

Inflation: Causes and Consequences: Part 1 - By Laurel Theresa Bain

Inflation is a persistent increase in the general price level. It reduces the amount of goods and services that consumers could purchase with their existing fixed income. It therefore erodes the value of money with adverse socio-economic impact. This article outlines the current inflationary period, explaining what inflation is and how it is determined. In Part 2 of this article, the causes and consequences of inflation would be highlighted; and some policy options would be outlined for mitigating the impact of inflation.

The Consumer Price Index [CPI] is the international standard for measuring the rate of inflation. Based on the statistics for Grenada, the inflation rate, as derived from the Consumer Price Index, was 1.92 percent in 2021. [Source: Eastern Caribbean Central Bank Website, 18, March 2022; <https://www.eccb-centralbank.org/p/consumer-price-index-2>]. This rate of inflation of 1.92 percent meant, in simple terms, that the aggregated prices of all the consumer items that were surveyed in December 2021, increased by 1.9 percent when compared with the aggregated prices of these same items in December 2020. This rate of inflation is used as the indicator of the increase in the general price level and the cost of living. The end of year [December], known as the 'end of period', Consumer Price Index is often used to present the inflation rate. There is also the average inflation rate which is based on the average monthly changes in the Consumer Price Index over the twelve months period during the year. The average inflation rate for Grenada in 2021 was 1.22 percent. [Source: Eastern Caribbean Central Bank Website, 18, March 2022; <https://www.eccb-centralbank.org/p/consumer-price-index-2>]. This implies that when considering price changes throughout the year, for the consumer items that were surveyed, prices increased on average by 1.2 percent in 2021.

The Consumer Price Index [CPI], as the name suggest, is an index. It is a technical concept. The actual price changes, as experienced by consumers, are lost in the presentation of the CPI and the inflation rate. It could therefore be perplexing to some consumers as it does not explicitly show the absolute changes in the prices encountered by consumers in supermarkets and other retail outlets.

The technical nature of the Consumer Price Index contributes, in part, to the difficulties encountered by some consumers in relating it to the changes in the general price level. The Consumer Price Index, similar to other index, is constructed from a starting year known as the 'base year'. A selected sample of items, that is, goods and services commonly consumed by households, referred to as the 'basket of goods', are identified and their prices in the base year are collected. The prices collected, weighed by their relative importance in the basket, are used to calculate the index. This weighted average value of the consumer items in the base year is equated to one hundred (100). In subsequent years, the prices of the items in the 'basket of goods' are collected, and the total value of these items is determined for each of the given year. This value is then compared with the value of the goods and services in the base year; and this provides for the comparison of price movements in the current year relative to the base year. Therefore, the Consumer Price Index for each year is calculated by dividing the value of the consumer items in the 'basket of goods' in the current year by the value of the same goods in

the base year and multiplying the result by one hundred (100) to derive the Consumer Price Index.

In Grenada, the base year on which the Consumer Price Index is calculated is 2010. Therefore, in applying the calculation method for Grenada, the Consumer Price Index for 2021 would be derived by dividing the value of consumer items, that is, the goods and services in the 'basket of goods', in December 2021 with the value of the same consumer items in 2010 and multiplying by one hundred (100). The resulting Consumer Price Index of 113.32 in 2021 means that relative to 2010, consumer prices increased by 13.32 percent. However, the Consumer Price Index rose from 111.19 in December 2020 to 113.32 in December 2021. This resulted in the 2.13 points increase in the Consumer Price Index [$113.32 - 111.19 = 2.13$]; which translated into the rate of inflation of 1.92 percent for 2021 [$2.13 / 111.19 * 100 = 1.92$ percent].

The Consumer Price Index [CPI], as a measure of the cost of living, could be perplexing to some consumers, particularly as it does not display the actual changes in the prices of the items. Therefore, for the consumers to relate to the changes to the cost of living, the absolute price changes of selected basic necessities in the various categories of goods and services for comparative periods could be published. There are some basic commodities such as rice, flour, sugar, milk, oil, eggs, laundry powder, and other products such as building materials that are frequently purchased by consumers, and the actual changes in the price of these products could be monitored and published. This would complement the report on the inflation rate, as measured by the Consumer Price Index, which is the standard indicator of inflation.

