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ИНОСТРАННЫЙ ЯЗЫК

Методическая разработка по практическим занятиям
для студентов направления подготовки
38.03.01 Экономика, направленность (профиль) «Мировая экономика»

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Введение

Изучение иностранного языка является неотъемлемой частью подготовки специалистов в области экономики. Данная методическая разработка была составлена по дисциплине «Иностранный язык» для студентов направления подготовки 38.03.01 Экономика. В соответствии с задачами дисциплины (сформировать общелингвистические представления о современном иностранном языке; привить навыки разговорной и письменной речи, умение читать и переводить на русский язык (без словаря и со словарем) тексты профессиональной направленности) представлены тексты по основным темам, включающие в себя лексические единицы и грамматические структуры, которыми должны владеть студенты в рамках данного курса.

Благодаря чтению и переводу данных текстов, освоению активной лексики, а также используемых грамматических конструкций студенты должны овладеть следующими навыками и умениями: продуктивного активного и пассивного освоения лексики английского языка; овладения грамматическим строем английского языка; подготовленного устного монологического высказывания на английском языке в пределах изучаемых тем; письменной речи на английском языке.

Text 1. Economist Guide: 5 Lessons Milton Friedman Teaches Us

By Sean Ross

When Milton Friedman won the Nobel Prize in Economic Sciences in 1976, it marked the turning of the tide in academic economic thought, away from doctrinaire Keynesianism and toward the burgeoning "Chicago school." Friedman brought about a renewed emphasis on prices, inflation and human incentives, a direct counter to Keynes' focus on employment, interest and public policy.

To the extent that Keynes saw himself as the enemy of laissez-faire (evidence suggests this is exactly how he felt), Friedman was the new public face of free markets. Friedman won a major intellectual victory after three decades of Keynesian policies ended in stagflation in the late 1970s, something establishment Keynesians, such as Paul Samuelson, thought was impossible.

From a technical perspective, Milton Friedman is best known for his monetary policy and "A Monetary History of the United States," an epic volume devoted to his scientific work. But this is only one of the many contributions Friedman made to the political economy. The following are five lessons contemporary economists can still learn from Milton Friedman.

1. You Should Judge Policies by Their Results, Not Their Intentions

In many ways, Milton Friedman was an idealist and libertarian activist, but his economic analysis was always grounded in practical reality. He famously told Richard Heffner, host of "The Open Mind," in an interview: "One of the great mistakes is to judge policies and programs by their intentions rather than their results."

Many of Friedman's most controversial positions were based on this principle. He opposed raising the minimum wage because he felt it unintentionally harmed young and low-skilled workers, particularly minorities. He opposed tariffs and subsidies because they unintentionally harmed domestic consumers. His famous 1990 "Open Letter" to then-drug czar Bill Bennett called for the decriminalization of all drugs, mostly because of the devastating unintended effects of the

drug war; this letter lost Friedman a swath of conservative supporters, whom he said failed "to recognize that the very measures you favor are a major source of the evils you deplore."

This lesson is critical for economists and policy wonks of all stripes. As Henry Hazlitt once put it: a bad economist only looks at the seen; the good economist looks at the seen and unseen consequences.

2. Economics Can Be Communicated to the Masses

During Friedman's landmark interviews on Phil Donahue's show in 1979 and 1980, the host said his guest was "a man who will never be accused of making economics confusing," and told Friedman "the nice thing about you is that when you speak, I almost always understand you." Dr. Friedman gave lectures on college campuses, including Stanford and NYU. He ran a 10-series television program entitled "Free to Choose" and wrote a book with the same name. At all times, Friedman adjusted his content for his audience.

Friedman's gift for communication was rare. Economist Walter Block, sometimes a friendly agitator of Friedman, memorialized his contemporary's 2006 death by writing, "Milton's valiant, witty, wise, eloquent and yes, I'll say it, inspirational analysis must stand out as an example to us all." More economists should learn from Friedman's success; learning a social science is not very useful if you cannot communicate it to laypeople.

3. Inflation Is Always and Everywhere a Monetary Phenomenon

The most famous excerpt from Friedman's writings and speeches is, "Inflation is always and everywhere a monetary phenomenon." He defied the intellectual climate of his era and reasserted the quantity theory of money as a viable economic tenet. In a 1956 paper titled "Studies in the Quantity Theory of Money," Friedman found that, in the long run, increased monetary growth increases prices but does not really affect output.

Friedman's work busted the classic Keynesian dichotomy on inflation, which asserted that prices rose from either "cost-push" or "demand-pull" sources. It also put monetary policy on the same level as fiscal policy. Amusingly, Friedman's insight was so sharp in his criticism of the Federal Reserve's mismanagement of the money supply that the Fed actually stopped releasing minutes from the board's meetings to avoid his scrutiny.

4. Technocrats Cannot Control the Economy

In a 1980 Newsweek column, Milton Friedman said: “If you put the federal government in charge of the Sahara Desert, in five years there’d be a shortage of sand.”

Friedman was a vicious critic of government power and was convinced free markets operated better on grounds of morality and efficiency. In terms of the actual economics, Friedman rested on a few truisms and basic, incentive-based analyses. He offered that no bureaucrat would or could spend money as wisely or as carefully as the taxpayers from whom it was confiscated. He spoke often of regulatory capture, that phenomenon where powerful special interests co-opt the very agencies designed to control them.

Friedman’s lesson is easy to understand: government policy is created and carried out through force, and that force creates unintended consequences that do not come from voluntary trade. Indeed, the valuable political power of government force creates an incentive for the wealthy and devious to misuse it, helping generate what Friedman dubbed “government failure.”

5. Government Failures Can Be Just as Bad, or Worse, Than Market Failures

Friedman combined his lessons about unintended consequences and the bad incentives of government policy. “Here you have a market failure,” Friedman told a Chicago student in a recorded lecture, “but in those same cases it’s also difficult to have government do anything about it…You have to put into the balance that when government seeks to achieve an answer, you’re likely to have a government failure.”

Friedman loved pointing out government failures. He exposed how President Nixon’s wage and price controls led to gas shortages and higher unemployment. He railed against the Interstate Commerce Commission (ICC) and Federal Communications Commission (FCC) for creating de facto monopolies in transportation and media. Famously, he contended that the combination of public schooling, minimum wage laws, drug prohibition and welfare programs had unintentionally forced many inner city families into cycles of crime and poverty.

