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Economics



IB ECONOMICS – INTERNAL ASSESSMENT FRONT COVER School code: Luanda International School * Candidate Name: Noel Castellanos * Candidate Number: *Teacher: Sebastian Sanogueira * Title of the article: China's inflation falls to 1.8 per cent, giving Beijing more room to stimulate slowing economy * Source of the article: Canadian Businesses <http://www.canadianbusiness.com/article/94646--china-s-inflation-falls-to-1-8-per-cent-giving-beijing-more-room-to-stimulate-slowing-economy> (accessed on: 27/08/2012) Date the article was published: 09/08/2012 * Date the commentary was written: 01/09/2012 * Word Count: 774 * Section of the syllabus the article relates to: Macroeconomics When talking about macroeconomics, two of the main goals of the government are to keep inflation low and constant and keep the economy growth high and stable. Inflation can be defined as a persistent, substantial rise in the general level of prices related to an increase in the volume of money and resulting in the loss of value of currency and economic growth can be defined as a steady growth in the productive capacity of the economy.

These two goals go hand in hand, as in many ways they depend on each other. The last few years China has experienced a high rate of inflation mainly due to a 2.4% rise in food prices, which has provoked a slowdown in the economic growth of the country. This was caused because the aggregate supply of the country decreased. Aggregate supply is defined as the total supply of goods and services produced within an economy at a given overall price level in a given time period.

The decrease of the aggregate supply caused a shift in the short run aggregate supply curve to the left, and consequently increased prices and

decreased the real output of the economy, slowing the economic growth, as shown in the graph below. The decrease of the real output would probably lead to higher unemployment rate, since companies would not have the same ability to pay all of the employees because companies are not making as much money, so cuts would have to be made. Unemployment rate is defined as the percentage of the work force that is unemployed.

Chinese manufacturing barely grew in July. The reason for these was because the high prices eventually led to a decrease on the aggregate demand, as people would try to spend less and save more, shifting the aggregate demand to the left ($AD - AD1$). Aggregate demand is define as the total amount of goods and services demanded in the economy at a given overall price level and in a given time period. With a decrease in aggregate demand and aggregate supply, the real output would decrease even more, affecting the money spent in the manufacture of the country. This is shown in the graph below.

What China has been trying to do to increase the economic growth is to cut interest rates, and pump money into the economy through high spending on building low-cost housing and other public works. By cutting interest rates, people are more willing to borrow money and spend it in the economy, increasing the economic growth of the country. In August inflation fell to 1.8%, from a 2.2% of the previous month and even higher inflation rate the previous year. With the lower inflation rates, the government has more room to make cuts in the interest rates and take other measures to increase the economy.

The problem with this is that the decrease of the steady decrease of inflation can make China to enter in a period of deflation. Deflation can be defined as a general decline in prices. This can potentially be very dangerous for the economy. The reason being that because of the prices decreasing, consumers would save money expecting lower prices, decreasing aggregate demand, shifting the aggregate supply curve to the left ($AD - AD1$) decreasing the average price level and the real output, which would lead to decrease in aggregate demand shifting the aggregate supply curve to the left ($SRAS - SRAS1$). This would create even more deflation and repeat the same process again, making worst and worst creating a downward spiral, as shown in the graph below. This would create very high unemployment, as companies' revenues and wages would get lower and lower, and economic growth would decrease even more. In many ways, and according to this evidence, deflation is a far worst case than high inflation, since both have almost the same effect, but deflation is more drastic.

The decline of inflation is mainly due to a fall in commodity prices. So to avoid a case of deflation, the Chinese government needs to be very cautious about the economic growth of the economy, because the fastest the increase in the economic growth, the fastest the increase of the prices in commodity prices, making this way, a steady inflation rate in the economy. To keep the economic growth the government could spend more money in the infrastructure of the country, because this would make the consumers more confident on spending money.

Also the government could try to decrease unemployment by creating job training programs and injecting money to companies, so that they employ

more. And finally the government should cut interest rates as much as they can. Bibliography: " Saturday Sep 1. " Investopedia a?? Educating the World aboutFinance. N. p. , n. d. Web. 01 Sept. 2012. ; lt; <http://www.investopedia.com/>; gt;. Dictionary. com. Dictionary. com, n. d. Web. 01 Sept. 2012. ; lt; <http://dictionary.reference.com/>; gt;.