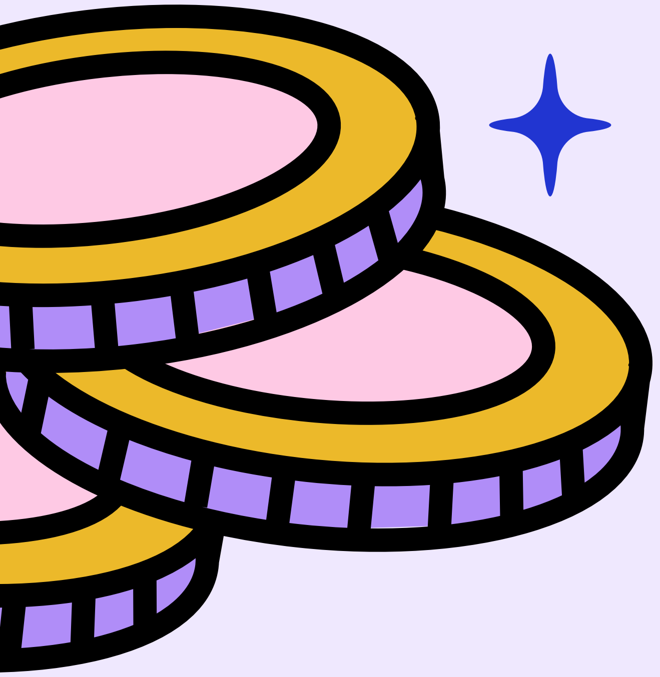
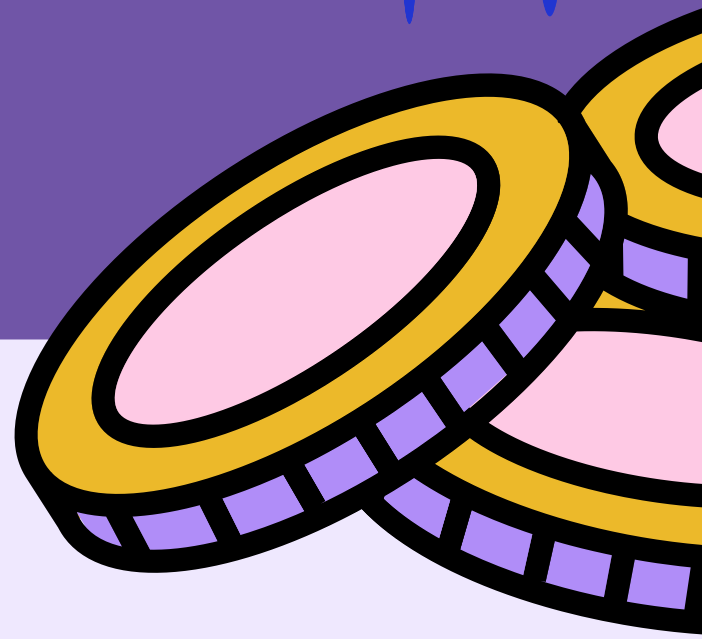
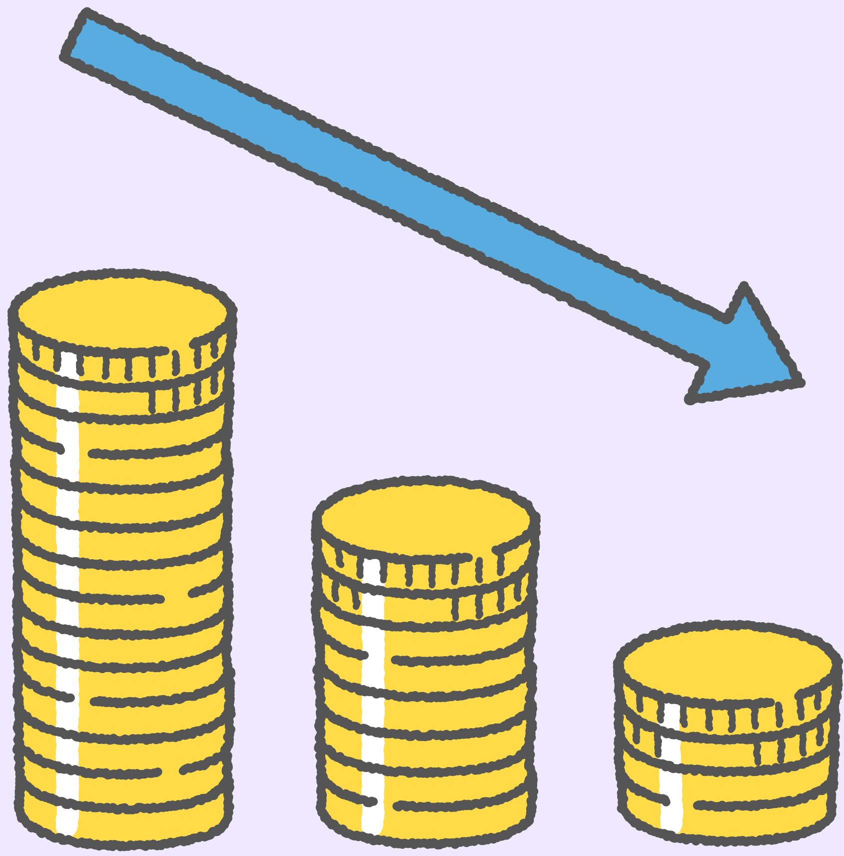
METHODS OF REGULATING INFLATION

