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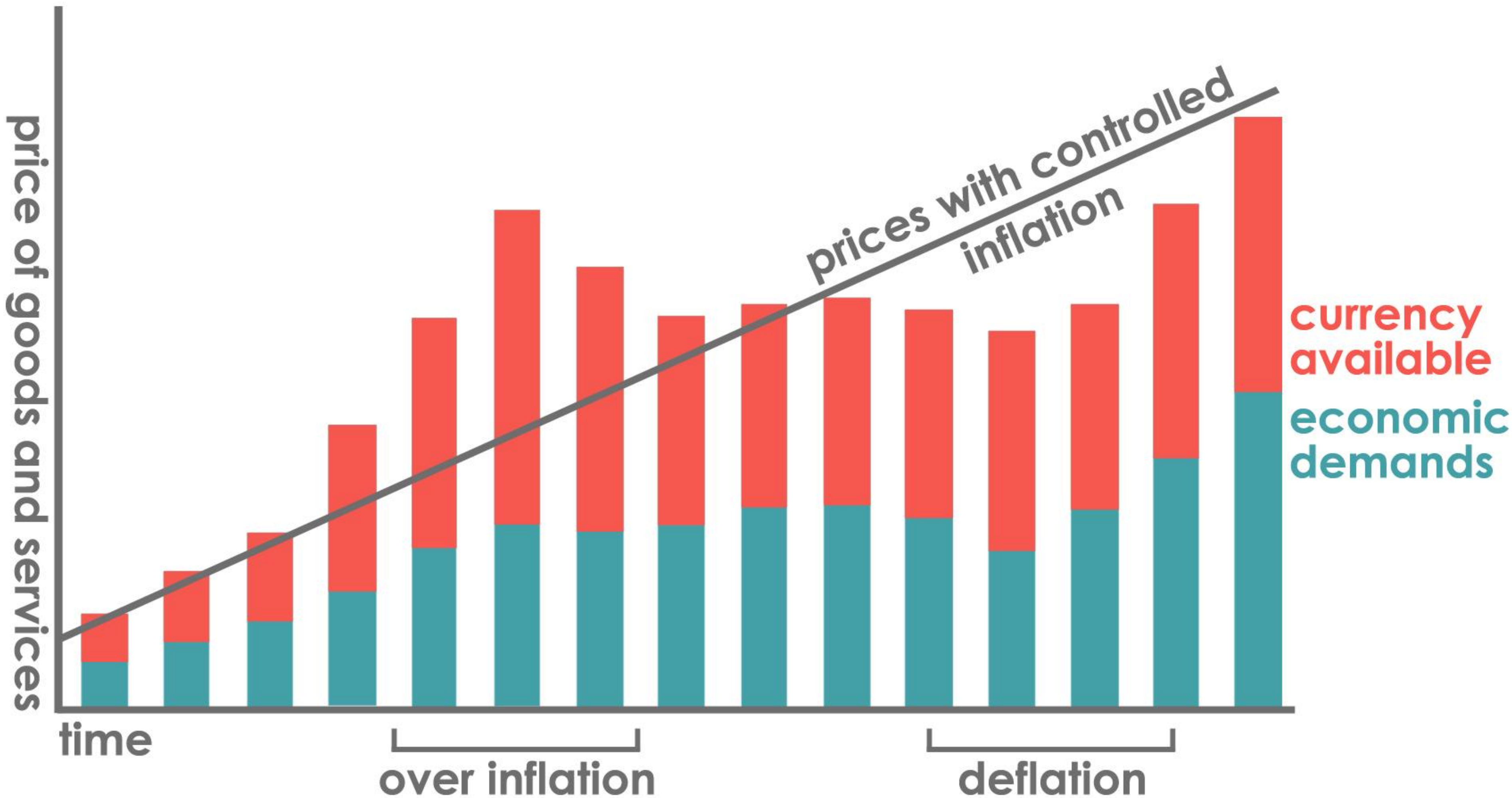
Inflation and Deflation

