Modern America
Ms. Shen

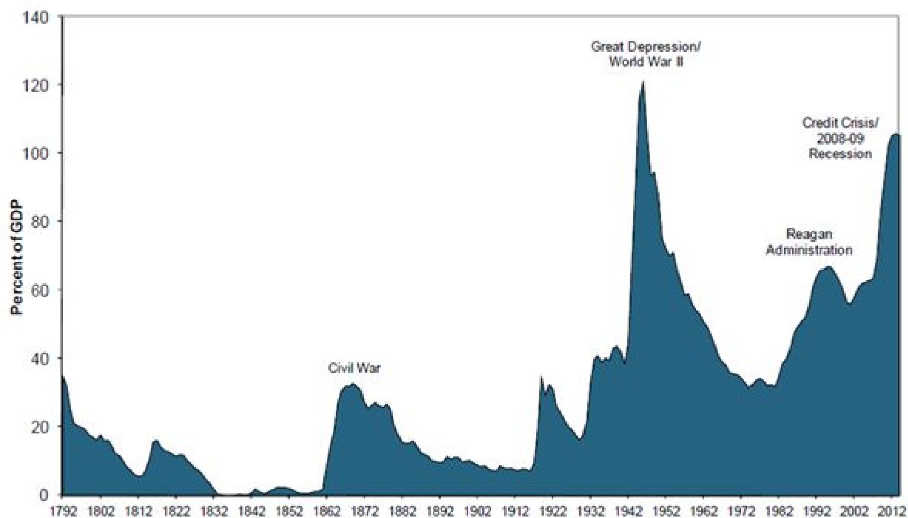
Name: ________________________________

Stagflation

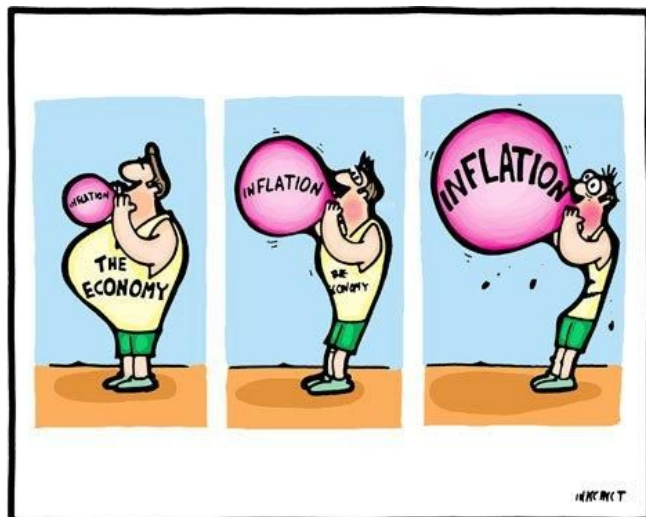
Stagflation is term that describes a "perfect storm" of economic bad news: high unemployment, slow economic growth and high inflation. The term was born out of the prolonged economic slump of the 1970s, when the United States experienced spiking inflation in the face of a shrinking economy, something economists had previously thought to be impossible.

The word stagflation didn't even exist until the 1970s. From 1958 to 1973, the United States experienced what's known as the "Post-War Boom." During this time, U.S. manufacturing and production of goods was growing, thereby increasing the nation's wealth as compared to other nations. The measure of a nation's wealth is often determined by placing a dollar value on all of the products produced and sold by that nation (GDP). During the post-war period, gross annual products in Western nations like the U.S. grew by an average of 5 percent annually, fueling a slow but steady rise in prices (inflation) over the same period.

QUESTION: What can you say about the "post-war boom"?