CONCEPT AND ESSENCE OF INFLATION





Inflation is a persistent, substantial rise in the general level of prices for goods and services over a period of time. When the general price level rises, each unit of currency buys fewer goods and services; consequently, inflation reflects a reduction in the purchasing power per unit of money. It is not just a one-time increase in the price of a specific product, but a broad-based economic phenomenon that affects the entire national economy. The main indicators used to measure it are the Consumer Price Index (CPI) and the Producer Price Index (PPI).



In simple words: Inflation is when money depreciates. If you used to be able to buy a full package of products for 100 hryvnias, but now you can only buy half of it, this is a consequence of inflation.

TYPES AND CAUSES OF INFLATION

To regulate inflation effectively, it is crucial to identify its roots. Demand-Pull Inflation occurs when the total demand for goods and services exceeds the economy's ability to produce them ("too much money chasing too few goods"). Cost-Push Inflation arises when the costs of production increase (e.g., higher wages or raw material prices), leading businesses to raise prices to maintain profit margins. Additionally, Built-in Inflation is linked to adaptive expectations, where workers demand higher wages to keep up with rising living costs, creating a continuous price-wage spiral.

In simple words: People have more money, but not more goods (demand), or it becomes more expensive to produce goods due to the prices of gasoline or electricity (costs).

MONETARY POLICY: INTEREST RATES

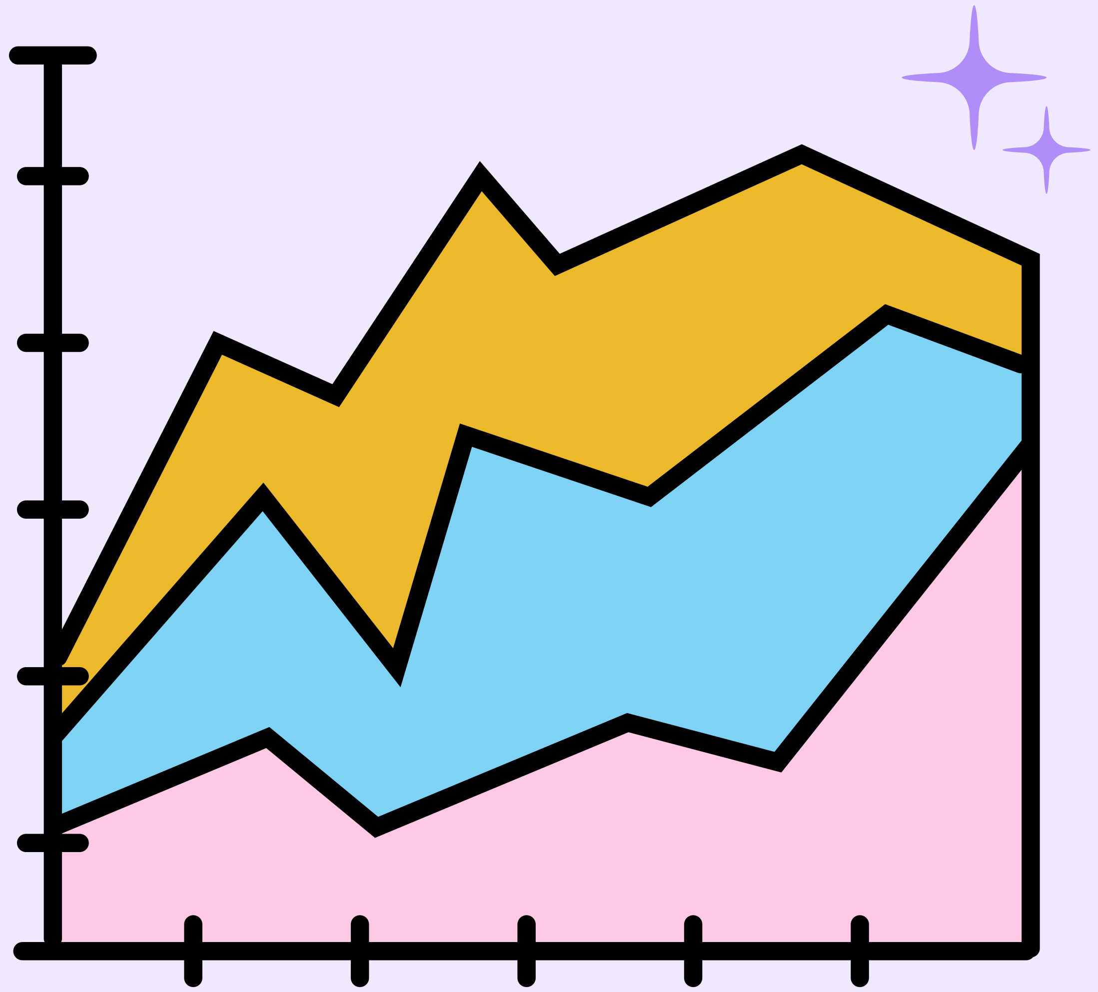
The primary tool of a Central Bank to curb inflation is the adjustment of interest rates (monetary contraction). By increasing the policy rate (refinancing rate), the Central Bank makes borrowing more expensive for commercial banks, businesses, and consumers. Higher interest rates encourage saving rather than spending and discourage taking out loans for consumption or investment. This reduces the total money supply in circulation and cools down the economy, leading to a gradual slowdown in price growth.

