
Welcome...

INFLATION

Siddharth Bhardwaj
Assistant Professor
Dept. of Economics
Patna College
Patna University
Patna 5

INFLATION

- Sustained and appreciable rise in the general price level of all the commodities in all the sectors of economy is called Inflation
- Inflation is basically a demand supply mismatch phenomenon whose symptom is price rise
- Only the sustained and appreciable price rise in all the sectors of the economy is called as inflation
- Opposite phenomena of inflation is deflation.
- The phenomenon of inflation is same as inflating the balloon. Hence the name.

INFLATION RATE

- Rate of inflation in Tth period:

$$\frac{\text{price level (Tth year)- (T-1 th year)}}{\text{price level(T-1th year)}}$$

Concept

- When the demand of the good become more than its supply it exerts a pressure on the price of the good causing inflation
- Hence its a demand supply mismatch phenomenon visible in the form of inflation
- Major Cases of demand supply mismatch leading to demand> supply

- ❑ Demand increases ,supply does not increases(demand pull inflation)
- ❑ Demand does not increase, supply decreases(cost push inflation) or stagflation(inflation plus stagnation).
- ❑ Increase in demand is more than increase in supply(phillips curve i.e growth in economy leads to inflation and decrease in unemployment) and structural bottlenecks(structuralist inflation).
- ❑ Decrease in supply is more than increase in demand(mixed demand pull and cost push)

Types of inflation

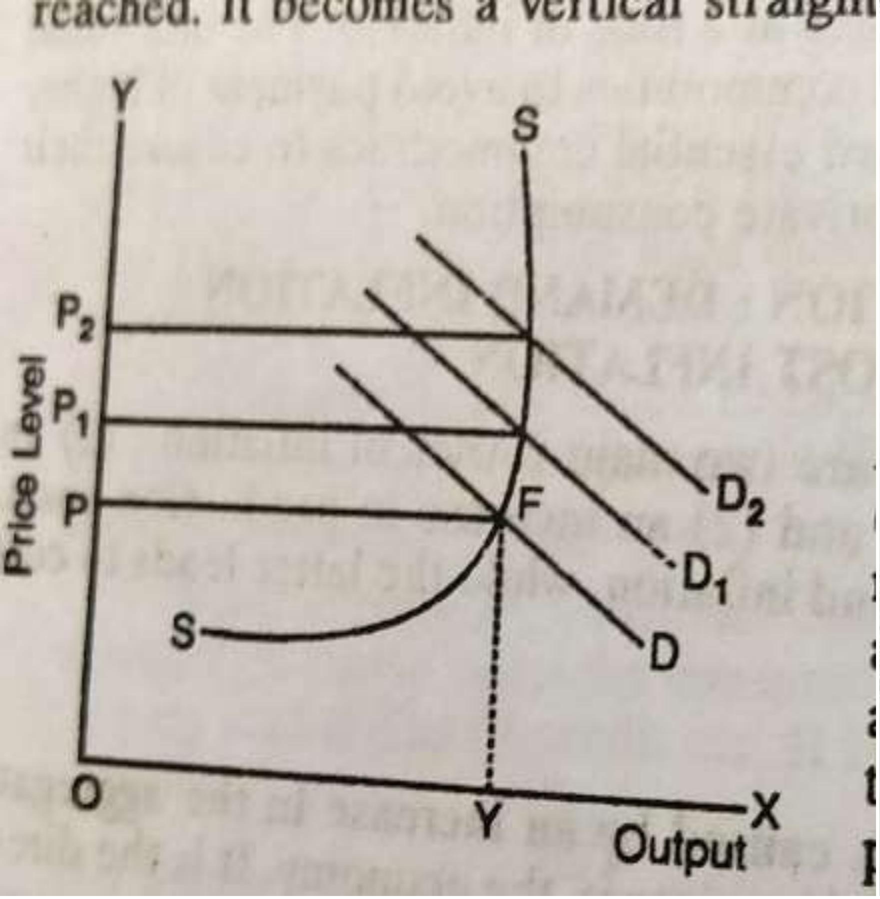
- 1. Demand pull inflation/excess demand inflation: demand increases beyond the potential output level of economy. Demand increases and supply does not increase further causing too much money chasing too few goods

