



Inflation



But what is...?

The European Central Bank is the central bank for the euro area. It is responsible for monetary policy (setting interest rates).

Monetary policy is what central banks do. By setting interest rates, a central bank can influence borrowing and lending decisions by households and firms. This is a powerful way to influence the economy.

Inflation expectations are closely watched by central bankers. If workers expect prices to rise, they will bid up wages. This can cause the very increase in prices which workers were afraid of.

Competitiveness refers to the ability of a country to sell its exports to others based on whether it can produce the right things for the right price and the right quality.

Questions? Use the Euro Challenge Forum!

A little inflation is fine, even desirable, but too much of it can be damaging, both to people's livelihoods and to the economy as a whole. Central banks are responsible for keeping inflation low and stable. High inflation usually occurs when an economy is over-heating (growing too quickly). When growth is too weak, there may be a risk of deflation (falling prices). Although this may sound attractive, it can be deeply damaging to an economy.

- ① What is **inflation**, and why can it be a bad thing? (Hint: watch the ECB price stability video on [Vimeo!](#))
- ② What is **deflation**, and why can it also be a bad thing? (ditto)
- ③ How is inflation measured? What's the "preferred" measure of inflation in the euro area?
- ④ What is the **job of a central bank**? What is the mandate of the **European Central Bank**? Is it different from the mandate of the US Federal Reserve?
- ⑤ How are fluctuations in **commodity prices** (e.g. gold, wheat, oil) viewed by central bankers in their assessment of inflation?
What are **inflation expectations**? How can they become self-fulfilling? What do you understand by the term **wage-price spiral**? (i.e. higher prices lead to higher wages, which lead to even higher prices)?
- ⑦ What are the **causes and effects of inflation** in the country you selected?
- ⑧ What is **competitiveness**, and has your country's competitiveness suffered as a result of higher inflation than its trading partners?
- ⑨ What **policies** can or can't your chosen country pursue to tackle high inflation, given that it is a member of the euro area? What policies might be best to reduce inflation but not dampen economic growth?