This concept wraps up many of Friedman’s most powerful ideas: policies have unintended consequences; economists should focus on results, not intentions; and voluntary interactions between consumers and businesses often produce superior results to crafted government decrees.

Text 2. Economist Guide: 3 Lessons Karl Marx Teaches Us

By Sean Ross

Karl Marx is often associated with such ideas as socialism and communism. It is surprising that so few are familiar with his actual philosophies and theories. Marx's best-known works are "Capital: A Critique of Political Economy," more commonly referred to as "Das Kapital," and "The Communist Manifesto," co-authored with his lifelong friend Friedrich Engels. He was, without question, one of the most important and revolutionary thinkers of his time.

"Capital," published in 1867, was by far the more academic work, laying forth Marx's theories on commodities, labor markets, the division of labor and a basic understanding of the rate of return to owners of capital. Nearly everything Marx wrote was viewed through the lens of the common laborer. From Marx comes the idea that capitalist profits are possible because value is "stolen" from the working class and transferred to the employers.

Marxist ideas have very few direct adherents in contemporary times; indeed, very few Western thinkers embraced Marxism after 1898, when economist Eugen von Böhm-Bawerk's "Karl Marx and the Close of His System" was first translated into English. In his damning rebuke, Böhm-Bawerk shows that Karl Marx fails to incorporate capital markets or subjective values in his analysis, nullifying most of Marx's more pronounced conclusions. Still, there are some lessons that even modern economic thinkers can learn from Marx, including the following.

1. Capitalism Is the Most Productive Economic System

Though he was its harshest critic, Marx understood the capitalist system was far more productive than previous economic systems. In "Capital," he wrote of "capitalist production" that combined "together of various processes into a social whole," which included developing new technologies. He believed all countries should become capitalist and develop that productive capacity, and then workers would naturally revolt into communism.

You do not have to believe in Marx's final conclusions to understand he is exactly correct: capitalism is the most productive

economic system in world history. According to a 2003 report from the Federal Reserve Bank of Minneapolis, per capita income and productivity around the world never grew faster than populations until the late 18th century, when Britain first adopted pro-free market policies.

2. The Labor Theory of Value Cannot Explain Profits

Like all of the classical economists, Karl Marx believed in the labor theory of value to explain market prices. This theory stated that the value of a produced economic good can be measured objectively by the average number of labor hours required to produce it. In other words, if a table takes twice as long to make as a chair, then the table should be considered twice as valuable.

Marx understood the labor theory better than his predecessors and contemporaries, even Adam Smith, and presented a devastating intellectual challenge to laissez-faire economists in "Capital;" if goods and services tend to be sold at their true objective labor values as measured in labor hours, how do any capitalists enjoy profits? It must mean, Marx concluded, that capitalists were underpaying or overworking, and thereby exploiting, laborers to drive down the cost of production.

While Marx's answer was eventually proven incorrect and later economists adopted the subjective theory of value, his simple assertion was enough to show the weakness of the labor theory's logic and assumptions; Marx unintentionally helped fuel a revolution in economic thinking.

3. Economic Change Leads to Social Transformation

Dr. James Bradford "Brad" DeLong, influential professor of economics at U.C. Berkeley, wrote in 2011 that Marx's "primary contribution" to economic science actually came in a 10-paragraph stretch of "The Communist Manifesto." Marx describes how economic growth causes shifts among social classes, often leading to a struggle for political power.

This underlies an often unappreciated aspect about economics: the emotions and political activity of the actors involved. A corollary of this argument was later made by French economist Thomas Piketty, who proposed that while nothing was wrong with income inequality in an economic sense, it could create blowback against capitalism among the people. Thus, there is a moral and anthropological consideration to any economic system.

Text 3. Economist Guide: 3 Lessons Adam Smith Teaches Us

By Sean Ross

For all the attention Adam Smith receives as the father of modern economics, most of his lasting influences are best classified as moral and social – maybe even anthropological. Smith was a Scottish professor of moral philosophy at Glasgow, and most of his economic insights were byproducts of this pursuit. Smith championed self-interest as enlightening and beneficial, and he viewed political or business power with contempt.

Smith was wrong on many of the details of his economic theory; like Karl Marx after him, Smith operated under the assumption of the now-defunct labor theory of value, for example. Smith either ignored or never fully addressed other aspects; he lacked a full-bodied theory of prices and made virtually no mention of time factors. Still, there are some valuable economic lessons left to be learned from his classic book, "An Inquiry into the Nature and Causes of the Wealth of Nations."

1. The Main Causes of Economic Growth Are Division of Labor and Accumulation of Capital

"Each individual becomes more expert in his own peculiar branch, more work is done upon the whole, and the quantity of science is considerably increased by it."

Adam Smith begins "The Wealth of Nations" with a simple discussion of the division of labor within a pin factory. From that point forward, his focus never really deviates; in some ways, "The Wealth of Nations" is a tribute to the nearly endless applications of this fundamental economic concept.

The division of labor increases productivity for three reasons: it saves time and reduces setup costs, repetition and specialized education lead to increased dexterity and productivity, and it encourages the invention of machines or automation in the specialized areas. Smith didn't discover these truths, but he did bring them together.

Smith also makes frequent reference to the stock of an economy, meaning savings and accumulated capital. Without pre-existing capital, businesses and entrepreneurs can't hire workers, build factories or begin

production. Smith understood that an economy requires savings to grow, for savings fuel investment and credit.

2. Voluntary Exchange Will Not Take Place Unless Both Parties Believe They Will Benefit

"Give me that which I want, and you shall this which you want, is the meaning of every such offer; and it is in this manner that we obtain from one another the far greater part of those good offices which we stand in need of."

It's inaccurate to think of economics as a science about market gains and losses. What economics really studies is how separate individuals benefit each other; namely that they do so unintentionally. Smith's crucial insight is that markets and society improve naturally when people are allowed to trade freely.

Basic deductive logic proves that people do not enter into a trades voluntarily when they don't expect to gain; otherwise they would not make the trade and would be better off staying put. Each successful trade sends a signal in the market that a certain good or service has value; if this happens enough, greater forces will be mobilized to bring about that good or service in greater abundance.

Nobel-winning economist Milton Friedman once said, "Most economic fallacies derive from the neglect of this simple insight, that market participants trade to benefit themselves." Friedman and Smith also knew that interfering with voluntary exchanges has the opposite effect.

3. Government Intervention Disrupts the Efficient Distribution of Resources on the Market

"But though the law cannot hinder people of the same trade from sometimes assembling together, it ought to do nothing to facilitate such assemblies, much less to render them necessary."

