How to Explain Inflation In Terms Simple Enough for a Child

Kids may not know what inflation means, but they're sure to notice when their allowance money suddenly doesn't stretch as far. As it turns out, the current price hikes provide an opportunity to help children understand the importance of smart financial planning.

By **Erica Jackson Curran** | Published on June 1, 2022

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At the gas pump, the grocery store, and our favorite restaurants, we've all felt the squeeze of inflation—and it's very likely that our kids have noticed, too. True, they may not be able to tell us what inflation means, but they'll realize their allowance money suddenly doesn't stretch so far. While the economic impact of inflation is hard-hitting, it provides an opportunity to help kids understand the economy and the importance of smart financial planning.

Brette Sember, former attorney and author of *The Everything Kids' Money Book*, says that a discussion about inflation may help kids be more understanding of parents' current financial struggles. "Kids may see that their parents are stressed or worried about money," Sember says. "Explaining inflation can help them put a name on it and understand what has happened."

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What Is Inflation?

Inflation, at its most basic definition, is a rise in prices. Parents should have no trouble finding examples to illustrate the concept, whether at the toy store or their family's favorite ice cream shop. For instance, a baseball bat that cost $20 two years ago may now cost $25, while a $6 banana split might be closer to $10. Inflation means our overall cost of living is going up.

Inflation is measured in a number of ways, but one of the most common measurements is the Consumer Price Index (CPI), used by the U.S. Bureau of Labor Statistics. The CPI gets its figures by surveying thousands of businesses and recording the prices of 80,000 consumer items each month—everything from food and clothing to housing costs and health care.

The Federal Reserve aims for a target inflation rate of 2%, but our current inflation rate in 2022 is more than 8%. Check out the U.S. Bureau of Labor Statistics' inflation calculator to see how this works.

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What Causes Inflation?

Inflation happens for many reasons, but they can be broken down into three main categories.

Demand-Pull Inflation: This happens when the supply of products or services can't keep up with demand. For example, nine kids want a banana split, but there's only enough ice cream to make five. The ice cream shop may raise their prices because they have fewer banana splits to sell, but they know some of their customers are willing to pay more to satisfy their cravings.

Cost-Push Inflation: The cost of producing products and services goes up, and businesses must raise their prices to continue making money. In the ice cream shop scenario, cost-push inflation would happen if the cost of ingredients like milk and sugar increases, and the ice cream shop owner has to raise prices in order to continue making a profit.

Built-In Inflation: This type of inflation happens when workers need higher wages to keep up with rising living costs. So if the ice cream shop's employees earn raises because their bills have increased, the shop's owner may raise ice cream prices to help cover those higher payroll costs.

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So what's to blame for today's record-breaking inflation? The COVID-19 pandemic, of course, is a major culprit. Many businesses are still struggling with supply issues created by staff shortages during the pandemic. On the other hand, many consumers have more money to spend, thanks to government stimulus payments, and interest rates are still relatively low. These are just some of the factors that have combined to create the historic inflationary period.

Is Inflation a Bad Thing?

While moderate inflation is completely normal and even signifies a strong economy, a high inflation rate—or hyperinflation—means that the value of our money has gone down. And that's not a good thing. On the other hand, both deflation (when prices fall) and stagflation (when an economy stops growing) can be harmful to the economy in their own ways.

How Can Inflation Impact My Family?

From canceled family vacations to reduced grocery budgets, there are many ways inflation may impact families. This can be disappointing and even scary for kids, but Sember recommends assuring them that it's not a permanent problem. "Some things cost more right now, but the family is not going to completely run out of money," she says. "Gas is an example of a price increase that is impacting a lot of families. Yes, the price of gas has gone up and maybe your family is trying to cut back on how much gas you're using.... So maybe you are taking a bus sometimes or you're riding bikes to the library. Or maybe some days you just decide you won't drive anywhere at all."

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Inflation is creating real financial challenges for many families, but parents may be able to relieve at least some of the pressure by being honest with their children. "Get kids on board with finding ways to save money or reduce expenses," Semper says. "Things that they can help with then become less scary."

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