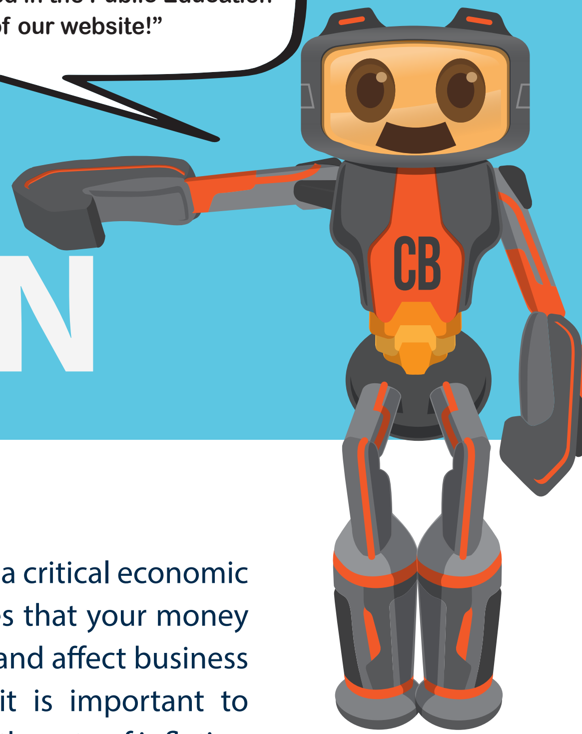
Central Bank of Trinidad & Tobago

INFLATION



What is Inflation and why is it important?

Inflation refers to movements in the general price level. It is a critical economic concept as it can reduce the amount of goods and services that your money can buy (purchasing power of money), discourage savings and affect business investment decisions. For all these reasons and more, it is important to accurately interpret movements in the rate. A slowdown in the rate of inflation does not mean that price levels have decreased. Rather, it means that price levels are increasing, but at a slower rate in comparison to the previous period. Since inflation is a rate of change, once the rate is positive, it implies that prices have increased. On the other hand, a fall in prices is reflected by a negative inflation rate.

Headline versus Core Inflation

Generally, when we speak of inflation we refer to what is known as **headline inflation** which examines general price levels. In Trinidad and Tobago, this is broken down further into **food inflation** and **core inflation**. Food inflation, as the name suggests, examines movements in general food prices. It tends to be much more volatile and is affected by a multitude of factors. These include, but are not limited to, weather patterns, health factors, seasonal demand and international prices (for goods which we import). For the Trinidad and Tobago economy, core inflation omits the food component.

It can affect purchasing power.

High inflation may discourage saving.

The rate of inflation could influence business investment.

Types of Inflation

Historically, the rate of inflation in Trinidad and Tobago has moved with our domestic economic cycle. When the economy is in an upswing we find economic activity tends to accelerate. In times of these upswings, demand outpaces supply creating a scenario of "too much money chasing too few goods". This creates what is known as **demand-pull inflation.** When demand is great, and the supply does not increase to meet this high demand, price levels tend to increase. The competing forces of economic agents (households, businesses, etc.) vying for limited resources drive prices upward.

There also exists what is known as **cost-push inflation.** This occurs due to price increases for the inputs needed to produce a good. When the overall costs of production increase, producers may choose to pass on these higher costs to the consumer in the form of higher prices. Cost-push inflation also occurs on account of depreciations in our local currency which may make imports more expensive. That is, when the value of our local currency falls, the cost of the foreign exchange required to import inputs also increases.

How is inflation measured?

To measure inflation, the Central Statistical Office (CSO) computes a monthly index, the Retail Price Index (RPI). This index[1] represents the overall price of a fixed group/basket of consumer goods. This basket is meant to reflect goods and services representative of the general spending patterns of consumers. The inflation rate is the rate of change in the index from one year to the same time in the previous year. In other words, an inflation rate of 2 per cent in any given month means that prices in that month are 2 per cent higher than they were in the same month exactly one year before.

So, if the inflation rate falls from 2 per cent in one month to 1.5 per cent in the next month, this does not mean that prices have fallen. They have actually risen in both months (note that the inflation rates were positive in both months), but prices increased more slowly in one month (1.5 per cent) vs. the prior month (2 per cent).

The Central Bank working for you

A major goal of the Central Bank of Trinidad and Tobago (CBTT) is to preserve price stability – to keep inflation in the optimum range, i.e. neither too low nor too high. To maintain an optimal and stable inflation rate, the CBTT uses its monetary policy tools.

1. This index is a statistical measure of changes in the prices of a basket of goods and services designed to help compare how these prices differ between time periods. The index examines a collection of price movements as opposed to price movements for an individual commodity.