Though Smith believed in a functional, limited government, he didn't want governments interfering with trade. Smith most famously used this argument against the prevailing economic theory of his time, something he labeled as "mercantilism," because it favored subsidies and tariffs. Smith showed that free moving markets maximize the efficient flow of resources, which maximized the public good. Overreach by bureaucrats only hinders this process because it interrupts with crucial market signals.

Even though two trading partners accidentally create greater value by voluntarily exchanging, no third party can create additional value by

forcing an exchange to take place – nor can a third party create additional value by forcefully interfering with the exchange of two separate parties. Rather, Smith felt that politicians and crony businessmen would likely use power to enrich themselves at the expense of the poor.

Text 4. Economic Conditions That Helped Cause World War II

By Matthew Johnston

Looking around at the magnitude of death and destruction that resulted from the Great War, leaders of the some of the world's major powers convened a conference in Paris, the outcome of which they hoped would ensure that no such devastation would ever happen again. Unfortunately, the combination of a poorly designed peace treaty and the most severe economic crisis the modern world had ever experienced brought about a deterioration of international relations that would culminate in a war even more calamitous than the one that preceded it.

The Pretense of Peace

The unfortunate irony of the Paris Peace Conference that begat the Treaty of Versailles was that, despite its authors' best intentions to ensure a world of peace, the Treaty contained a seed that when sown in the soil of economic crisis would give rise, not to peace, but to war. That seed was Article 231, which with its label "the war guilt clause" placed sole blame for the war on Germany and its need to make reparations payments as punishment. With such extensive reparations payments, as well as forced surrender of colonial territories and military disarmament, Germans were naturally resentful of the Treaty.

As early as 1923, the newly constituted Weimar Republic began delaying payments on war reparations, which initiated a retaliatory response by France and Belgium. Both countries would send troops to occupy the industrial center of the Ruhr River valley region effectively appropriating the coal and metal production that took place there. As much of German manufacturing was dependent on coal and metal, the loss of these industries created a negative economic shock leading to a severe contraction. This contraction as well as the government's continued printing of money to pay internal war debts generated spiraling hyperinflation.

While price and economic stabilization would eventually be achieved – partly through the help of the American Dawes plan of 1924 – the hyperinflation wiped out much of the life savings of the middle class. The political consequences would be devastating as many people became distrustful of the Weimar government, a government that had been founded on liberal-democratic principles. This distrust, along with resentment over the Treaty of Versailles, lent itself to the increasing popularity of more left and right-wing radical political parties.

The Great Depression and Deterioration of International Trade

The onset of the Great Depression would serve to undermine any attempts at creating a more open, cooperative and peaceful post-war world. The American stock market crash in 1929 caused not just a cessation of loans provided to Germany under the Dawes Plan, but a complete recall of previous loans. The tightening of money and credit eventually led to the collapse of Austria's largest bank in 1931, the Kreditanstalt, which kicked off a wave of bank failures throughout Central Europe, including the complete disintegration of Germany's banking system.

Deteriorating economic conditions in Germany helped the Nazi party grow from being a relatively small fringe group to being the nation's largest political party. Nazi propaganda that put blame on the Treaty of Versailles for much of Germany's economic hardships fuelled Hitler's rise in popularity with voters, who would make him German chancellor in 1933.

More globally, the Great Depression would have the effect of motivating individual nations to adopt more beggar-thy-neighbor trade policies in order to protect domestic industries from foreign competition. While such trade policies can be beneficial on an individual level, if every country turns to protectionism it serves to reduce international trade and the economic benefits that come with it. Indeed, countries without access to important raw materials will be especially burdened by the lack of free trade.

From Imperialism to World War

While the British, French, Soviets and Americans had large colonial empires to turn to for access to much needed raw materials, countries such as Germany, Italy and Japan did not. The deterioration of international trade led to the formation of more regional trade blocs with the 'have' nations forming blocs along colonial lines, like Great Britain's Imperial Preference system.

While ‘have-not’ nations looked to form their own regional trade blocs, they found it increasingly necessary to use military force to annex territories with the much needed resources. Such military force required extensive rearmament and thus, in the case of Germany, meant direct violation of the Versailles Treaty. But, rearmament also reinforced the need for more raw materials and consequently the need for territorial expansion.

Such imperialist conquests like Japan’s invasion of Manchuria in the early 1930s, Italy’s invasion of Ethiopia in 1935 and Germany’s annexation of most of Austria and parts of Czechoslovakia in 1938, were all manifestations of the need to expand territories. But these conquests would soon draw the ire of two of Europe’s major powers, and following Germany’s invasion of Poland, both Britain and France would declare war on Germany on September 3rd, 1939, thus commencing the Second World War.

The Bottom Line

Despite noble aspirations for peace, the outcome of the Paris Peace Conference did more to reinforce hostility by singling out Germany as the sole instigator of the First World War. The Great Depression and the economic protectionism it engendered would then serve as the catalyst for the hostility to manifest itself in the rise of the Nazi Party and increasing imperialist ambitions amongst world nations. It was then only a matter of time before small imperialist conquests would lead to the breakout of World War II.

Text 5. War’s Influence on Wall Street

By Andrew Beattie

The world of business has always been a harsh, survival-of-the-fittest environment. Like any realm in which there is competition and the threat of losses, the investing world is rife with conflict. So it is not surprising to see so many military terms creeping into the vocabulary of everyday investors or TV analysts. Take a look at the war-related terms that have invaded the corporate ranks.

Scorched Earth

In 1812, Czar Alexander Romanov decimated the French army that Napoleon led against Russia – even though the French had superior

numbers, tactics, quality of soldiers, munitions and everything else you'd put on your guaranteed-victory checklist. So how did one of the greatest military minds of all time lose in such a horrendous fashion? The simple answer is the Czar's scorched-earth policy: as the Russian army retreated, they burned every shelter, animal and plant that would catch fire, effectively leaving the French army without any "found" supplies to sustain them through a Russian winter. Napoleon's previous campaigns relied heavily on the spoils of war to replenish the troops, so he was utterly unprepared for an adversary who would rather destroy his own kingdom than let another take it.

Scorched earth continues to be a terrifying strategy for aggressors to face. In business mergers and acquisitions, not every takeover is welcome. In order to scare off a hostile firm, the target firm will liquidate all its desirable assets and acquire liabilities. However, this approach can prove to be a suicide pill because, even if it is successful, the company must try to reassemble itself or go down in the flames of a self-inflicted fire.

