The Influence of Dollar, Gold, and Petrol Prices on Inflation

Zarshad Ahmad[1]
Yasir Rahim[2]

Abstract

The current study aims to produce a framework that helps in understanding how the increase of prices creates an effect on Inflation and how the increase in inflation creates an effect on other inflationary measures. The center of attention of this study is to check the influence on inflation in Pakistan. The study would let the readers know the influence and will help them in further studies. This study examines the relationship between the Dollar, Gold and petrol prices on inflation in Pakistan. The study is conducted for the period July 2008 to June 2013 on monthly basis. Simple linear regression test using SPSS were employed to analyze the data. ANOVA and Coefficient results show the positive relationship. The coefficient of correlation in this study is .876 which means that they have a very strong relationship with each other and creating influence. The result produced in this study shows the high influence of Dollar, Gold and Petrol prices on Inflation in Pakistan. This study should be further extended by using other variables, such as; interest rate, oil prices, energy prices, CPI etc. to improve the economic condition of Pakistan. The results indicate that these three factors played a dominant role in the recent inflation. This finding will contribute to the government of Pakistan in making tight policies to control the inflation rate using Dollar, Gold and Petrol prices, which makes the current study unique.

Keywords: Inflation, Dollar prices, Gold prices, Petrol prices

[1]BBA, Abasyn University Peshawar
[2]Lecturer, Abasyn University, Peshawar

Inflation is a phenomenon which disturb the whole economic system, with this disturbance and increase in prices of goods and devaluation of money no one invest its saving or surplus in the economy which is not stable, neither does the FDI flows in. In such condition the unemployment rates goes higher and start creating its influence on the GDP of the country, The GDP per capita get lower and lower which effect the value of the money. In such conditions the expenses of daily routine life increases and savings decreases. In Finance our first decision is to bringing money into business and if there is less value of money and the prices of raw materials are higher how the foreign investment flows in the economy. The decrease in the investment decrease the production process which further create increase in unemployment rate and which create decrease in income and income decreases the savings of the person which forces the individual to invest less or not to invest.

In the world there is hardly any country which is not suffering from the problem of inflation, that's why inflation is an observable fact now a day and became the center of attention for both the economist and policy makers. major causes of inflation in the economy of a country depends on so many factors, like CPI, FDI, bad governance, food prices, utility prices, oil prices, gold prices, money supply, fiscal deficit and so many other factors. Inflation by Friedman (1963), "inflation is always and everywhere considered a Monterey phenomenon". The simple definition of inflation is "the persistent increase the in the prices of goods and persistent decrease in the value of money".

After the crises of 1998/99 the inflation in Pakistan was stable till 2003 because of the tight monetary policies and in late 2003 inflation started accelerating from that point. And at last in April 2005 reaches to the 11%, which was a danger fact according to the Sherani & Sakib (2005) Avoiding the influence of oil prices on the economy is a mistake because from the previous researches it is shown that the oil prices is creating much influence on the economy of any country. Petrol is causing direct effect on the cost of production, previous studies shows that the increase in the petrol prices causes an increase in unemployment rate and decrease in output. The prices till 2007 were falling but after 2007 the prices of petrol changed almost 100%, with this increase.

In the petrol prices the increase in the CPI also occurred and the increase in inflation also took place. With that increase Pakistan also suffered in GDP. In 2008 many countries suffered because of the increase in petrol prices, mostly the developing countries such as India, Pakistan and China. The inflation also occurs with the issuance of surplus paper money in the economy, with this factor the inflation also occurs.

Gold is considered as the most precious asset and started to invest in the gold, people who were investing in the stock market started investing in the gold that's why Pakistan is considered as the world largest 10 consumer of the world, due to this the demand of gold increased in Pakistan, While Pakistan is very small producer of the gold.

In the study of Blose (2010), it is showed via calculations that the prices of gold have no changes with the inflation and Inflation has no effect on the prices of gold it only effect the cost of carry which cause an indirect effect on the prices of gold. While in his study he also mentioned that in the study of Chaudhry, Koch, & Christie-David (2000). The goal for monetary policy is the stability of prices, many research shows that the stability in prices level provides a healthy environment to the economy of the country. The stability in inflation then becomes the ultimate goal for central banks.