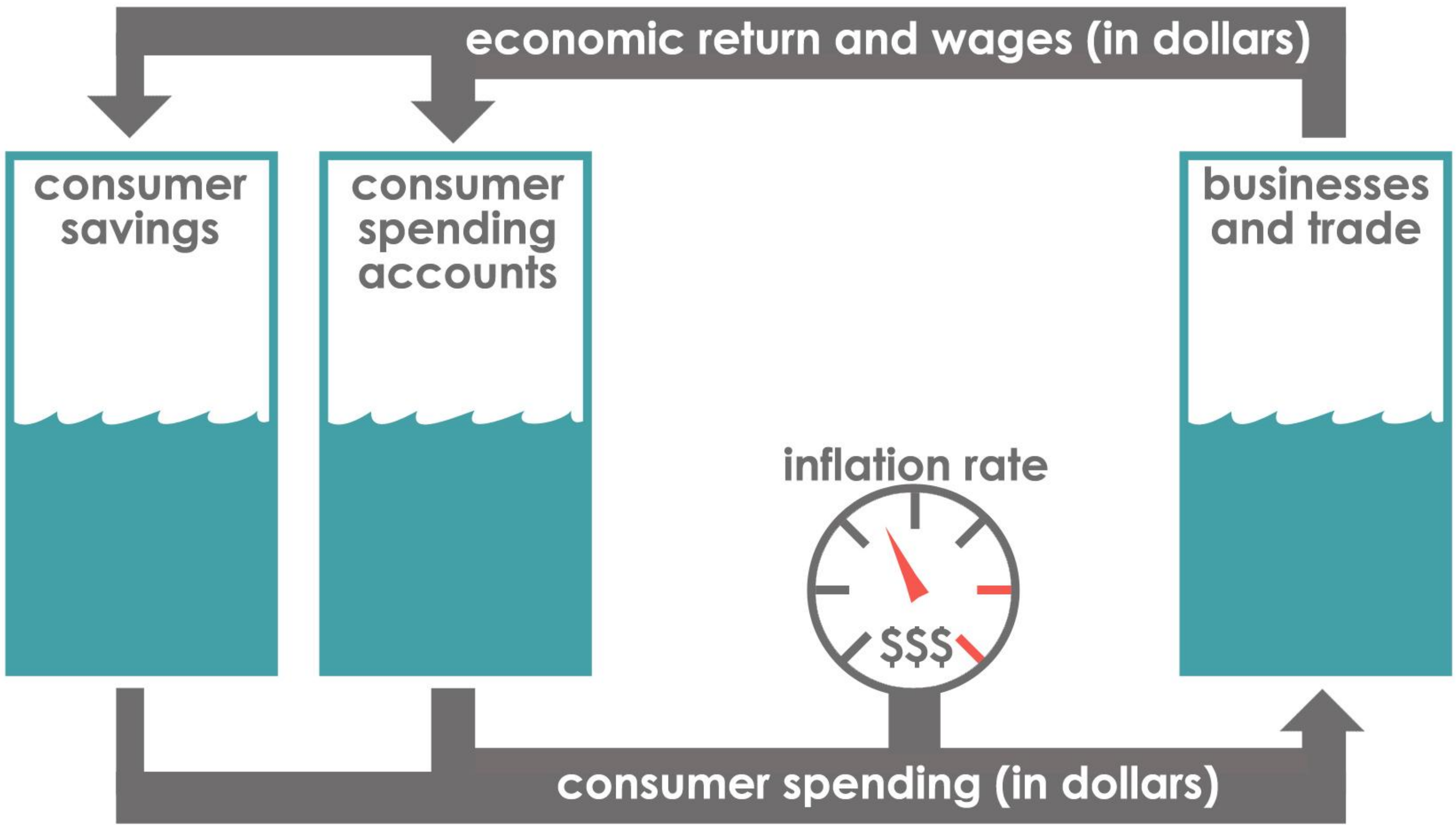
Inflation is a complex indicator of economic developments. Along with its opposite, **deflation**, inflation expresses changes in the availability of currency and/or the amount of money needed within an economy. If there are too many dollars in the system, sales prices inflate to compensate—each dollar buys you less. If currency is in demand, prices deflate—each dollar is able to buy you more. While controlled inflation can help prevent short-term shocks to the economy, **over-inflation** can causes serious problems in local markets and can greatly reduce the value of personal savings. Deflation typically occurs when a prolonged recession causes the economy to shrink repeatedly. Decreasing prices encourage people to hold onto money and wait for cheaper goods, causing the economy to shrink further. This cycle can become a "**deflationary spiral"** and is extremely dangerous.



Inflation: Dollars in Exchange

Though there are many views of inflation, one way to think of it is as “dollar pressure” on goods. A simple economy consists of consumers (who save and spend) and businesses that take money, grow and pay wages to workers. As money is added, more dollars move through the system, increasing pressure and causing prices to inflate. However, even if no money is added, increased consumption can simulate additional money through speed of its use alone. This “fast” money puts pressure on prices and can lead to economic bubbles. In a normal growth economy, worker wages tend to rise consistently, generating predictable inflation.

Saved money moves slowly, but in a normal economy the in-out flow of saved money equalizes. Many times, when the economy slows, the government will lower the federal borrowing rate, making credit easier to obtain and saving less appealing. As money drains out of savings, it feeds spending and investment, jumpstarting the economy. However, if rates are lowered and savings are ignored during a healthy economy, this practice can overheat the economy and needlessly drive up prices.



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