Blitzkrieg Tender Offer

In the first two years of the World War II, Nazi Germany crushed its opponents all over Europe by means of the Blitzkrieg or "lightning war" strategy, a set of tightly focused military maneuvers of overwhelming force. Striking with tanks, artillery and planes in one area, the Nazis defeated France's supposedly impenetrable Maginot Line, which was still accustomed to the traditional front-based warfare.

The Blitzkrieg strategy used in corporate takeovers is a slight departure from the German warfare of the 1940s. A Blitzkrieg tender offer is an overwhelmingly attractive offer a takeover firm makes to a target firm. The offer is designed to be so attractive that objections are few or non-existent, allowing an extremely quick completion of the takeover. This tender offer's allusion to the World War II is based only upon the speed of the conquest; there was nothing alluring or attractive about the Nazis' Blitzkrieg.

Dawn Raid

When organized warfare and the military were considered "gentlemen's affairs", a declaration of war, a location and a time would be issued to the adversary. Raids and guerilla warfare were the arenas of savages and rebels, not the tactics of a self-respecting army. However, the American Civil War, the two World Wars, the Vietnam War and the improvement of weaponry obliterated the old code of warfare, and made

it commonplace to attack at any time – including dawn, when sleep is still thick in the enemy's eyes. Because at day break the level of preparedness is lower, the dawn raid maximized enemy casualties and so became a standard military practice. This logic has carried over to the corporate sector.

A dawn raid in the investing world occurs when a firm (or investor) purchases a large portion of shares in a target firm at the opening of the market. A stock broker for the hostile firm helps the firm build up a substantial stake (and maybe a controlling interest) in the unsuspecting target. The hostile firm significantly lowers its takeover costs by already holding a big chunk of its prey. Because the process is initiated through a brokerage and at the market opening, the target firm doesn't figure out what's going on until it's too late. Even though only 15% of a firm's stock can be captured in a dawn raid, this percentage is often enough for a controlling interest. (When an individual investor decides to do this, he or she is referred to as a raider.)

A dawn raid is sneakier and more effective than a formal bid in most cases, but it may lead to resentment from the target firm. Unlike the dawn raid in war, the dawn raid of the corporate world makes the people you just attacked before their morning coffee not just your defeated enemies but now a part of your own army, meaning dissent may soon brew in the ranks.

Capitulation

Capitulation is a term that finds its roots in the Medieval Latin word "capitulare" which means "to draw up terms in chapters". Since the 1600s, however, capitulate has been synonymous with surrender, or defeat, usually military defeat. In the stock market, capitulation refers to the surrendering of any previous gains in stock price by selling equities in an effort to get out of the market and into less risky investments. True capitulation involves extremely high volume and sharp declines, which are indicative of panic selling. After capitulation selling, many people believe the market place essentially becomes a bargain store because everyone who wanted out of a stock, for whatever reason (including forced selling due to margin calls), has sold. It follows logically (but only in theory) that the stock price should reverse or bounce off the lows. Simply put, some investors believe that true capitulation is the sign of a bottom.

War Chest and War Bonds

The gathering of a war chest has been around as long as war. Emperors and kings would begin to amass tithes and taxes long before declaring war, presumably placing the funds in a chest (maybe labeled with a note “to attack the Dutch” or something). The reason for this hoarding was that experienced warriors cost money: mercenaries made up the bulk of the leadership, and peasants, who were conscripted, provided the cannon fodder.

This tradition of saving up to wage war, either aggressively or defensively, has continued on into the modern world of corporate warfare. Simply put, a war chest refers to the funds a company uses to initiate or defend itself against takeovers.

Rather than pulling out of already stretched budgets, the governments of some countries (U.S. included) use war bonds to raise a war chest. War bonds are government-issued debt, and the proceeds from the bonds are used to finance military operations. War bonds essentially fund a war chest that is voluntarily filled by the public. The appeal for these bonds is purely patriotic as they generally offer a return lower than the market rate. Basically, buying a war bond is supposed to make citizens feel like they are doing their part to support the troops – in the World War II, these bonds were hyped by sentimental persuasion and depictions of the evils of the enemy.

War Babies

War babies are quite common all over the world. Children are classified as war babies if they satisfy one or both of the following:

1. They were born or raised during an invasion of their country.
2. They were fathered by foreign soldiers. This was extremely common in Vietnam. In fact, there are still war babies attempting to gain U.S. citizenship.

In contrast, the war babies of the investing world are the companies that enjoy a jump in stock prices during or before a war (traditionally a time of decline for the market). These companies are usually defense contractors who build munitions, aircraft, artillery, tanks, etc. Although these companies aren’t the bastard children of foreign soldiers, people usually do avoid claiming war babies in times of peace.

The Bottom Line

That’s that for the military parade down Wall Street. Military terms have crept into many vocabularies and the fiercely competitive realm of finance is no exception.

Text 6. How Interest Rates Can Go Negative

By Adam Hayes, CFA

For a long time economists believed that nominal interest rates, or the amount of money received for depositing money, were theoretically bounded by zero to the downside. Lately, however, central banks from Europe to Japan have implemented a negative interest rate policy (NIRP) in order to stimulate economic growth. How is this lower bound broken?

Real Rates Can and Have Been Negative

Before addressing how negative interest rates are being employed today, it is worth noting that the real interest rate, which adjusts for inflation and accounts for the true cost of borrowing, can and has been negative before. The real rate is calculated as: real rate = nominal rate – inflation. If the central bank sets the nominal rate at 1% annualized and inflation is 2% a year, the real rate would be effectively negative 1%. For example, $100 put into a bank would grow to $101 after twelve months, but be worth $98.98 in terms of buying power after inflation. In other words, the depositor has lost money by keeping it in the bank.

Negative Nominal Rates

The negative nominal rates that have been in the news as central banks seek to stimulate their sagging economies, affect a very specific rate that only impacts members of the banking or financial system. The central bank's overnight interbank lending rate (examples are LIBOR and EURIBOR) is how much banks charge each other to borrow short-term reserves with the central bank acting as a warehousing facility for any excess reserves that the banking system cannot internally match up. It is important to understand that negative interest rates only apply to a small portion of funds, exceeding a certain amount, held by the central bank on behalf of the financial sector. Moreover, these negative rates do not directly impact most other depositors, who have been used to very low rates of interest for nearly a decade anyhow.