Background

Since 1970s it is shown in the researches that persistent and high inflation is very much harmful to the growth of the Pakistan economy, an appropriate inflation rate target in Pakistan is 6%.

The main goal for the SBP should be the maintaining of stability of prices; SBP can make policies for the sustainable growth of the economy. Till 2008 Pakistan was not considering the petrol as a determinant of inflation which is shown from the study of Khan, Ahmed, & Hyder (2007), but if we look to the situation of 2008 petrol prices which boomed all over the world and all the world faced so many problems because of the factors which was not considered seriously the factor of the inflation.

Pakistan economy is facing so many problems after independence some of them are resolved and some need to be tackle as soon as possible, one of the biggest problem in the economy is the factor of inflation. In case of Pakistan Inflation can be terrible if it cross the limit of 6 percent Sherani & Sakib (2005) but if we look to history, in 1980 it was 7.2 percent and in 1990 average inflation increased to 9.6 percent. And now a day it is reached to the double figure so Pakistan is in the terrible situation.

Purpose

The purpose of this study is to show the relationship between inflation, Dollar prices, Gold prices and petrol prices. The other main purpose of this study is to present the scenario which show the inflation in Pakistan.

Problem Statement

Due to the increase in prices of petroleum products, major problem is caused which is high cost of living, instability in the prices of goods and services, low Per capita income in the country. Whenever there is increase in the prices of petrol occurs it also affects Transportation, Cost of goods and services.

Research Objective

To identify

- The influence of Dollar prices on the inflation.
- The influence of Gold prices on the inflation.
- The influence of Petrol prices on the inflation.

Research Questions

- Is there any influence of Dollar prices on the inflation in Pakistan?
- Is there any influence of Gold prices on the inflation in Pakistan?
- Is there any influence of Petrol prices on the inflation in Pakistan?

Research Scope

To seek the influence of Dollar, Gold and petrol prices on the inflation. So many researches are conducted in market, but in this study the center of focus is Pakistan. The scope of this research is very vast now a day in the market because every businessman is afraid of investing in instable situation.

Significance of the Research

It will help the business sector by giving them a stable environment and also help the researchers to analyze the factors that mostly disturb the economy of Pakistan, although nowadays instability of economy is a big problem in Pakistan, so this study will help the readers to understand the situation of Pakistan. With the help of this study if someone wants to bring an improvement in the business sector, he will do it. The significance of this study is to give an output which is applicable in market for researcher or anybody who read this research.

Literature Review

Inflation by Friedman (1963), "inflation is always and everywhere considered a Monterey phenomenon". Abdullah, Shaari, & Hussain (2012) mentioned that the influence of oil prices is shown as compare to the exchange rate for the period of 2005 to 2011, that oil prices is creating effect on the inflation while exchange rates is not creating influence on the inflation. In this is mentioned that petrol prices during 1990 to 2007 was stable but after that it started to increase which created a huge influence on the economies of all over the world. In the year 2008 the prices of petrol reached to the huge peek and again decreased later. During this study the co-integration test also showed the maximum Eigen statistic and showed a higher critical value than the trace statistic value which is not good for an economy. The inflation can be used to distribute growth and generate growth when it is low (Fortin, 2003).

Abdullah, Shaari, & Hussain (2012) in their study also discussed that the inflation in not good for the economy, it directly or indirectly creating burden on the poor people, force them to live on the high cost of living which also increase the poverty of the country which no any country accept, each and every country want to get rid of high inflation that they live in the standard what they deserve.

Khan, Ahmed, & Hyder (2007) mentioned CPI, GDP, and GNP as a determinants of recent inflation in Pakistan, in this study nothing is mentioned about the Dollar prices, Gold prices and petrol prices, they only focused on the CPI, GDP, and GNP etc. it shows that they underestimate these factors which must come into the consideration while looking for an inflation. In this study the main focus on the factors which resolved easily.