In simple words: The bank raises interest rates on loans. It becomes more expensive for people to borrow money, they buy less, demand falls, and prices stop growing so quickly.

OPEN MARKET OPERATIONS

Open Market Operations involve the buying and selling of government securities (bonds) by the Central Bank. To reduce inflation, the Central Bank sells government bonds to commercial banks and the public. When banks buy these securities, their cash reserves decrease, which limits their ability to issue new loans. This process effectively "mops up" excess liquidity from the financial system. By reducing the volume of money available in the economy, the Central Bank exerts downward pressure on inflationary trends.

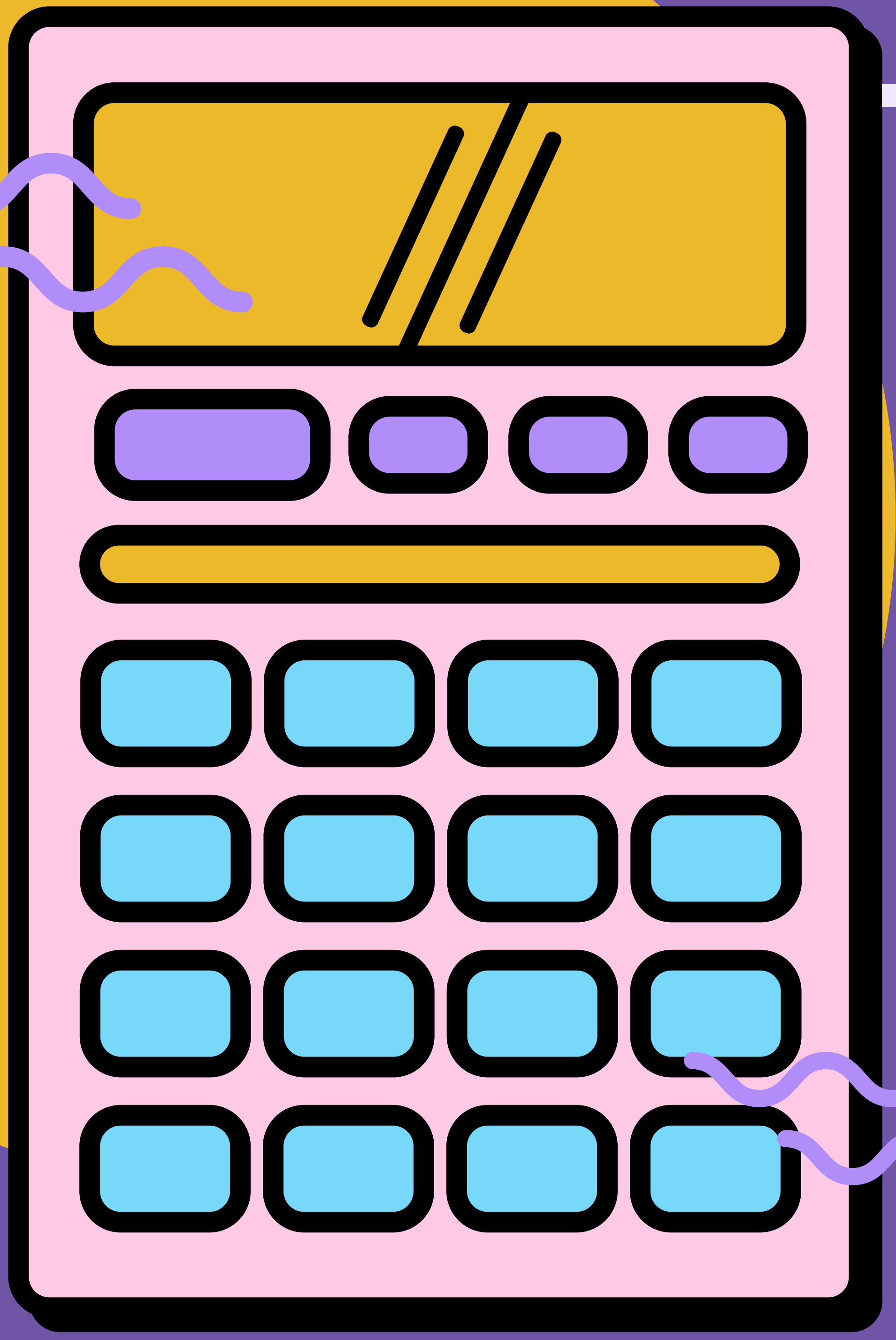
In simple words: The government sells securities (paper with a promise to return the money later) to take "excess" cash out of the hands of banks and people.