The overnight interest rate is the basis for nearly every other interest rate including those on retail bank deposits, certificates of deposit (CDs), mortgages, auto loans and yields on corporate bonds. A

negative nominal rate could serve to bring down all of those rates as well. The goal is that depositors would rather spend or lend those funds rather than have their value slowly erode over time. Many see this as a signal of desperation by central bankers who have failed to stabilize macroeconomic activity via traditional monetary policy methods, or even by quantitative easing (QE).

The Bottom Line

Japan now joins the European Central Bank (ECB), Sweden, Switzerland and Denmark in enacting a negative interest rate policy in order to kick-start the economy. The goal is to discourage financial institutions from hoarding cash and instead to lend or invest it. While only specific funds held by the banking sector will be subject to paying negative interest rates, it has the potential to lower interest rates across the board making it easier to borrow money for all. At the same time, such a move to negative rates may imply that central banks are out of ammunition in combating recessionary pressures in the economy and that, if this fails to produce good results, there may not be anything left to do.

Text 7. What Is the Quantity Theory of Money?

By Reem Heakal

The concept of the quantity theory of money (QTM) began in the 16th century. As gold and silver inflows from the Americas into Europe were being minted into coins, there was a resulting rise in inflation. This led economist Henry Thornton in 1802 to assume that more money equals more inflation and that an increase in money supply does not necessarily mean an increase in economic output. Here we look at the assumptions and calculations underlying the QTM, as well as its relationship to monetarism and ways the theory has been challenged.

QTM in a Nutshell

The quantity theory of money states that there is a direct relationship between the quantity of money in an economy and the level of prices of goods and services sold. According to QTM, if the amount of money in an economy doubles, price levels also double, causing inflation (the percentage rate at which the level of prices is rising in an

economy). The consumer therefore pays twice as much for the same amount of the good or service.

Another way to understand this theory is to recognize that money is like any other commodity: increases in its supply decrease marginal value (the buying capacity of one unit of currency). So an increase in money supply causes prices to rise (inflation) as they compensate for the decrease in money's marginal value.

The Theory's Calculations

In its simplest form, the theory is expressed as:

MV = PT (the Fisher Equation)

Each variable denotes the following: M = Money Supply V = Velocity of Circulation (the number of times money changes hands) P = Average Price Level T = Volume of Transactions of Goods and Services

The original theory was considered orthodox among 17th century classical economists and was overhauled by 20th-century economists Irving Fisher, who formulated the above equation, and Milton Friedman.

It is built on the principle of "equation of exchange":

Amount of Money x Velocity of Circulation = Total Spending

Thus if an economy has US$3, and those $3 were spent five times in a month, total spending for the month would be $15.

QTM Assumptions

QTM adds assumptions to the logic of the equation of exchange. In its most basic form, the theory assumes that **V** (velocity of circulation) and **T** (volume of transactions) are constant in the short term. These assumptions, however, have been criticized, particularly the assumption that V is constant. The arguments point out that the velocity of circulation depends on consumer and business spending impulses, which cannot be constant.

The theory also assumes that the quantity of money, which is determined by outside forces, is the main influence of economic activity in a society. A change in money supply results in changes in price levels and/or a change in supply of goods and services. It is primarily these changes in money stock that cause a change in spending. And the velocity of circulation depends not on the amount of money available or on the current price level but on *changes* in price levels.

Finally, the number of transactions (**T**) is determined by labor, capital, natural resources (i.e. the factors of production), knowledge and organization. The theory assumes an economy in equilibrium and at full employment.

Essentially, the theory's assumptions imply that the *value* of money is determined by the*amount* of money available in an economy. An increase in money supply results in a decrease in the value of money because an increase in money supply causes a rise in inflation. As inflation rises, the purchasing power, or the value of money, decreases. It therefore will cost more to buy the same quantity of goods or services.

Money Supply, Inflation and Monetarism

As QTM says that quantity of money determines the value of money, it forms the cornerstone of monetarism.

Monetarists say that a rapid increase in money supply leads to a rapid increase in inflation. Money growth that surpasses the growth of economic output results in inflation as there is too much money behind too little production of goods and services. In order to curb inflation, money growth must fall below growth in economic output.

This premise leads to how monetary policy is administered. Monetarists believe that money supply should be kept within an acceptable bandwidth so that levels of inflation can be controlled. Thus, for the near term, most monetarists agree that an increase in money supply can offer a quick-fix boost to a staggering economy in need of increased production. In the long term, however, the effects of monetary policy are still blurry.

Less orthodox monetarists, on the other hand, hold that an expanded money supply will not have any effect on real economic activity (production, employment levels, spending and so forth). But for most monetarists any anti-inflationary policy will stem from the basic concept that there should be a gradual reduction in the money supply. Monetarists believe that instead of governments continually adjusting economic policies (i.e. government spending and taxes), it is better to let non-inflationary policies (i.e. gradual reduction of money supply) lead an economy to full employment.

QTM Re-Experienced

John Maynard Keynes challenged the theory in the 1930s, saying that increases in money supply lead to a decrease in the velocity of circulation and that real income, the flow of money to the factors of production, increased. Therefore, velocity could change in response to changes in money supply. It was conceded by many economists after him that Keynes' idea was accurate.

QTM, as it is rooted in monetarism, was very popular in the 1980s among some major economies such as the United States and Great

Britain under Ronald Reagan and Margaret Thatcher respectively. At the time, leaders tried to apply the principles of the theory to economies where money growth targets were set. However, as time went on, many accepted that strict adherence to a controlled money supply was not necessarily the cure-all for economic malaise.

Text 8. Globalization and the Butterfly Effect

By John Edwards

The butterfly effect concept has become important in the finance world as globalization continues to increase and capital markets connect. Volatility in one small area of the international markets can grow rapidly and bleed into other markets, and a hiccup in one corner of the international markets can have global consequences. Improvements in technology and wider access to the Internet has increased the degree to which international markets influence each other. This has led to more episodes of extreme market volatility.

The butterfly effect has become well-known in popular culture, and the concept has clear applications to finance. It and chaos theory may provide a partial explanation for the unpredictability of capital markets.

Origin and Meaning of Butterfly Effect

The phrase "the butterfly effect" was first coined during a scientific meeting in 1972. Scientist Edward Lorenz gave a talk on his work regarding weather prediction models. The phrase suggests that the flap of a butterfly's wings in Japan could create a small change in the atmosphere that might eventually lead to a tornado in Texas.