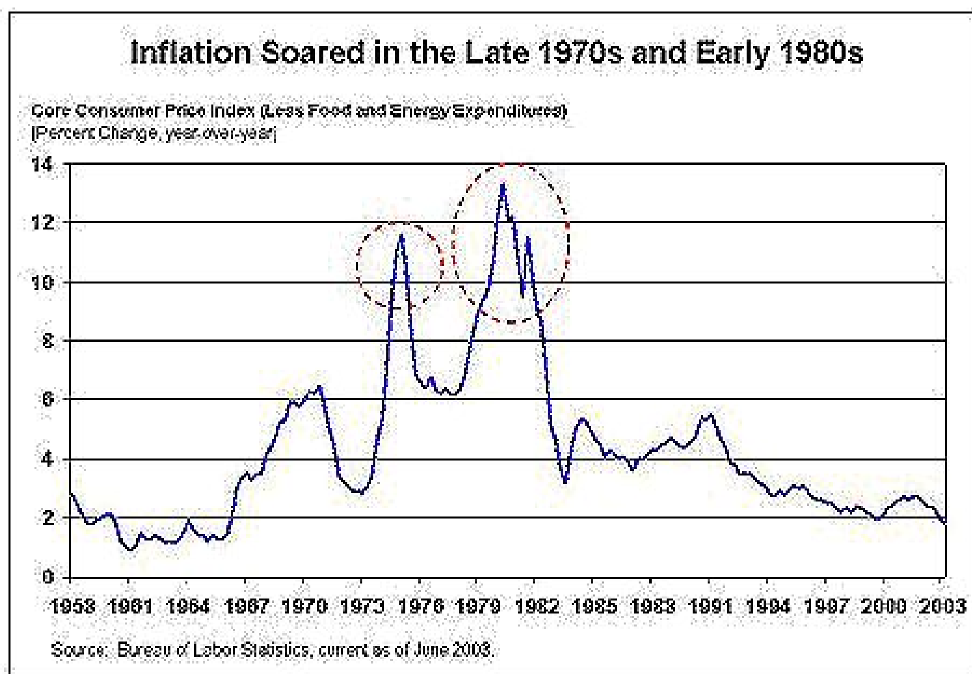
In a healthy economy, ideally, the value of goods & services rise at a similar rate as prices. This growth should happen gradually (a rapid rise is called hyperinflation and that is BAD!) As a frame of reference, today's inflation rates are around 2% which is considered healthy. In post-WWI Weimar Germany, inflation ran into the tens of thousands (it was cheaper to burn money for fuel than it was to buy a loaf of bread)!



DEFINE: "**<u>Inflation</u>**"

During the 1970s in the U.S., the inflation rate was 5.5%. By 1974, it was 12.2%, and it peaked at a crippling 13.3% in 1979.

WHAT IS THE TREND IN INFLATION RATES IN THE 1970s?



The stock market was also negatively impacted. From 1970 to 1979, the value of stocks increased but at a lower rate than inflation. Let's look at the S&P 500 as an example. This is one of the ways we measure the health of the stock market is through a look at 500 large companies that sell stock. The S&P 500 saw a growth rate on average of 5.9% annually. But when you subtract for inflation, (average 7.4% annually), the market lost value every year.

In the 1970s, the U.S. experienced something called "stagflation." The word stagflation is a contraction of "stagnant" and "inflation."

- INFLATION: (See above!) :(
- ECONOMIC STAGNATION: When the economy is stagnant, it means that the gross domestic product (GDP) -- the standard measure of a nation's total economic output -- is either growing at a very slow rate or shrinking.
    - UNEMPLOYMENT: The natural result of economic stagnation is increased unemployment. Businesses lay off employees to save money, which in turn decreases the purchasing power of consumers, which means less consumer spending and even slower economic growth.

Thanks to growing inflation, prices continued to rise and workers expected their wages to rise accordingly. For a while, employers were willing to raise wages, but then inflation began to rise faster than wages so employers stopped raising wages.

Adding more fuel to the fire, the OPEC oil embargo of 1973 (REMEMBER THE NOTES ON THE ENERGY CRISIS) brought oil prices to record new levels. Prices skyrocketed, not only at the gas pump -- where long lines and shortages were common -- but across all U.S. industries.

DEFINE IN WORDS THAT MAKE SENSE TO YOU: "**Stagflation**"

Stagflation is dangerous. Imagine a scenario in which you have both a sinking economy and runaway inflation. With high unemployment, consumers have less money to spend. Add inflation, and the money they *do* have is worth less and less every day. If you're on a fixed income, inflation erodes the value of your monthly check. And if you've managed to save some money, inflation eats away at its value, too. Inflation is a real confidence killer in an already depressing economic environment.