In this study showed that the gold prices create no effect on the inflation while the expected inflation increase create some effect on the prices of gold because of the carrying charges increased, in this study it is showed that there is no direct effect of the gold prices on the inflation. In this study the case somehow is showed reversed that the unexpected changes in the inflation and CPI is creating effect on the Gold prices but up to very little extent. In this study it is also mentioned that the investor if know about the future inflation, the investor will go for the bond market instead of gold market Blose (2010).

Khan (2005) showed that inflation is not good for any economy, each country must control it within time. In this study it is also shown that Pakistan is going through a serious stage and he also discussed that the positive rate of inflation for the economy of Pakistan is 3 – 6 percent, which create good influence on the economy of Pakistan, means the inflation rate must not exceed 6%.

Mustafa, Hirani, Nasar, Hashmi, Fazlano, & Ansari (2012) mentioned in the study that the main cause of inflation is the imbalance between the demand and supply of goods and services in the economy, which causes excess demand. In this study their main focus is on the devaluation of money for which they selected the money supply and interest rate as factors, they ignored all the other factors which is necessary to be studied. In this study the result of R showed .802 which means that these two factors are creating very huge influence on the inflation rate.

In this study it is stated that the prices of petrol increased by various Nigerian regimes and these changes mainly occurred in the period of 1990 to 2007 where there is no fluctuation in the world Petrol prices and the prices are stable, the changes sometimes occurred twice a year. In this study it is also shown that increase in the petroleum prices create an influence on the economy of the Nigeria and it also create an influence on any developing country. Due to the increase in the petroleum products the cost of production directly increases which cause a direct effect on the cost of living, Transportation and many other services, which means that the increase in prices of petrol or petroleum is big problem for the people living in the country. In his study he also showed that the inflation rates sometimes reached to the 72% which is a very dangerous situation for the economy of the country. It is also mentioned in his study that due to a good policy they took control of the inflation which is created because of the increase in petrol prices. Arinze (2011)

Khan & Schimmelpfennig (2006) in their study focus of the inflation is on wheat or money. There focus is somehow also on the CPI changes. In this study it is showed that inflation is very bad for the poor peoples and also for the middle class because the inflation also drops their role and they reach to the poverty level. It is very dangerous state for poor's because they have very few assets to live and they have few options to protect themselves from the inflation. The savings of the poor peoples are almost in the cash on which they live their lives and they have nothing else. The inflation may not affect the high class but it effects both the middle and lower class.

LeBlanc & Chinn (1994) clearly determined that the oil prices had positive and significant effect on the inflation of the economy. In this study it is also analyzed that the oil prices is creating more influence as compare to the CPI and other factors. The clear link between oil prices changes and inflation is the key determinant to the monetary policy. The good policy can control the inflation.

LeBlanc & Chinn (1994) in their study focused on United Kingdom, France, Germany, Japan and United States mostly the European countries. It is also mentioned in this study that in these countries, oil is creating more effect then other factors which means it is the factor which not only disturbing Pakistan but also disturbing other countries. The oil prices play its role in all over the world in the increasing of inflation rate.

Kahn (1987) mentioned that the foreign exchange value of dollar created fear of inflation. In this study it is also mentioned that the falling rate of dollar brings the higher inflation and sometimes it brings increase in the prices, the increase in lower dollar indirectly increase the prices of domestically produced goods and this increase in inflation does not be forecasted that either it is large or small, permanent or temporary. In this study it is also mentioned that dollar has minor effect on domestic inflation and on temporary basis. It is also mentioned that increase in inflation also bring an increase in consumer prices by 14%. As he discussed that dollar fell is direct factor for increasing the inflation rate. It is mentioned in the conclusion that the decline in dollar by 40% brings increase in the CPI by 12%-16%.

Narayan, Narayan, & Zheng (2008) concluded that the investors can use the gold market as a hedge against the coming inflation and oil markets could be used to predict the prices of the gold market.

Kolluri (1981) mentioned in his study that there is no association exists between the Inflation rate and Gold prices, the Gold prices cannot be used for the hedging and is not utilized for other activities. In this he agrees that sometime the Gold prices give investors good return as compare to stocks. In this study it is mentioned that the Gold in past years used as a protective asset but now it is not used as a protective asset.

