Inflation, Deflation, Stagflation, and Hyperinflation

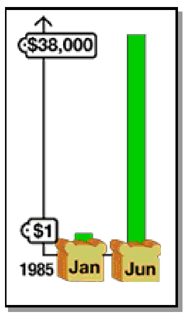
Key Concepts

- **Inflation** is a general increase in all prices across an economy, while **deflation** is a general decrease in all prices across an economy.
- Periods of **hyperinflation** are characterized by very rapid increases in the price level across the economy.
- An economy experiencing **stagflation** faces rising prices and falling output.
- Changes in price are determined by the relationship between the product and money, not by the value of the product.

Most countries experience a slow increase in the overall price level, or **inflation**. **Deflation**, however, is much rarer than inflation and typically occurs during periods of **depression**.

Hyperinflation

In Bolivia in 1985 the inflation rate rose to 38,000% over 6 months.



Hyperinflation is a very rapid increase in the price level.

A historical example of hyperinflation occurred in Bolivia in 1985. The chart on the left illustrates the 38,000% increase in prices over a six-month period. By printing more money and creating "trash cash," the government exacerbated the situation and the economy reverted to barter.

Stagflation

As oil prices rose in the U.S. in 1974, output (real GDP) fell by .6% and the annual inflation rate was 11%.

As the cost of business rose, companies produced less.

In 1980 the real GDP growth was –.3% while inflation was 13.5%.

Rising prices and declining output identify **stagflation**. The U.S. experienced a period of stagflation during the 1970s oil **supply shocks**. In 1974 prices rose at a rate of 11%, while GDP fell by 0.6%.