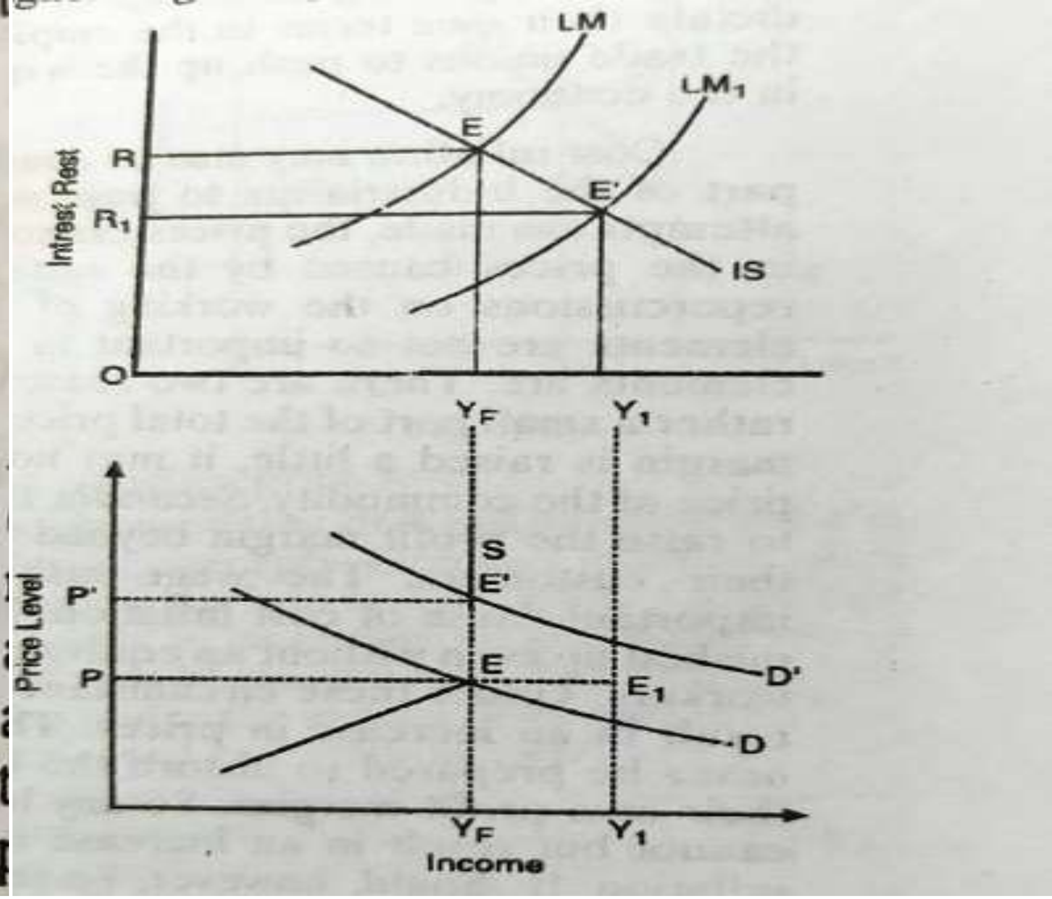
- 2. cost push inflation: rise in cost of production(oil price, farm price , import price, wage push , profit push , mark up push) leading to decrease in supply comparison to demand.