Lorenz studied how small differences in initial values led to large differences in weather models at the Massachusetts Institute of Technology. In 1961, he had entered an initial condition in a weather model as 0.506, rather than the precise number of 0.506127, which resulted in a completely different and unexpected weather pattern. In 1963, he wrote a paper on this concept, titled "Deterministic Nonperiodic Flow." The butterfly effect concept shows how difficult it is to predict dynamic systems, such as weather and financial markets. Study of the butterfly effect has led to advances in chaos theory.

Application of Chaos Theory to Markets

Capital markets go through alternating periods of calm and storminess. However, they are not always chaotic, and the shift between calm and chaos is often sudden and unpredictable. Some believe that these concepts of chaos theory can be used to understand how financial markets operate.

Markets tend to grow bubbles that eventually pop with drastic consequences. Financial bubbles often grow because of positive feedback. When investors make money during a rise in the financial markets, other observers think the investors must have made a smart decision, which leads the observers to invest their own money in the markets. The result is more buying and stock prices going higher. The positive feedback loop leads to prices beyond any logical or justifiable level. The loop eventually ends, and the last investors in are left hanging with the worst positions.

The same concept can explain volatile bear markets. The markets can suddenly shift due to outside factors, which causes investors to pay attention only to negative news. Initial selling leads to more selling as market participants liquidate their positions. The negative feedback loop tends to accelerate quickly, often resulting in a market full of undervalued stocks.

Fractals and the Markets

Prominent scientist Benoit Mandelbrot applied his work in fractals in nature to financial markets. He found that examples of chaos in nature, such as the shape of shorelines or clouds, often have a high degree of order. These fractal shapes can also explain chaotic systems, including financial markets. Mandelbrot noted that asset prices can jump suddenly with no apparent cause.

Many in the markets tend to dismiss the extreme events that occur less than 5% of the time. Mandelbrot argued that these outliers are important and play a significant role in financial market movements. Traditional portfolio theory tends to underestimate how often these high-volatility events occur. While his fractals cannot predict price movements, he argued that they could create a more realistic picture of market risks.

Examples of the Butterfly Effect in Markets

Although technology has increased the impact of the butterfly effect in global markets, there is a long history of financial bubbles going back to the tulip market bubble in Holland during the 17th century. Tulips were a status symbol among the elite. They were traded

on exchanges in Dutch towns and cities. People sold their belongings to begin speculating on tulips. However, prices began to drop and panic selling ensued.

There are more recent examples of bubbles. On October 1987, known as Black Monday, the Dow Jones Industrial Average (DJIA) lost around 22% in one trading day, the largest percentage drop ever for that market. There was no apparent cause for the drop, though the DJIA had some large down days the week before, and there were international issues in the Persian Gulf. In retrospect, issues with panic selling and perhaps program trading might be partly to blame.

In 2015, the Chinese stock market encountered significant volatility, dropping over 8% in one day. Similar to Black Monday, there was no single event or cause for the drop. This volatility quickly spread to other markets, with the S&P500 and the Nikkei losing around 4%. Also like Black Monday, there had been weakness in the Chinese markets in prior months.

Chinese officials had begun devaluing the renminbi. However, the main cause was likely the high degree of margin used by Chinese retail investors. When prices began to drop, investors received margin calls from their brokers. Retail investors were forced to liquidate their positions quickly to meet the margin calls, leading to a negative feedback loop of selling. In years prior, the Chinese government encouraged people to put their money in the market. Markets will only become more interconnected as technology continues to improve, and the butterfly effect will continue to be a factor in global markets.

Text 9. 4 Factors That Shape Market Trends

By Cory Mitchell

Trends are what allow traders and investors to capture profits. Whether on a short- or long-term time frame, in an overall trending market or a ranging environment, the flow from one price to another is what creates profits and losses. There are four major factors that cause both long-term trends and short-term fluctuations. These factors are governments, international transactions, speculation and expectation, and supply and demand.

Major Market Forces

Learning how these major factors shape trends over the long term can provide insight into why certain trends are developing, why a trend is in place and how future trends may occur. Here are the four major factors:

1. *Governments*

Governments hold much sway over the free markets. Fiscal and monetary policy have a profound effect on the financial marketplace. By increasing and decreasing interest rates the government and Federal Reserve can effectively slow or attempt to speed up growth within the country. This is called monetary policy.

If government spending increases or contracts, this is known as fiscal policy, and can be used to help ease unemployment and/or stabilize prices. By altering interest rates and the amount of dollars available on the open market, governments can change how much investment flows into and out of the country.

2. *International Transactions*

The flow of funds between countries impacts the strength of a country's economy and its currency. The more money that is leaving a country, the weaker the country's economy and currency. Countries that predominantly export, whether physical goods or services, are continually bringing money into their countries. This money can then be reinvested and can stimulate the financial markets within those countries.

3. *Speculation and Expectation*

Speculation and expectation are integral parts of the financial system. Where consumers, investors and politicians believe the economy will go in the future impacts how we act today. Expectation of future action is dependent on current acts and shapes both current and future trends. Sentiment indicators are commonly used to gauge how certain groups are feeling about the current economy. Analysis of these indicators as well as other forms of fundamental and technical analysis can create a bias or expectation of future price rates and trend direction.

4. *Supply and Demand*

Supply and demand for products, currencies and other investments creates a push-pull dynamic in prices. Prices and rates change as supply or demand changes. If something is in demand and supply begins to shrink, prices will rise. If supply increases beyond current demand, prices will fall. If supply is relatively stable, prices can fluctuate higher and lower as demand increases or decreases.

Effect on Short- and Long-Term Trends

With these factors causing both short- and long-term fluctuations in the market, it is important to understand how all these elements come together to create trends. While these major factors are categorically different, they are closely linked to one another. Government mandates impact international transactions, which play a role in speculation, and supply and demand plays a role in each of these other factors.

Government news releases, such as proposed changes in spending or tax policy, as well as Federal Reserve decisions to change or maintain interest rates can have a dramatic effect on long term trends. Lower interest rates and taxes encourage spending and economic growth. This has a *tendency* to push market prices higher, but the market does not always respond in this way because other factors are also at play. Higher interest rates and taxes, for example, deter spending and result in contraction or a long-term fall in market prices.

In the short term, these news releases can cause large price swings as traders and investors buy and sell in response to the information. Increased action around these announcements can create short-term trends, while longer term trends develop as investors fully grasp and absorb what the impact of the information means for the markets.