The extent to which the inflation rate, as calculated from the Consumer Price Index, reflects current price developments in any country is influenced by the relevance of the consumer items in the 'basket of goods'. The foundation for constructing the Consumer Price Index [CPI] is the survey of a sample of households and their accompanying expenditure, known as the Household Budget Survey [HBS]. The results of the HBS are used to identify a combination of goods and services purchased by a typical household. These goods and services are categorized and placed in, what is known as, the 'basket of goods', which reflects the day-to-day consumption expenses of the majority of consumers.

The 'basket of goods' also shows the relative dominance of the items purchased by consumers by applying weights to each item purchased and then to the category of goods and services in the 'basket of goods'.

In the context of Grenada, the Household Budget Survey, on which the items in the 'basket of goods' was determined, was derived from the Country Poverty Assessment: Grenada Carriacou and Petit Martinique that was undertaken in 2008/2009. Over the twelve years period, the items purchased by the majority of consumers, referred to as the expenditure pattern, would have changed and the 'basket of goods' from which the Consumer Price Index is calculated becomes outdated. Therefore, an updated 'basket of goods' is required to ensure that the items in the 'basket of goods' reflect the purchasing pattern of consumers. The recently published "Grenada Survey of Living Conditions and Household Budget Survey" [SLCHBS] of

2018/2019 would provide some information for the development of a revised ‘basket of goods’ to capture modifications in consumers’ expenditure pattern between 2008/2009 and 2018/2019. Supplementary information would be required to include the modification in household expenditure pattern brought about by the Covid-19 Pandemic.

The constructs of the Consumer Price Index, including the items in the ‘basket of goods’ are important, particularly as this is an inflationary period. The higher rate of inflation in 2021 was global. This high rate of inflation was already projected to persist into 2022 and is now further aggravated by the Russia/Ukraine war. As an open economy, Grenada would not be insulated from the higher prices.

Specifically, the inflation rate in Grenada, and the other countries of the Eastern Caribbean Currency Union [ECCU], is influenced by the inflation rate of their main trading partners, particularly the USA. Among these trading countries, the inflation rate in the USA reached a high of 7 percent in December 2021. The inflation rate was 5.4 percent in the UK, 4.8 percent in Canada and 5.3 percent in Germany (Source: Trading Economics, 18 March 2022, <https://tradingeconomics.com/countries>). This is a period of political and economic uncertainty as manifested by the Russia/Ukraine war. Prices were already projected to remain high in 2022, which could be extended to 2023. In this context, the inflation rate in the USA is estimated at 8.5 percent for the first quarter of 2022 and forecasted at 6.3 percent at the end of 2022. The inflation rate for Canada is forecasted at 5.3 percent for the first quarter of 2022 and 3.6 percent at the end of the year; and for the UK, it is forecasted at 5.8 in the first quarter and 3.8 percent at the end of the year. (Source: Trading Economics, 18 March 2022, <https://tradingeconomics.com/countries>). The inflation rate is projected to moderate in 2023, but economic, social, and political developments could derail economic forecast.

In summary, inflation is a general increase in the price level, and the Consumer Price Index [CPI] is the international standard for measuring inflation. The changes in price experienced by consumers are lost in the presentation of the Consumer Price Index and the inflation rate. A supplementary publication of the actual changes in prices of selected goods and services would assist the public in relating to the actual price changes and the cost of living. The inflation rate is projected to remain high in 2022. In this dynamic economic environment, it is important that the items in the ‘basket of goods’ for the calculation of the Consumer Price Index be updated to reflect current consumer expenditure pattern. In doing so, the rate of inflation would be more aligned with the cost of living.

In Part 2 of this Article, the causes and consequences of inflation would be examined, and some policy options would be outlined for mitigating the impact of inflation.

Knowledge is power and experience is the greatest teacher.

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