The inflation rate in united states of america economics essay

Inflation is a persistent general increase in the prices, where the value of money is falling [REF]. By observing the varying inflation rate of the US for last couple of years, one of the factors that relates to this scenario is due to the increase in demand of goods and services relative to the supply. Referring to the figure 1 a below where P1 indicates the current price, with D1 as Demand and AS as supply. When the demand increase to D2, the price for the same goods and services will change to P2 making the products more expensive. Now If we look over at the time period from November 2010 September 2011 where there was a steady increase in the inflation, the unemployment rate during the same time decreased to 9% from 9. 8% on November 2010, resulting on the the demand of goods and services to increase to AD2, which caused the price to inflate than previous months. However this pattern does not match the trend when we look at the unemployment level from September2011 to March 2012. The unemployment rate decreased by almost 1% in these six months from 9% to 8. 1% yet the inflation rate decreased.

Another factor that determines this trend is the money supply by the bank. We know that when the interest rates are low, the value of money decreases making for a plentiful flow of money in the market. These causes the consumers to spend more as the availability of bank credits are easy. The chart below shows the interest rate in US during these two years.

Looking at the chart above, we can see that when the inflation rate was rising, the interest rates were falling. The interest rate for the month of November in 2010 was 0. 19%, as the interest rates slowly started to decrease reaching the lowest rate of 0. 08% on September 2011. This

resulted in the increased money supply deprecating the value of money making consumers spend more raising the demand, which increased the inflation rate during this month. After September 2011, interest rate slowly started to increase reaching 0. 13% on March, resulting on the value of money to increase decreasing the inflation.

Looking at the exports during this period further clarifies this trend. When the inflation rate was increasing in the US, there was an increase in the export as well. Since the value of United State Dollars (USD) deprecated, there was a more demand of goods in the foreign market, making the rise on the inflation rate.

Question 2

The graph above shows the exchange rate of Malaysian Ringgit(MYR) against the United States Dollar (USD). As we can see from above the value of Ringgits was stronger during the month from June till the end of August. For the month of June the average exchange rate was MYR 1 was equal to USD 0. 33. The value of Ringgits slightly appreciated on the month of July reaching an average of USD 0. 34 per Ringgit, and 0. 33 for August. The value of Ringgits gradually depreciated for the month of September, reaching the lowest value of USD 0. 31 per Ringgits. The last remaining months showed somewhat mixed results. The value of MYR appreciated on October followed by depreciating on November and gradually increasing in December.

The market of Foreign Currency Exchange depends upon Net Exports (NX) and Net Foreign Investment (NFI). Net Exports is the imbalance between the

Exports and Imports of goods; whereas Net Foreign Investment is imbalance between Purchase of and sales of capital assets. For an economy, Net Exports and Net Foreign Investment should balance (NX = NFI) ~ (DD = SS). The price that balances this Supply and Demand is the Real Exchange Rate.

In our context whenever there is more demand of Malaysian goods abroad, the demand of Malaysian Ringgits on the market increases, resulting the currency to appreciate. As the goods produced in Malaysia are being more expensive, people tend to increase the import of goods on Malaysia as well, making the Net Export balanced and unchanged. This effect is explained in the graph below.

In the figure above, as the demand of Malaysian Ringgits increases from D1 to D2, it results an increase in the real exchange rate from E1 to E2 as well, leaving the net export intact.

In another scenario, the depreciation of the Ringgits may occur, when there is the supply of ringgits on the market is more. For example, when Malaysia wants to purchase assets on USA, it has to first exchange its currency into US dollars. When this happens the quantity of ringgits on the market increases making the exchange rate depreciate. The figure below further elaborates this scenario.