**Understanding inflation**

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Inflation has become central to the Pakistani zeitgeist in 2021-22 in a way that it hadn’t been in decades. Debates today revolve around currency devaluation, rising import bills and supply chain issues, as inflation in Pakistan starts to bite the common man like never before in the history of the country. However, trying to understand it can be a mind-bending task.

In fact, people who have studied markets and the economy for years often do not know the ins and outs of how inflation is calculated or for that matter its after effects on society—from who wins and who loses to whether it is good or bad news. For a better understanding of an average person, let’s try and understand how it is measured and what it means for one’s security and savings.

Inflation is basically a loss of purchasing power over time: It means that one’s Rupee will not go as far tomorrow as it did today. It is typically expressed as the annual change in prices for a basket of goods and services. There are two main inflation gauges: One, the Consumer Price Index (CPI) that measures the cost of things the urban consumers buy out of pocket. The other, Personal Consumption Expenditures index (PCE), is released at more of a lag and measures things people consume, including things they do not pay for directly—notably healthcare (unfortunately not really available in case of Pakistan, so perhaps inflation is always more relevant to CPI in our case) and public facilities in shape of public transport, subsidised utilities, housing, etc., again things that our successive governments have failed to provide over time.

[Real Madrid’s Dani Carvajal tests positive for COVID-19](https://nation.com.pk/15-Jan-2022/real-madrid-s-dani-carvajal-tests-positive-for-covid-19)

So, in essence when it comes to inflation in Pakistan, it is really the people who face the brunt, no matter how it is calculated. Central banks (primarily responsible for keeping the inflation under check) of responsible economies in general try and keep PCE increases under 2/3 percent annually while setting a slightly higher tolerance (around 3/4 percent) for the CPI, just to give the companies the room to manoeuvre, if required. Clearly, the inflation levels in Pakistan tell us why our central bank and the government have failed their people in recent years!

In determining the causes of inflation, in the short term a high inflation can be attributed to hot money—one in which people have a lot of surplus cash or are accessing a lot of credit on cheap rates and are wanting to spend it. Meaning, if consumers are buying goods and services eagerly enough, businesses may need to raise prices. Or companies may choose to charge more because they realise that they can raise prices and improve their profits without losing sales. But inflation can—and often does—rise and fall based on developments that have little to do with economic conditions.

[Stolen assets of developing countries must be returned, says FM Qureshi](https://nation.com.pk/15-Jan-2022/stolen-assets-of-developing-countries-must-be-returned-says-fm-qureshi)

For example, rising gas and oil prices due to skewed governmental policies and spending. Analyse this closely and our story has been one where the government maintains a large footprint on the energy sector and has repeatedly failed to make smart choices with its supply chain arrangements—a phenomenon exacerbated by continuous failures to contain undesired imports amidst a free-falling value of the Pak Rupee.

As a result, people get punished while almost every Pakistani government tries to temporarily buy its way out of insolvency through poorly negotiated financing programs (IMF) and coercive or counterproductive taxation drives, thereby not only increasing the public pain but also prolonging the economic impasse indefinitely. The important question in today’s context is where exactly is inflation headed and should one be worried?

The official take that we are being constantly fed is naturally that 2022 will bring relief, since the economic managers see no evidence that rapid inflation is turning into a permanent feature of Pakistan’s economic landscape. And this, even as prices keep on rising quickly: The CPI is clocking in double digits for more than 18 months now and at around 13 percent today, whereas, the food inflation in many periods has simply run amok, being as high as over 20 percent on comparative month-on-month scales; still the government managers opine that they have plenty of reasons to believe that the on-going price burst will fade!

[Punjab governor signs Amendment Ordinance 2022 to curb profiteering, hoarding](https://nation.com.pk/14-Jan-2022/punjab-governor-signs-amendment-ordinance-2022-to-curb-profiteering-hoarding)

They argue that many of the increases this year relate to a global inflationary trend and as supply-chain issues ease and consumption settles down, the prices will also start reversing. Ironically, one feels that there are on the contrary, some quite clear concerning signs that inflation in Pakistan is in fact becoming stickier, meaning that unless prudently addressed, it is likely to last much longer rather than just fading away in 2022. The reality is that all input costs have picked up, productivity has declined, poor public sector enterprises’ management and short-sighted economic governance is squeezing businesses, supply-chain issues in Pakistan remain largely unaddressed as the government functionaries simply may not have the capacity to tackle them, the Rupee continues to slide, manufacturing disruptions keep on increasing by the day, the energy sector remains mismanaged and as rising interest rates put more and more pressure on operations, we run the danger of soon entering the Economic Stagflation Stage—Stagflation is characterised by slow economic growth and relatively high unemployment—or economic stagnation—which is at the same time accompanied by rising prices (i.e. inflation).

[President Alvi condoles with Sanjrani over death of his brother](https://nation.com.pk/14-Jan-2022/president-alvi-condoles-with-sanjrani-over-death-of-his-brother)

A question that is often asked is that is inflation always bad? Though the absolute answer to this question is in ‘no’, however, whether or not inflation is bad mainly depends on the circumstances and therefore, in specific context to Pakistan, we need to at least for now in the current economic picture term it as undesirable for Pakistan.

Almost everyone agrees that extremely rapid price increases—or hyperinflation—invariably spells trouble, both for the country and its people. These rapid increases destabilise the political system, turn middle class workers into paupers overnight, and make it impossible for businesses to plan. Weimar Germany, where hyperinflation helped to usher Hitler into power, is often cited as a case in point on the extent of ultimate damage inflation can kick-start or even cause! On a slightly more mundane note, high inflation is essentially never good for business.

According to a very extensive recent study conducted by Aswath Damodaran of NYU’s Stern School of Business, financial assets historically have almost always fared poorly during inflation booms. The argument being simple: One will need to make higher returns to even break-even.

[6.6-magnitude quake jolts off Indonesia's Banten, strong tremors felt in Jakarta](https://nation.com.pk/14-Jan-2022/6-6-magnitude-quake-jolts-off-indonesia-s-banten-strong-tremors-felt-in-jakarta)

Whereas, for a corporation it might have been attractive to invest money for a 3 percent annual payback before an inflationary burst, once inflation has taken off to 4 percent or beyond, its investment would actually be declining in terms of real-world purchasing power.

Additionally, inflation can be tough on the underlying business itself. Companies that lack pricing power—meaning that they cannot easily pass costs on to customers—suffer the worst, because they are forced to absorb input cost increases by taking a hit to their profit margin. Finally, high inflation invariably spurs the central bank to increase interest rates, in the name of cooling off the economy by slowing demand. And this is where the tricky part comes in, because if the central bank increases lending rates drastically, it could plunge the economy into a recession, which in-turn tends to be disastrous not only for the businesses, but also for everyone else. “The worse inflation is, the more severe the economic shutdown has to be to break the back of inflation.” — Damodran.

The trouble is that not every economy can survive through such shock therapy.