Impact of inflation on economic growth

Research Type

In order to understand the impact of inflation on the economic growth of Pakistan, quantitative research is carried down.

Data Type

Secondary data is collected from various websites and data bases.

Source of Data

In order to collect the secondary data, websites are consulted.

Techniques

Regression analysis will be used as the statistical technique in this research after gathering secondary data. Once the data have been collected results will be analyzed through regression analysis.

Sample

Data is collected from 1997 -2007 for all the variables from the WDI website.

Theoretical Framework

Interest rate

(Independent)

Inflation

(independent)

Economic Growth

Investment

FDI

(Independent)

%Growth in money supply

(Independent)

Definitions and relation of variables.

Economic Growth:

Economic growth is the increase of per capita gross domestic product (GDP) , described as the annual rate of change in real GDP. Economic growth is driven by a change in productivity, which involves producing more goods and services with the same inputs of labour, capital, energy and materials. Economists say that there lies a difference between short-term economic stabilization and long-term economic growth. But the topic of economic growth is primarily concerned with the long run.

Inflation:

It is an increase in the cost of commodities that are necessary for humans to live , such as bread, milk, cheese, oil, shelter, clothing, medical services, cotton, electronics, etc or a decrease in the value of money so that it takes more currency to buy the same goods and services it did in the past.

Higher rates of inflation are going to have adverse effects on the economic growth. There is less economic growth when there is high inflation usually.

Interest rates:

It is a rate which is charged for the use of money or the price for borrowing money. An interest rate is expressed as an annual percentage of the principal. Interest rates often change as a result of inflation and Federal Reserve policies. Interest rates may vary causing a change in other factors. Investors want to preserve the “ purchasing power” of their money. If inflation is higher it will result in higher risk and investors will be considering higher interest rate to lend their money. Therefore, when the interest rates are likely to rise, it gives an increase to inflation resulting in less economic growth. People will save more and invest less as they are likely to earn more profit on their savings.

Investment:

Investment is the use of money in a way that it earns you more money. Or it can be termed as the process of investing funds in an asset that is likely to earn you great money in the future. Gains that might come from the asset invested in could be in the shape of interest, income or appreciation in the value of the asset. Foreign direct investment is defined as a business or a concern from one country making a physical investment into another country. The direct investment in buildings, machinery and equipment with making a portfolio investment, which is considered an indirect investment. Foreign direct investment plays a positive role in the process of economic growth. FDI helps in developing new products and technologies faster than local firms. This is one of the causes why developing countries are keen to attract FDI.

Broad money:

Broad money is a gauge of the money supply that includes more than just physical money such as currency and coins . It includes demand deposits at commercial banks, and any dues held in easily reachable accounts. Components of broad money are still very liquid, and can usually be converted into cash very easily.

The most commonly used measure of broad money is M2, which includes currency and coins, and deposits in checking accounts, savings accounts, overnight repos, and non-institutional money market accounts. This is the major measure of the money supply, and is the economic indicator usually used to assess the amount of liquidity in the economy. With the loosening of money supply by the Federal Bank, there's going to be a rise in inflation leading to slow economic growth in most of the cases. But if the money supply is loosened for a shorter time period, there is a likelihood that economic growth would raise.

Research Hypothesis

The objective of this study is to measure the impact of inflation on the economic growth

H0: Inflation does not have an effect on Economic growth

H1: Inflation does have an effect on economic growth

The objective of this study is to measure the impact of broad money on economic growth

H0: Broad money has insignificant relationship with economic growth

HA: Broad money has significant relationship with economic growth.

H0: B1 = 0

HA: B1 =/= 0

The objective of this study is to measure the impact of interest rates on economic growth.

H0: Interest rates have insignificant relationship with economic growth

HA: Interest rates have significant relationship with economic growth

H0: B2 = 0

HA: B2 =/= 0

The objective of this study is to measure the impact of investments on economic growth

H0: Investment has insignificant relation with economic growth

HA: Investment has significant relation with economic growth

H0: B3 = 0

HA: B3 =/= 0