

A Parents' Guide: Talking to Your Kids About Inflation

Overview:

Over the past year, the cost of things has risen substantially. The United States, and really the world, is experiencing the highest rate of inflation in more than four decades. In fact, adults who grew up in the 1970s will remember “stagflation,” when the country experienced rising prices and interest rates, even though the economy was struggling. The last time the country experienced this level of price growth, disco was popular, and Star Wars was new.

If you are a parent or guardian, your kids might have questions about inflation. Junior Achievement has developed this guide to help explain what causes prices to rise.



Q. What is inflation anyway?

While there are many ways to define inflation, the simplest is when “too many dollars chase too few goods or services.” What this means is demand for a product or service is much higher than the supply of products or services available. For example, say you are in a store and there is one copy of a popular video game but five people want to buy it. If the store didn’t have a policy on a set price for that video game, the five people would be inclined to offer more and more money until one of them was able to win out and purchase the game at a much higher price, which is a form of inflation.

An example of this in real life is cars. Because of supply chain issues caused by the pandemic, there are too few cars available for the number of people who want to buy them. As a result, the price of cars, especially used ones being resold, has gone up. You see the same thing happening with food, school supplies, and more.

Q. Why are we seeing inflation now?

Much of economy is dependent on the global supply chain. Think of a supply chain as all the people, companies, processes, and materials that go into manufacturing a product. For instance, your smartphone might have a screen made in India, a microprocessor made in the United States, a microphone made in Malaysia, and a bunch of other parts from different regions of the world. All these materials might go to China, where they are assembled into phone which is eventually sold in the United States.



The pandemic caused disruption in this supply chain. People either had to stop work, or fewer people were working during the pandemic, which caused “breaks” in the supply chain. These disruptions still continue today, so, for example, the company assembling phones in China might be waiting on the microphones from Malaysia before they can complete the phone and send it to stores. This results in a shortage of phones, which means people are willing to pay a bit more for the remaining phones that are available for sale. When this happens enough, prices go up and you have inflation.

Additional causes include fiscal and monetary policy.

During the pandemic, many people were out of work and the economy was in danger of going into recession, or worse. To help offset this, the Federal government in the United States, like other governments around the world, pumped money into the economy through fiscal policy. Fiscal policy is when the government adjusts spending or tax rates in response to economic factors. In the case of the pandemic, the Federal government stimulated the economy through payroll tax cuts to workers and forgivable loans to employers. While these efforts helped support the economy during the pandemic, they also contributed to driving up prices as the economy recovered.

As for monetary policy, that is managed by the Federal Reserve, which is a central bank which regulates the U.S. banking system. The Federal Reserve (The Fed) will lower interest rates (the cost to borrow money) when the economy is struggling and will raise interest rates when the economy is doing well, and prices begin to rise. This is an example of monetary policy. In the case of the pandemic, the Fed kept interest rates low to help the economy. However, with prices now rising, the Fed is in the position of having to increase interest rates, which makes it more expensive to use loans to buy cars or houses, for example. This results in less demand for things often purchased using loans or credit (cars, houses, appliances, furniture) and should eventually cause prices of those and other items to go down.

Q. Will inflation end? If so, when?

While the Federal government probably won’t raise taxes or cut planned spending to fight inflation (fiscal policy), the Fed is continuing to raise interest rates in an effort to drive down prices (monetary policy). If history is a guide, inflation will eventually be put in check.

Though there are times when inflation was especially stubborn and stayed around for several years, such as in the 1970s, the increases in prices usually start to come down within a two-to-three-year period as changes in fiscal and monetary policy begin to take effect. Inflation should also be impacted by the recovery of supply chains as the pandemic continues to wane in the months ahead.