RESERVE REQUIREMENTS

The Central Bank can regulate the money supply by changing the required reserve ratio. This ratio dictates the minimum percentage of deposits that commercial banks must keep in their accounts with the Central Bank instead of lending them out. By raising reserve requirements, the Central Bank reduces the money multiplier effect, meaning commercial banks have less capital available to create credit. A tighter credit market leads to lower spending and investment, which helps stabilize the price level.

In simple words: the National Bank tells regular banks: "You can't give all your money out as loans, you have to hide some of it in a safe." People have less money — inflation falls.



FISCAL POLICY: TAXATION AND SPENDING

Fiscal policy is the use of government spending and taxation to influence the economy. To combat inflation, the government can implement Contractionary Fiscal Policy. This involves increasing taxes, which reduces the disposable income of households and the after-tax profits of corporations, thereby lowering aggregate demand. Additionally, the government can reduce its own public spending on infrastructure, subsidies, or services. A lower budget deficit (or a surplus) reduces the amount of money flowing into the economy, helping to balance supply and demand.

In simple terms: The government raises taxes or starts spending less itself. People and businesses have less "free" money to spend.

SUPPLY-SIDE POLICIES

While monetary and fiscal policies focus on demand, supply-side policies aim to reduce inflation by increasing productivity and economic efficiency. These include deregulation, investments in technology, and infrastructure improvements that lower production costs. By making the economy more competitive and efficient, the aggregate supply of goods increases. When the supply of goods rises to meet or exceed demand, price levels naturally stabilize or decline. This method is particularly effective against cost-push inflation without causing a recession.

In simple terms: Instead of taking money from people, the government helps factories produce more goods faster and cheaper. When there are a lot of goods, their prices do not rise.

EXCHANGE RATE REGULATION

In an open economy, the exchange rate significantly affects domestic inflation. By promoting a stronger national currency, a country can reduce the cost of imported raw materials, energy, and finished goods. This is known as "importing low inflation." Central Banks may intervene in the foreign exchange market by selling foreign reserves to buy the local currency, increasing its value. A stronger currency makes exports more expensive but helps keep domestic prices stable by making essential imports cheaper for consumers and manufacturers.

Simply put: If the hryvnia is strong, imported goods (like gasoline or appliances) are cheaper. This restrains the overall price increase in the country.

INCOME POLICY AND DIRECT CONTROLS

Direct intervention or "Income Policy" involves the government setting limits on wage increases and price growth. This can be done through voluntary agreements with labor unions and businesses or through mandatory price freezes on essential goods and services (like utilities or bread). While direct controls can provide short-term relief during periods of hyperinflation, they are often criticized for creating market distortions, shortages, and "black markets." Economists generally prefer market-based instruments over administrative price fixing.

In simple terms: The state simply says: "I forbid raising prices above this limit." This helps quickly, but not for long, because the goods may simply disappear from stores.

INFLATION TARGETING ↗

Inflation targeting is a modern framework where the Central Bank publicly announces a specific medium-term numerical target for the inflation rate (e.g., 5%). The bank then adjusts its monetary tools to ensure the actual inflation stays close to this target. This strategy increases transparency and builds public trust. When businesses and households believe that the Central Bank will maintain low inflation, they adjust their expectations accordingly, which prevents the self-fulfilling prophecy of rapid price hikes.

In simple words: the National Bank says: "We will make sure that inflation is exactly 5%." Everyone believes it, does not panic and does not buy everything at once, which in itself helps to keep prices normal.

THANK YOU FOR YOUR ATTETION