When restrictions started to lift, these savings poured out into the economy. People started revenge spending and the revenue incurred by the tourism industry shot up. This led to a hefty increase in demand for various goods and services. For example, Americans started spending an average of $765 more a month compared with last year (2021).

On the other hand, the supply decreased due to reduced production caused by some countries still in lockdown and government imposed mobility restrictions. Furthermore, China's Zero covid policy continued to slow down manufacturing which reflected on decreased imports of many countries depending on China for a variety of goods. This caused major Supply chain issues. The chart below shows the abrupt increase in supply chain issues peaking in Europe and heavily affecting the USA.

The excess demand led to an increase in the prices of goods and services leading to Inflation.

Inflation reflects the fall in the value of money. What this means is that the real spending power of the consumer decreases, leaving them worse off. For example, the same 10$ bill in 2017 and in 2022 won't buy you the same amount of goods since the value of the currency has decreased since 2017, due to Inflation. This is why Abu couldn't purchase as many candies as he used to pre-pandemic with $10.

Increased inflation forces people into poverty and leaves the poor worse off. For example, the cost of living crisis in Britain caused by soaring energy and food prices is highly undesirable and problematic. A recent forecast showed that the energy bill will soar €4266 in January and the inflation will hit a high of 13% by the end of year. The graph below displays the inflated energy prices in the recent years.



The Russia Ukraine war is an equal contributor to the rising inflation throughout the world. Against an already turbulent backdrop of global inflationary pressures amid rising food and energy prices and disrupted supply chains following the coronavirus pandemic, the war between Russia and Ukraine is exacerbating supply and demand tensions, damaging consumer sentiment and is threatening global economic growth. Russia is unique as it is a very large commodity exporter and has the ability to impact many markets. It is one of the world's largest exporters of crude and natural gas, with its primary customer Europe. It is the largest exporter of both palladium and wheat. Ukraine exports mainly steel, coal, fuel and petroleum products, chemicals, machinery and transport equipment and grains like barley, corn and wheat. More than 60% of the exports go to other former Soviet Republics countries with Russia, Kazakhstan and Belarus being the most important.

The war has led to a reduction in imports in other countries leading to hikes in prices of goods. For example, the prices of oil are inflated in many countries right now.

In my opinion, the current inflation will continue to go up in the wake of the ongoing Russian Ukraine war. The war is a global growth hit as reflected in the IMF's reduced global growth forecast of 2022; from 4.1 % to 3.2%. The duration of the current inflation episode will depend on (1) the central bank's response and (2) the duration of the War in Ukraine and its impact on energy prices, food prices, and global growth. If history is any guide, we will not experience an out-of-control surge in inflation beyond a couple of years into the future.

The central banks must control inflation by reducing repo rates and selling bonds on open markets. But there are limitations to what central banks can accomplish as well. Monetary policy can't improve bottlenecks in the supply of microchips, which are driving car prices higher or increase the supply of gas. Even when monetary policy is effective in getting inflation down, there is always the risk of the central bank overshooting its aims and pushing the economy into a recession.

Higher Inflation is the inevitable consequence of the large fiscal packages and monetary accommodations introduced by Western Governments over the last few years. The large fiscal packages by the governments during the pandemic led to increased savings by the consumers which inevitably led to increased spending post lockdown. The supply couldn't keep up with the high demand leading to an increase in the prices. Supply-chain disruptions also persisted across the global economy, with Russia's invasion of Ukraine and the recent rise of Covid-19 cases in China adding additional pressures.The war led to increased prices of imported goods like oil, gasoline etc.

Henceforth, the large fiscal packages and monetary accommodations by the government, the covid-19 pandemic, Supply chain disruptions and the Russia-Ukraine War have all inevitably led to the inflated world that we live in today.