

## MICROECONOMICS AT WORK EXERCISE

### THE DETERMINATION OF PRICES – AND THE AGGREGATE EFFECT

**REFERENCE:** Laura Cohn, ‘**Continental Drift – Toward Inflation**’, *BusinessWeek*, 13 October 2003, pp. 58-9.

**CHAPTERS RELEVANT TO THIS EXERCISE:** Chapters 3, 6, 7

### OVERVIEW

As a result of a number of demand and supply factors, prices in several international markets for *commodities* (minerals and agricultural products) have risen in a fairly short period of time – up to 30% in the case of wheat. This applies in many world markets, but particularly those in the geographical area of continental Europe (which allowed the sub-editor some fun with the heading). The aggregate effect of these increases is a *general* increase in the level of prices across the economy i.e. inflation.

### QUESTIONS

1. What have been the major influences on the price of wheat?
2. How has the price of wheat been reflected in the price of commodities that it is used to manufacture?
3. Has it been demand or supply influences that have had the major impact on the price of industrial metals? Explain the mechanisms.
4. Explain the references to ‘futures’ trading in these commodities.
5. What is the magnitude of the overall inflationary effect of these various price rises anticipated to be?
6. How is the increase in commodity prices likely to affect the determination of interest rates? What is meant by the reference to the incoming director of the European Central Bank as an ‘interest rate hawk’ mean and what effect is this likely to have?