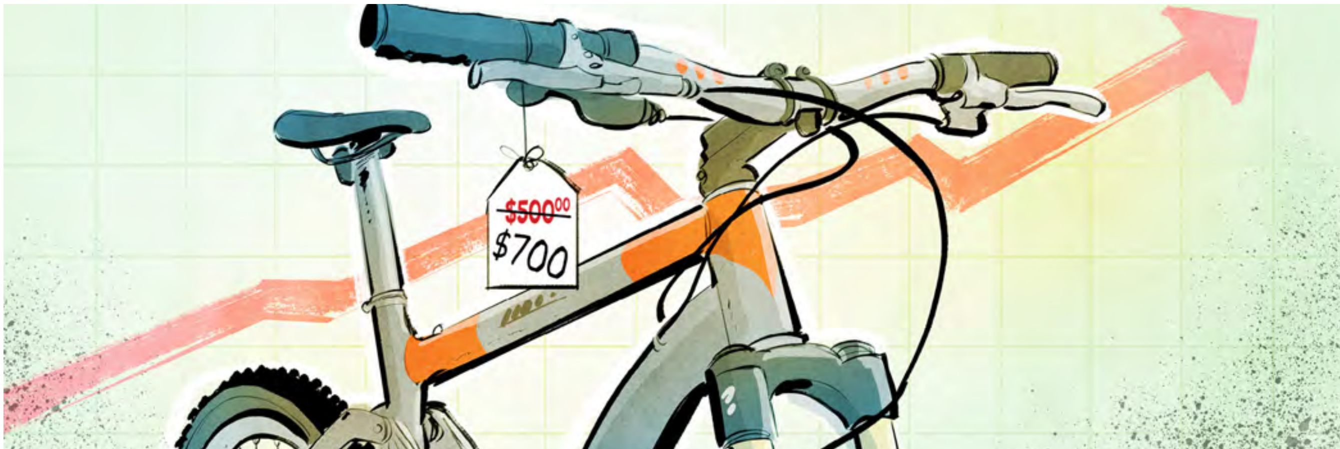
National

# Inflation Hits the Family Budget

## – A Loonie Doesn't Buy What It Used to




You've been saving up to buy a new $500 bike. For a full year, you've been working hard doing odd jobs and chores. Now, you're ready to make your purchase.

But the news isn't good. Your buying power isn't what it was just 12 months ago. The bike that used to cost $500 is selling for as much as $700 today. That's an increase of 40 percent.

Now you'll need to earn more money. And there's no guarantee that the price of your dream bike won't be out of reach when you're ready to buy it once again.

### Galloping Inflation

What accounts for the huge cost increase you've just experienced? Inflation. It has sent the price of goods and services soaring in Canada and around the world.

What is inflation? It's a continuing rise in the average level of prices over time. It occurs when there is an imbalance between supply and demand.

Supply is how much of something, such as a product or a service, is available to buy. Demand is how many buyers there are for those things. When there's more supply than demand, prices usually go down. When there's more demand than supply, prices often go up.

An increase in the price of a few items isn't a big problem. However, governments are concerned when prices rise too much and too quickly for many items. Why? Because when this happens, money loses some of its value. And if the buying power of a loonie decreases so much that people find it hard to purchase what they need, there is widespread hardship.

### The CPI "Basket"

In Canada, we measure inflation using the Consumer Price Index (CPI). The CPI reflects price changes that consumers pay for a fixed "basket" of goods and services. The CPI "basket" consists of a mix of necessities and luxuries. These range from food and shelter to clothing, transportation, and recreation.

The CPI keeps track of the monthly percentage that the cost for the total "basket" of items changes. These changes are averaged over a 12-month period to get the annual inflation rate.

### A Fine Balance

Some inflation is normal in a healthy economy. A steady rise in prices can even be good for a country's growth – as long as this inflation is predictable.

Suppose, for example, you're the owner of a small coffee shop. If you know that the cost of beans is going to rise at a reliable rate, you can prepare for the hike over time. You can gradually adjust your staffing, your menu prices, and other factors. When every business knows what to expect in this way, the value of a dollar usually remains on an even keel.

Moderate inflation can be good for average consumers, too.

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# Inflation Hits the Family Budget

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Say your family has borrowed money to buy a car. Inflation makes that debt shrink, because the borrowed amount has lost some value. Another example: if your family owns a home, as housing prices go up, that **asset** is now worth more.

## Pocketbook pain

However, too much inflation creates instability and insecurity. So what is the ideal level of inflation? Experts say that in Canada, it is two percent.

In 2020, the annual rate in our country was 0.7 percent – too low by that measurement. But by 2021? It had jumped to 3.4 percent. That made essential items such as food, clothing, and shelter more expensive. And in July, Canada's central bank predicted inflation would hit 7.2 percent in 2022. That's the biggest jump in 40 years.

This high inflation rate is causing pain among Canadians living on **pensions**. It's even impacting families with average incomes.

## Reasons for the rise

Several factors have contributed to current high inflation rates. One culprit is COVID-19. During the pandemic, many people received government help or had extra money that they would have spent on commuting or work clothing. So they shopped. They upgraded computers, bought workout equipment, invested in new appliances, and so on. The supply of these and other items didn't keep up with demand, so prices rose.

The Russia-Ukraine war is another factor. It is causing **supply chain** issues and material shortages. For example, over one-quarter of the world's wheat comes from Ukraine and Russia, but this wheat was trapped due to the conflict. So the cost of bread and related goods shot up. Higher wheat prices also affected farm animal food. That in turn drove up prices for chicken, beef, pork, dairy, and eggs.

Another reason? There are more jobs in North America today than there are people willing to fill them. To attract workers, employers have had to hike wages. They are passing those increases on to consumers.

## What can be done?

A rise in interest rates – that is, the cost to consumers and businesses of borrowing money – is the principal tool that **central banks** use to try to curb inflation.

In 2019, before the pandemic, when Canada's economy was stronger, the Bank of Canada made borrowing money cheap. Its rate was under two percent to encourage spending so the economy could grow.

But this July, Canada's central bank made the largest one-time increase in interest rates since 1998. The hike brought the rate up to 2.5 percent from the previous 1.5 percent.

How could this help? The logic is that when interest rates go up, people borrow less money. They cut spending on non-essential items as a result. Businesses, too, spend less. This cools the economy, causing the inflation rate to decrease – ideally back to two percent.

But will this tactic work this time around? You'll find out when it's time to buy a bike again. ★

## Definitions

**asset**: something such as money or property that a person or company owns

**central bank**: a country's national bank that sets its monetary policy and interest rates, and oversees its money supply

**pension**: money paid regularly by the government or a company to a person no longer working due to age or health

**supply chain**: the system of people and things that are involved in getting a product from the place where it is made to the person who buys it