The International Effect

International transactions, balance of payments between countries and economic strength are harder to gauge on a daily basis, but they play a major role in longer-term trends in many markets. The currency markets are a gauge of how well one country's currency and economy is doing relative to others. A high demand for a currency means that currency will rise relative to other currencies.

The value of a country's currency also plays a role in how other markets will do within that country. If a country's currency is weak, this will deter investment into that country, as potential profits will be eroded by the weak currency.

The Participant Effect

The analysis and resultant positions taken by traders and investors based on the information they receive about government policy and international transactions create speculation as to where prices will move. When enough people agree on direction, the market enters into a trend that could sustain itself for many years.

Trends are also perpetuated by market participants who were wrong in their analysis; being forced to exit their losing trades pushes

prices further in the current direction. As more investors climb aboard to profit from a trend, the market becomes saturated and the trend reverses, at least temporarily.

The S & D Effect

This is where supply and demand enters the picture. Supply and demand affects individuals, companies and the financial markets as a whole. In some markets, such as the commodity markets, supply is determined by a physical product. Supply and demand for oil is constantly changing, adjusting the price a market participant is willing to pay for oil today and in the future.

As supply dwindles or demand increases, a long-term rise in oil prices can occur as market participants outbid one another to attain a seemingly finite supply of the commodity. Suppliers want a higher price for what they have, and a higher demand pushes the price that buyers are willing to pay higher.

All markets have a similar dynamic. Stocks fluctuate on a short and long-term scale, creating trends. The threat of supply drying up at current prices forces buyers to buy at higher and higher prices, creating large price increases. If a large group of sellers were to enter the market, this would increase the supply of stock available and would likely push prices lower. This occurs on all time frames

The Bottom Line

Trends are generally created by four major factors: governments, international transactions, speculation/expectation, and supply and demand. These areas are all linked as expected future conditions shape current decisions and those current decisions shape current trends. Government affects trends mainly through monetary and fiscal policy. These policies affect international transactions which in turn affect economic strength. Speculation and expectation drive prices based on what future prices might be. Finally, changes in supply and demand create trends as market participants fight for the best price.

Text 10. 6 Factors That Influence Exchange Rates

By Jason Van Bergen

Aside from factors such as interest rates and inflation, the exchange rate is one of the most important determinants of a country’s

relative level of economic health. Exchange rates play a vital role in a country's level of trade, which is critical to most every free market economy in the world. For this reason, exchange rates are among the most watched, analyzed and governmentally manipulated economic measures. But exchange rates matter on a smaller scale as well: they impact the real return of an investor's portfolio. Here we look at some of the major forces behind exchange rate movements.

Overview

Before we look at these forces, we should sketch out how exchange rate movements affect a nation's trading relationships with other nations. A higher currency makes a country's exports more expensive and imports cheaper in foreign markets. A lower currency makes a country's exports cheaper and its imports more expensive in foreign markets. A higher exchange rate can be expected to lower the country's balance of trade, while a lower exchange rate would increase it.

Determinants of Exchange Rates

Numerous factors determine exchange rates, and all are related to the trading relationship between two countries. Remember, exchange rates are relative, and are expressed as a comparison of the currencies of two countries. The following are some of the principal determinants of the exchange rate between two countries. Note that these factors are in no particular order; like many aspects of economics, the relative importance of these factors is subject to much debate.

1. Differentials in Inflation

As a general rule, a country with a consistently lower inflation rate exhibits a rising currency value, as its purchasing power increases relative to other currencies. During the last half of the 20th century, the countries with low inflation included Japan, Germany and Switzerland, while the U.S. and Canada achieved low inflation only later. Those countries with higher inflation typically see depreciation in their currency in relation to the currencies of their trading partners. This is also usually accompanied by higher interest rates.

2. Differentials in Interest Rates

Interest rates, inflation and exchange rates are all highly correlated. By manipulating interest rates, central banks exert influence over both inflation and exchange rates, and changing interest rates impact inflation and currency values. Higher interest rates offer lenders in an economy a higher return relative to other countries. Therefore, higher interest rates

attract foreign capital and cause the exchange rate to rise. The impact of higher interest rates is mitigated, however, if inflation in the country is much higher than in others, or if additional factors serve to drive the currency down. The opposite relationship exists for decreasing interest rates – that is, lower interest rates tend to decrease exchange rates.

3. Current-Account Deficits

The current account is the balance of trade between a country and its trading partners, reflecting all payments between countries for goods, services, interest and dividends. A deficit in the current account shows the country is spending more on foreign trade than it is earning, and that it is borrowing capital from foreign sources to make up the deficit. In other words, the country requires more foreign currency than it receives through sales of exports, and it supplies more of its own currency than foreigners demand for its products. The excess demand for foreign currency lowers the country's exchange rate until domestic goods and services are cheap enough for foreigners, and foreign assets are too expensive to generate sales for domestic interests.

4. Public Debt

Countries will engage in large-scale deficit financing to pay for public sector projects and governmental funding. While such activity stimulates the domestic economy, nations with large public deficits and debts are less attractive to foreign investors. The reason? A large debt encourages inflation, and if inflation is high, the debt will be serviced and ultimately paid off with cheaper real dollars in the future.

In the worst case scenario, a government may print money to pay part of a large debt, but increasing the money supply inevitably causes inflation. Moreover, if a government is not able to service its deficit through domestic means (selling domestic bonds, increasing the money supply), then it must increase the supply of securities for sale to foreigners, thereby lowering their prices. Finally, a large debt may prove worrisome to foreigners if they believe the country risks defaulting on its obligations. Foreigners will be less willing to own securities denominated in that currency if the risk of default is great. For this reason, the country's debt rating (as determined by Moody's or Standard & Poor's, for example) is a crucial determinant of its exchange rate.

5. Terms of Trade

A ratio comparing export prices to import prices, the terms of trade is related to current accounts and the balance of payments. If the price of a country's exports rises by a greater rate than that of its imports, its

terms of trade have favorably improved. Increasing terms of trade shows greater demand for the country's exports. This, in turn, results in rising revenues from exports, which provides increased demand for the country's currency (and an increase in the currency's value). If the price of exports rises by a smaller rate than that of its imports, the currency's value will decrease in relation to its trading partners.

6. Political Stability and Economic Performance

Foreign investors inevitably seek out stable countries with strong economic performance in which to invest their capital. A country with such positive attributes will draw investment funds away from other countries perceived to have more political and economic risk. Political turmoil, for example, can cause a loss of confidence in a currency and a movement of capital to the currencies of more stable countries.