Qayyum, Javid, & Munir, Inflation Expectations Survey (2010) noted that the major objective for the Central Bank is the stability of Prices, which is the very important thing in order to control the inflation. State bank must make the policies with which the increase in prices of goods and services controlled easily. SBP make the policies which not only strengthen the economy but also not take the people to the poverty, where they cannot afford the life which they deserve. In this study it is mentioned that the Oil prices is contributing 14.3% in increasing the inflation. In this study it is also mentioned that the expected inflation is higher than the actual inflation.

Every economist looks differently to the causes of inflation. The classical viewed inflation as increased currency in circulation. Qayyum & Haque (2006) mentioned that inflation is a monetary phenomenon; in this study the annual data for the period of 1960-2005 is used. The conclusion made is that the proposition is valid in case of Pakistan. In this study it is also mentioned that 90 % of the variation in the inflation is due the monetary policies adopted by the State Bank of Pakistan.

Madhavi & Schimmelpfennig (2005) mentioned in his study that the leading indicators for inflation are Broad money growth and Private sector credit growth.

Qayyum, Javid, & Munir, Inflation Expectations Survey (2011) showed that in the year of 2011 the Inflation increased due to Oil Prices is 28.9, and still the expected inflation is going higher than the actual inflation. In this study the influence is higher than the previous study, in order to stop increase the government must make the rigid policies, with the help of which the prices will not go out of control.

Qayyum & Munir, Inflation Expetations Survey (2011) Mentioned that oil prices causes inflation up to 15.9% while in this study they also mentioned about the gold prices that gold is also creating an effect in the inflation, the inflation caused because of the gold is 7.0%. Same trend is displayed in this study that the Expected inflation is higher than the actual inflation. In this study for the first time they are focusing on the Gold prices and it is 7.0% of total which is an unavoidable factor.

Levin & Wright (2006) Mentioned in his study that the gold sometimes considered as a Store of value and the investment made in the stocks of gold are regarded as return on value.

Pitchard (2010) clearly mentioned that the investors of so many stocks are coming toward an investment in the gold, they investing their money in gold mostly as compare to the other stocks. The trend is going to change the organization must take serious action to attract the investors toward themselves instead they are investing in gold. In this study it is also mentioned that the organization can attract the investors by offering them higher dividend then they are getting it with gold.

In this study it is clearly mentioned that in last few years (after 2008 crises) there has been an explosion in research on gold raised. The gold now a days become a financial asset as compare to other assets. Lucey (2011)

Alhajji (2004) mentioned that the prices of Oil are in US dollars while products we are buying is on the local currencies. It is also mentioned in this study that study that the prices of Oil is higher in Dollars and some other currencies but Lower in some other currencies like Euro and Yen. The devaluation of increases Oil demand and reduce the Oil supply, with this dollar devaluation in dollar increase the demand of Oil in the Europe and Japan. The devaluation of dollar leads to direct inflation, reduces the purchasing power of common man and increases the cost of operations and increase the cost of almost every activity.

Qayyum & Munir, Inflation Expections Survey (2012) mentioned that the inflation caused because of the oil prices is much higher than the last survey; it is displayed this time 22.8% and did not mentioned about the gold prices. In this study they focused on international inflation, which also contributed 7.9%. In this study it is showed that the greatest factor of inflation is Bad Governance 38.1%. In this factors the international inflation is said to be the inflation which is caused because of the international products (export and Import).

Tahir (2006) Found that CPI is the core inflationary measure. The extreme changes in the prices level is also the main reason or mean rate of inflation. The policy makers should also focus on the unrepresentative price changes. In this study the price changes means inflation according to the definition of inflation, In this study he is avoiding all factors which is mentioned by so many researchers like Oil prices, WPI, GDP, GNP, Energy and so many other factor which really need some focus in according.

Chou & Tseng (2011) examined the long run and short run effects of oil prices on inflation. The research is conducted for only one country (Taiwan). The result clarifies that the oil prices in global market has the significant and positive effect on inflation in long run but not in short run, in short run it is proved that effect in not significant.

Shahzadi & Chohan (2011) shows that the peoples are investing more in the precious metals like gold as compare to the stocks; this behavior is disturbing the stock exchanges and also the stock exchange of Pakistan. In this study it is showed that it has negative relationship between KSE 100 index and monthly average gold prices, but showed that it has positive relationship in the aspect of the inflation which is not clearly mentioned in that study.

