Australians are concerned about inflation.
ABC News Business Reporter: Gareth Hutchens

Our expectations of future price increases have jumped to a six-and-a-half year high, after petrol prices increased more than 10 per cent just in the past fortnight.

But where is inflation heading?

And why in the world are some analysts talking about stagflation?

What is 'stagflation'?

"Stagflation" is a portmanteau of two words: stagnation and inflation.

The term was first coined in reference to the economic crisis that hit the global economy in the 1970s.

Multiple countries were hit by stagnant growth and rising unemployment, at the same time as high and rising inflation.

Australia was one of them.

Authorities couldn't grasp how high unemployment *and* rising inflation could occur simultaneously.

And at the same time, the world's financial system was being forced to adapt to US president Richard Nixon's decision, in 1971, to sever the link between the US dollar and gold.

It meant the global economy was having to transition, through the decade, to a new system of floating exchange rates and 'fiat' money (where currency has "value" because central banks and governments *say* it has value).

It was a chaotic period.

The old "full employment" growth model of the post-war years, and the global financial system on which it relied, were both breaking down in the 1970s.

Why was it such a problem?

Economist Saul Eslake, who was a junior Treasury official in the late 1970s, said the combination of high unemployment and rising inflation was baffling.

"I think policymakers struggled to understand stagflation partly because, at the time, economic theory and conventional wisdom didn't comprehend that you could have the two together," he told the ABC.

"Then, in part, because policymakers failed to recognise that the factor that was constraining potential economic growth was the fact that the oil shocks of the 1970s had rendered redundant a large part of the capital stock."

What does Mr Eslake mean by that?

What is Stagflation? Is Australia heading there?

Well, he said much of the world's manufacturing and transport technology in the 1970s was built on the assumption of cheap oil.

But the severe oil price shocks of that decade limited the rate at which economies could grow, because they rendered much of the capital stock commercially and economically irrelevant.

"But all policymakers could see was persistently high unemployment," he said.

"So they thought economies had spare capacity and room to grow further, which meant that they pursued stimulatory monetary and fiscal policies, and the result of those, given that the economy was actually constrained by a lack of capital, was high inflation, as well as high unemployment."

Saul Eslake, from Corinna Economic Advisory, says policymakers struggled for years to understand stagflation*(ABC News: Cameron Atkins)*

Mr Eslake said it wasn't until governments began focusing on policies that would expand the potential growth rate of the economy that they were able to break free from the combination of high unemployment and high inflation.

"It took Australia almost a decade longer to break free of that combination than it did most of the other advanced economies in the world," he told the ABC.

Are we seeing stagflationary dynamics today?

Currently, prices for cars have soared, property prices have exploded, and prices for oil, coal, and gas have skyrocketed.

The higher energy prices are feeding back into supply chains, as global growth starts to slow.

So are we again seeing any stagflationary dynamics?

Mr Eslake said there were some signs of higher inflation at levels of unemployment that we now regard as high, such as in the United States, in a way that we haven't seen in years.

But he said the institutional arrangements in Australia's labour market were today very different from what they were in the 1970s.

"A much smaller proportion of the workforce in almost all advanced economies belongs to unions, indexation clauses or cost-of-living adjustment clauses as they're called in the US, which applied to more than half of the workforce in the '70s and early '80s, are now far less commonplace," he said.

"We in Australia don't have wage indexation in the way that we did from the late 1960s until the late 1980s.

"So in that respect, in particular, I think it's less than likely that we're going to see a repeat of that [stagflation] experience, but it's by no means impossible, and financial markets are obviously very concerned about those risk."

Could this inflation just be temporary?

At the moment, economists are debating whether the uptick in inflation in regions such as North America, Europe, and Asia will be temporary, slightly-longer lasting, or become endemic.

Claudia Sahm, a former US Federal Reserve economist, said, although the next year or two will be painful, she thinks at this stage that the price rises will be a temporary phenomenon.

"I don't have a crystal ball, and I do fully respect the fact that higher prices cause hardship," Ms Sahm told the ABC this week.

"[But] my impression is, this is temporary pain."

Ms Sahm said we were seeing different kinds of inflation at the moment, but the most serious was the mismatch between demand and supply.

She said consumers had come roaring back after the lockdowns, but it was taking time for companies to ramp production back up.

"We've been living through a global pandemic and and places where a lot of production starts, whether it's in south-east Asia or other emerging markets, they've really struggled," she explained.

"And once the system gets backlogged, the ships, the trucks, the transportation, it takes time, and we know from supply and demand that if there isn't enough supply to demand demand, prices go up.

"That's a big part of it."

Ms Sahm said there would be "a lot of bumps in the road ahead," and it could be "well into next year" before inflation returned to pre-pandemic levels, but at this stage it looked like the inflation problem would be temporary.