The Bottom Line

The exchange rate of the currency in which a portfolio holds the bulk of its investments determines that portfolio's real return. A declining exchange rate obviously decreases the purchasing power of income and capital gains derived from any returns. Moreover, the exchange rate influences other income factors such as interest rates, inflation and even capital gains from domestic securities. While exchange rates are determined by numerous complex factors that often leave even the most experienced economists flummoxed, investors should still have some understanding of how currency values and exchange rates play an important role in the rate of return on their investments.

Text 11. Cost-Push Inflation Versus Demand-Pull Inflation

By Reem Heakal

Do you remember how much less you paid for things even two years ago? This increase in the general price level of goods and services in an economy is inflation, measured by the Consumer Price Index and the Producer Price Index. But there are different types of inflation, depending on its cause. Here we examine cost-push inflation and demand-pull inflation.

Factors of Inflation

Inflation is defined as the rate (%) at which the general price level of goods and services is rising, causing purchasing power to fall. This is different from a rise and fall in the price of a particular good or service. Individual prices rise and fall all the time in a market economy, reflecting consumer choices or preferences and changing costs. So if the cost of one item, say a particular model car, increases because demand for it is high, this is not considered inflation. Inflation occurs when *most* prices are rising by some degree across the whole economy. This is caused by four possible factors, each of which is related to basic economic principles of changes in supply and demand:

1. Increase in the money supply.
2. Decrease in the demand for money.
3. Decrease in the aggregate supply of goods and services.
4. Increase in the aggregate demand for goods and services.

In this look at what inflation is and how it works, we will ignore the effects of money supply on inflation and concentrate specifically on the effects of aggregate supply and demand: cost-push and demand-pull inflation.

Cost-Push Inflation

Aggregate supply is the total volume of goods and services produced by an economy at a given price level. When there is a decrease in the aggregate supply of goods and services stemming from an increase in the cost of production, we have cost-push inflation. Cost-push inflation basically means that prices have been “pushed up” by increases in costs of any of the four factors of production (labor, capital, land or entrepreneurship) when companies are already running at full production capacity. With higher production costs and productivity maximized, companies cannot maintain profit margins by producing the same amounts of goods and services. As a result, the increased costs are passed on to consumers, causing a rise in the general price level (inflation).

Production Costs

To understand better their effect on inflation, let’s take a look into how and why production costs can change. A company may need to increases wages if laborers demand higher salaries (due to increasing prices and thus cost of living) or if labor becomes more specialized. If the cost of labor, a factor of production, increases, the company has to allocate more resources to pay for the creation of its goods or services. To continue to maintain (or increase) profit margins, the company

passes the increased costs of production on to the consumer, making retail prices higher. Along with increasing sales, increasing prices is a way for companies to constantly increase their bottom lines and essentially grow. Another factor that can cause increases in production costs is a rise in the price of raw materials. This could occur because of scarcity of raw materials, an increase in the cost of labor and/or an increase in the cost of importing raw materials and labor (if the they are overseas), which is caused by a depreciation in their home currency. The government may also increase taxes to cover higher fuel and energy costs, forcing companies to allocate more resources to paying taxes.

Putting It Together

To visualize how cost-push inflation works, we can use a simple price-quantity graph showing what happens to shifts in aggregate supply. The graph below shows the level of output that can be achieved at each price level. As production costs increase, aggregate supply decreases from AS1 to AS2 (given production is at full capacity), causing an increase in the price level from P1 to P2. The rationale behind this increase is that, for companies to maintain (or increase) profit margins, they will need to raise the retail price paid by consumers, thereby causing inflation.

Demand-Pull Inflation

Demand-pull inflation occurs when there is an increase in aggregate demand, categorized by the four sections of the macroeconomy: households, businesses, governments and foreign buyers. When these four sectors concurrently want to purchase more output than the economy can produce, they compete to purchase limited amounts of goods and services. Buyers in essence “bid prices up”, again, causing inflation. This excessive demand, also referred to as “too much money chasing too few goods”, usually occurs in an expanding economy.

Factors Pulling Prices Up

The increase in aggregate demand that causes demand-pull inflation can be the result of various economic dynamics. For example, an increase in government purchases can increase aggregate demand, thus pulling up prices. Another factor can be the depreciation of local exchange rates, which raises the price of imports and, for foreigners, reduces the price of exports. As a result, the purchasing of imports decreases while the buying of exports by foreigners increases, thereby raising the overall level of aggregate demand (we are assuming

aggregate supply cannot keep up with aggregate demand as a result of full employment in the economy). Rapid overseas growth can also ignite an increase in demand as more exports are consumed by foreigners. Finally, if government reduces taxes, households are left with more disposable income in their pockets. This in turn leads to increased consumer spending, thus increasing aggregate demand and eventually causing demand-pull inflation. The results of reduced taxes can lead also to growing consumer confidence in the local economy, which further increases aggregate demand.

Putting It Together

Demand-pull inflation is a product of an increase in aggregate demand that is faster than the corresponding increase in aggregate supply. When aggregate demand increases without a change in aggregate supply, the 'quantity supplied' will increase (given production is *not*at full capacity). Looking again at the price-quantity graph, we can see the relationship between aggregate supply and demand. If aggregate demand increases from AD1 to AD2, in the short run, this will *not* change (shift) aggregate supply, but cause a change in the quantity supplied as represented by a movement along the AS curve. The rationale behind this lack of shift in aggregate supply is that aggregate demand tends to react faster to changes in economic conditions than aggregate supply.

As companies increase production due to increased demand, the cost to produce each additional output increases, as represented by the change from P1 to P2. The rationale behind this change is that companies would need to pay workers more money (e.g. overtime) and/or invest in additional equipment to keep up with demand, thereby increasing the cost of production. Just like cost-push inflation, demand-pull inflation can occur as companies, to maintain profit levels, pass on the higher cost of production to consumers' prices.

The Bottom Line

Inflation is not simply a matter of rising prices. There are endemic and perhaps diverse reasons at the root of inflation. Cost-push inflation is a result of increased costs of production, itself a result of different factors. The increase in aggregate demand causing demand-pull inflation can be the result of many factors, including increases in government spending and depreciation of the local exchange rate. If an economy identifies what type of inflation is occurring (cost-push or demand-pull),

then the economy may be better able to rectify (if necessary) rising prices and the loss of purchasing power.

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