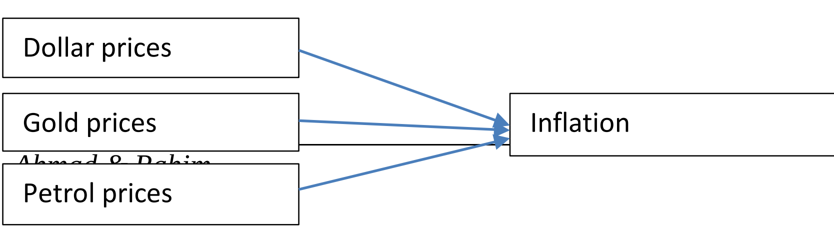
Büyüksalvarcı (2010) confirms the findings by showing the effects of 7 economic variables (Gold prices, Oil prices, Interest rate, CPI, foreign exchange rate, Money supply and Industrial production index) on the Turkish stock exchange. In his study he also mentioned that gold is now an alternative tool of investment for Turkish investors. The increase in the prices of gold attract the investors, the investors tends to invest in gold rather than in stocks, which cause the stock prices fall. Therefore the relationship between gold prices and stock returns are negative, increase in one cause decrease in other and vice versa.

Agha & Khan (2006) observed that there is a long run relationship between the inflation and fiscal indicators in Pakistan. The study was conducted for the period of 30 years from 1973-2003. The authors also concluded that the economy of Pakistan strongly get effected by the borrowing of government banks for the fiscal deficits and budgetary supports.

In this study author believes that increase in money supply shifts the aggregate demand which increases output and decreases unemployment rate below the natural rate of unemployment and increases wage rate. Increased wage rate results in decrease in the demand for labor which shifts the aggregate supply curve leftward. If this process continues in subsequent years, the economy will experience higher inflation Mishkin (2004)

Theoretical Framework

In the conceptual frame work of this study, our research begins by asking the question that what explains inflation in Pakistan.



The problem

Price stability in the economy of Pakistan is main problem and is the Prime agenda for the State Bank of Pakistan. It is very important to understand the relationship between the Inflation rate, Dollar Exchange prices, Gold prices and Petrol prices.

Specifically, the study poses the question: to what extent inflation in Pakistan is volatile, and what are the causative factors of inflation in Pakistan?

Hypotheses

$H_{A1:}$ Dollar prices have positive and significant effect on inflation
$H_{A2:}$ Gold prices have positive and significant effect on inflation
$H_{A3:}$ Petrol prices have positive and significant effect on inflation

Research Methodology

It is an empirical study which tests the nature and dynamics of inflation. Various econometric models used to suit the various important issues, the issue used here is the Linear Regression Model.

Linear Regression Model

This is fairly easy, tractable and simple in yielding. In this study the Linear Regression Model is used to fulfill the classical assumptions. Linear Regression Model provides the good environment for taking further decisions. Linear Regression Model produces the Model summary which shows the clear relationship between dependent and Independent variable. Linear Regression Model also produces ANOVA and Coefficients which tells about the significance of the variable. As it is a simple tool which helps in further decision making so it is used by most of the economist.

Population and sample

This study covers the 5 year data from July 2008 to June 2013.The sample plan is to go for monthly data. The data collection will be on monthly basis for 5 years which give 60 entries for each variable.

Sources of Data

The source of data is internet. All the data used in this research is easily available on the internet. In this monthly data series comprised of four variables – Dollar prices (exchange rate), Gold Prices, Inflation rate, and Petrol Prices.

Analysis Technique

In this study, the use of simple linear regression is to highlight the relationship and clear picture of the effect of Dollar, Gold and petrol prices on the inflation in Pakistan.

