

Analysis of the Causes of Inflation in China and Policy Solutions

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Abstract: This paper recollects Minister Zhu Rongji's successful implementation of an impermeable economic system in China, leveraging the power of the market economy. However, the recent evidence and data presented in the articles indicate a significant dependence on income derived from the real estate industry and state-owned enterprises within the Chinese government. This heavy reliance, paired with mounting debts and the prominence of powerful corporations, paints a potentially troublesome picture. Consequently, the writer expresses a preference for the exploration of novel solutions to maintain China's economic prosperity, encouraging a shift away from reliance on these sectors. In conclusion, the identified factors surrounding inflation in China necessitate careful consideration and proactive measures to avert potential repercussions on both the domestic economy and the broader global stage. The writer emphasizes the importance of addressing these concerns with deliberate attention and a forward-thinking approach to safeguard China's prosperity and contribute positively to the overall stability of the world economy.

Keywords: inflation, China, policy

1. Introduction

China's economy has presented a difficult obstacle in the form of managing inflationary pressures in recent years. This specific investigation delves into the web of intricate causes and effects surrounding inflation in China. Pertinent literature and statistical data have provided insights on the issue. Inflation, a term for extended surges in price levels, is rooted in numerous origins in China. These include amplified domestic demands caused by increased incomes, fluctuations in commodity prices, especially in food and energy, and a liberal monetary policy that includes abundant money supply and easy credit access [1]. Multiple factors caused the China's inflation. Firstly, an increase in domestic demand, supported by rising incomes and consumption, has led to pressure on prices for many Chinese citizens. Secondly, fluctuations in commodity prices, especially those related to food and energy, heavily impact China's inflation rate due to its heavy dependence on imports for these commodities [2]. Additionally, expansionary monetary policy, characterized by increased money supply and easy access to credit, has also been a contributing factor [1].

The Chinese economy is heavily influenced in a variety of sectors due to inflation. Households' living standards will be lowered and there will be reduced consumption as a result of the reduction in consumers' purchasing power [3]. Production costs will increase, putting added pressure on small and medium-sized businesses, which may suffer financially and have to cut jobs [4]. Furthermore, inflation creates uncertainty that affects investment decisions, reducing actual investment returns [5]. The adverse impact of inflation on vulnerable groups with limited access to resources and assets raises concerns. Additionally, social inequality is further magnified, making it an even more pressing issue.

2. Case Description

In recent years, China has been facing a significant challenge in regulating its inflationary pressures. This case description explores the causes and effects of inflation in China, by using upon relevant literature and statistics to provide insights into this economic phenomenon.

Inflation has enormously effects on several sectors of the Chinese economy. Firstly, it decreases consumers' purchasing power, leading to declined consumption and decreased standard of living for households [3]. Secondly, inflation puts pressure on businesses, particularly small and medium-sized businesses, by increasing their production costs, which may lead in decreased profitability and potential job losses [4]. Moreover, inflation impacts investment decisions, as it increases uncertainty and reduces the real return on investment [5]. Lastly, inflation can also lead to social inequality, as it disproportionately affects vulnerable groups with limited access to resources and assets.

To combat inflation, Chinese policymakers have implemented a combination of fiscal and monetary measures. Firstly, the People's Bank of China has adjusted interest rates and reserve requirements to tighten monetary policy and limit credit growth [6]. Secondly, the government has implemented price controls and subsidies to stabilize essential commodities' prices, such as food and energy [5]. Additionally, policymakers have focused on promoting supply-side structural reforms to enhance productivity and reduce production costs [7].

China's inflation challenge represents a significant economic issue that requires effective policy responses. By understanding the causes and effects of inflation, policymakers can set up appropriate measures to ensure stability and sustainable economic growth. Continual monitoring of inflationary pressures and valuable macroeconomic management will be crucial for mitigating the adverse impacts of inflation on China's economy and its citizens' well-being.

3. Analysis on the Problems

Inflation refers to a comprehensive and sustained phenomenon of price increases that occurs in the operation of the economy. The problem of currency depreciation caused by the excess of money supply over actual demand. There are two indirect causes of inflation, namely cost-push and demand-pull [8]. Cost-push inflation is specifically a higher price level caused by higher cost production factors. In the demand supply curve, an increase in production costs will cause the supply curve to shift to the left, leading to the emergence of new price equilibrium points and an increase in price levels [8]. The reason for the cost increase may be due to the increase in raw material costs. For example, a company that relies on oil production may choose to increase product prices while maintaining profits due to the rise in international oil prices. Another reason is due to the increase in wages, resulting in an increase in labor costs [9]. Demand-pull inflation, as the name suggests, refers to the rise in price levels caused by excessive demand. The total demand includes consumption, investment, net exports, etc., but the increase of these factors does not directly lead to inflation. If there is still spare capacity in the economy, but once there is a shortage of resources, the total supply cannot match the total demand, and inflation will occur [9]. Demand-pull inflation also includes monetary inflation, where excessive demand is due to excessive money supply [9].