In this study, first the Linear Regression Model ran while taking Inflation rate as a dependent variable and Dollar prices, Gold prices and Petrol prices as independent variables which is shown in Table 1, Table 2 and Table 3. Then the test ran for every single variable, on first it is ran for the Dollar prices (Independent Variable) and Inflation rate (Dependent Variable) which is shown in Table 4. Then the test ran for the Gold Prices (Independent Variable) and Inflation rate (Dependent Variable) which is shown in Table 5 and at last the test ran for the Petrol prices (Independent Variable) and Inflation rate (Dependent Variable) which is shown in Table 6. These single variable test done to check the influence of each variable on Inflation.

Data Analysis and Results

Table 1. Model Summary

R	R Square	Adjusted R Square
.876[a]	.768	.755

The R value shows the coefficient of Correlation is the numerical measure of the relationship between three variables. The R value (.876) shows the positive Correlation between the Dollar, Gold and Petrol prices with the Inflation rate. The R square value (.768) mean 76% is reliable to be used for the estimation of the population and explain the percentage variance in Inflation rate is explained by Dollar, Gold and petrol prices. 75.5% change in Inflation is attributed because of Dollar, Gold and petrol prices.

Table 2. ANOVA

	df	F	Sig.
Regression	3	61.626	.000[b]

This table tests the significance of hypothesis, the results shows that Dollar, Gold and petrol Prices have a significant influence on Inflation rate, F (3, 56) = 61.626, p = 0.000, which indicates that in the present study Dollar, Gold and petrol prices has a significant influence on inflation rate.

Table 3. Coefficients

	B	T	Sig.
(Constant)	61.393	8.612	.000
Dollar Prices	-.607	-5.831	.000
Gold Prices	.000	-3.042	.004
Petrol Prices	.150	4.348	.000

This table shows the variable and their significance, since the present study has three variables, the value of Standardized Coefficient is similar to the value of Pearson correlation. In this case Dollar, Gold and petrol prices are significant {Dollar (t=-5.831, p=0.000) Gold (t = -3.042, p = 0.004) Petrol (t=4.348, p=0.000)}. Overall these results clearly show a significant effect of the Dollar, Gold and petrol prices on Inflation rate.

Discussion

The appropriate inflation target for Pakistan is 5 percent Sherani & Sakib (2005) but the periods of high inflation has overlapped the low growth, which must be stopped. In this we agree with Khan & Schimmelpfennig (2006) that the high inflation slow down the growth while high growth is associated with low inflation environment.

Gold has the influence on so many other economic factors and other factors has its influence on the gold, as in the study of Chaudhry, Koch, & Christie-David (2000) they showed that Gold responds strongly to the release of the CPI. The Unemployment Rate and GDP also have significant effects on gold.

Dollar exchange is playing its role in the inflation in two ways, in one way increase in dollar exchange prices brings increase in inflation and in some places decline in dollar exchange prices increase in the inflation as mentioned in the study of Kahn,(1987).

As it is mentioned in the study of Arinze (2011) that they controlled the inflation in Nigeria with the help of good policy. As Nigeria is also a developing country; and controlled its inflation which was up to 72% with the help of good policies, so the Pakistan can also take the possible steps which help them in developing their economy and stopping the increase in the inflation.

In this case the objective of the SBP should be, price stability, and focus on the policies to keep inflation closer to target (5%). The inflation is not good for the any country as it create burden on poor people to live on high cost of living. Poverty line will directly accelerate when inflation happens. It automatically deepens poverty in Pakistan. This study and findings will contribute the Pakistani government in making policies to the control the petrol prices.

Conclusion

This study is conducted to find the relationship between Dollar prices, Gold prices, Petrol prices and Inflation rate from July 2008 till June 2013. So all the null hypotheses are rejected in this study. The Inflation rate in Pakistan in these years (2008-2013) were the major problem, the fluctuation in Inflation rate disturbed the economic system. The increase in oil prices creates a huge effect on the economy and also slows down the economic activities. In this study, the results in the study shows the significant influence. The result presented in the paper shows that the Dollar, Gold and petrol prices (Economic Factors) determine inflation in Pakistan and also show the inter relativity and also show the dependability on each other; With the increase of independent variables, the dependent variable increases but in some cases the increase in dependent variable causes increase in independent variables in the form of international inflation. This also affects the business activities. The solid actions are required to acquire stability in Pakistan economy, the government must make good and effective policies to enhance the economic conditions of the country.

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