For China, the main reason for its inflation in modern times is the significant increase in labor costs, and the era of population dividend has passed. With the constraints of population policies, the era of population dividend in China has also begun to show a declining trend. In addition, China has continuously introduced policies to increase labor wages and benefits, resulting in a significant increase in the average wage of urban employment in China. The pressure of wage increases directly leads to price increases, which to some extent leads to inflation [10]. Secondly, the decline in agricultural product production caused by natural disasters is also one of the main reasons for inflation. Since the 1990s, the profits of intermediate links in the circulation of agricultural products in China have far exceeded those of producers. The excessive hype in the liquidity sector has led to an escalation of inflation expectations. Speculative speculation and hoarding are the main culprits that exacerbate inflation [10].

4. Suggestion

The problem of inflation in a country usually requires a range of macroeconomic policies to address it. Inflation is a generalized increase in prices that may have negative economic and social impacts. China needs to adjust to it by controlling its currency, and the central bank can adopt a tight monetary policy, thereby raising the benchmark interest rate and reducing the money supply, i.e., when aggregate demand is greater than aggregate supply, and economic growth is overheating, creating inflationary pressures, the central bank reduces the money supply by tightening the monetary stance to curb the momentum of the expansion of aggregate demand.

Monetary adjustments can also be made by appreciating the currency in order to reduce the cost of imports and alleviate inflationary pressures. Because many enterprises are not fully participating in the market now, the state can prevent large enterprises from abusing their monopoly position in the market to raise prices through control, so that small and medium-sized enterprises can participate in the market. The government also needs to consider putting the prices of key commodities in the mimeograph under control to prevent prices from rising too fast.

On the market side the government can invest in infrastructure to raise productivity levels and reduce production costs, which will help to curb inflation. Similarly, technological innovation is a very important thing to encourage innovation and technological progress in order to increase productivity.

In terms of foreign policy, there is a need to manage and optimize trade policy to ensure stable imports and exports, which will help balance the foreign exchange market. An example is like after the outbreak of the epidemic in 2020, international oil prices fell below \$0 for a while, and China's domestic oil and gas prices also fell sharply. While international oil prices bottomed out in April 2020, the rate of decline in China's oil and gas prices began to slow down, and began to rise rapidly in early 2021, with the rate of growth reaching a peak in May of the same year. In the second half of 2021 to the present day, China's oil and gas prices are still rising, but at a significantly lower rate of growth. It can be seen that China's gasoline price increase is in the same direction as the international crude oil price increase. Controlling imports and exports is helpful to balance the foreign exchange market [11].

In education and training can be used to improve the skills of the labor force through education and training to increase the employment rate, thus reducing the social impact of inflation.

The solution to inflation will take some time, and more importantly, it will require non-stop patience and sustained efforts all the time.

5. Conclusion

Inflation generally refers to the phenomenon of sustained and widespread price increases over a period of time caused by the currency supply exceeding the actual demand for money and the actual purchasing power exceeding the output supply, resulting in currency depreciation under the conditions of paper currency circulation. This article completes the analysis of the causes of modern inflation in China through literature search and analysis, and concludes that the main reason is cost-push inflation, which is due to the rise in labor costs and wages, as well as the rise in energy and raw material prices. Secondly, the increase in people's income has led to an increase in total demand, leading to demand-pull inflation. The decline in agricultural product production caused by natural disasters. Through analysis, it has been found that inflation will have a more serious impact, leading to a decrease in people's purchasing power and a decline in their living standards. Some small and medium-sized enterprises may reduce production costs through layoffs, resulting in potential unemployment risks. The wealth gap in society has increased. However, inflation can also be weakened and prevented through a series of policy measures, and the central bank can adjust the money supply and interest rates through monetary policy. The government can use supply side policy to invest in infrastructure, encourage innovation, and provide education and training to improve production efficiency and reduce costs. By studying inflation in a country, companies can make future investment predictions and reflect the current economic development status of the country. The harm that inflation brings to society is very serious. Inflation can cause price increases, social unrest, and instability in people's minds. The research method of this article focuses more on case analysis and theoretical analysis, so more rigorous quantitative research and model calculations are needed in the future to support it.

Authors Contribution

All the authors contributed equally and their names were listed in alphabetical order.

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