- 3.structuralist inflation/bottleneck inflation: demand supply mismatch due to structural bottlenecks of economy

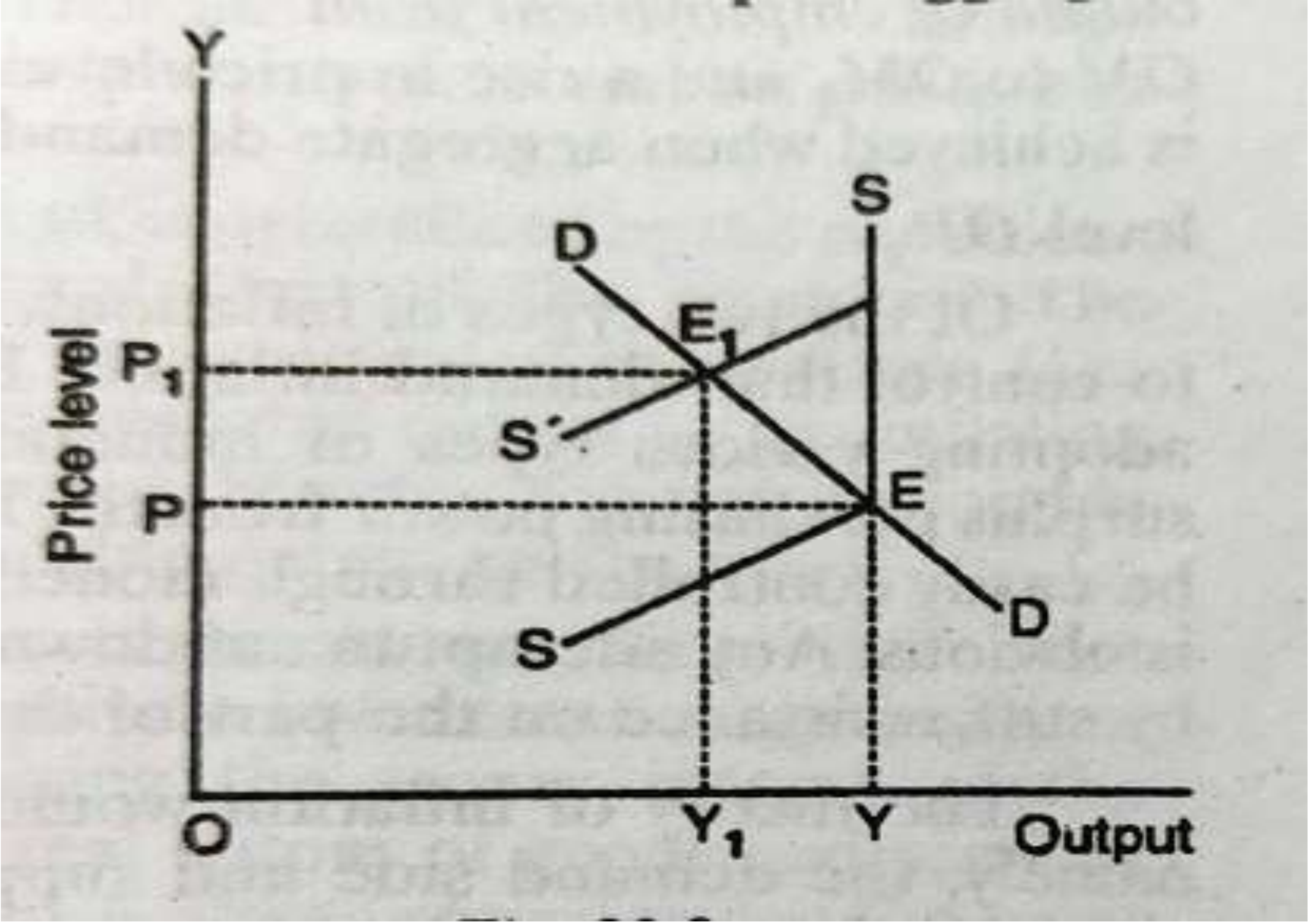
- 4.Mixed inflation: combination of demand pull and cost push inflation which is difficult to differentiate in the economy.

- 5. hyperinflation: Very large spike in inflation which is difficult to control either due to too much money supply in the economy leading to too much money chasing too few goods(monetarist theory of inflation) or inflation fuelled by inflationary expectations of the market(dynamic inflation).

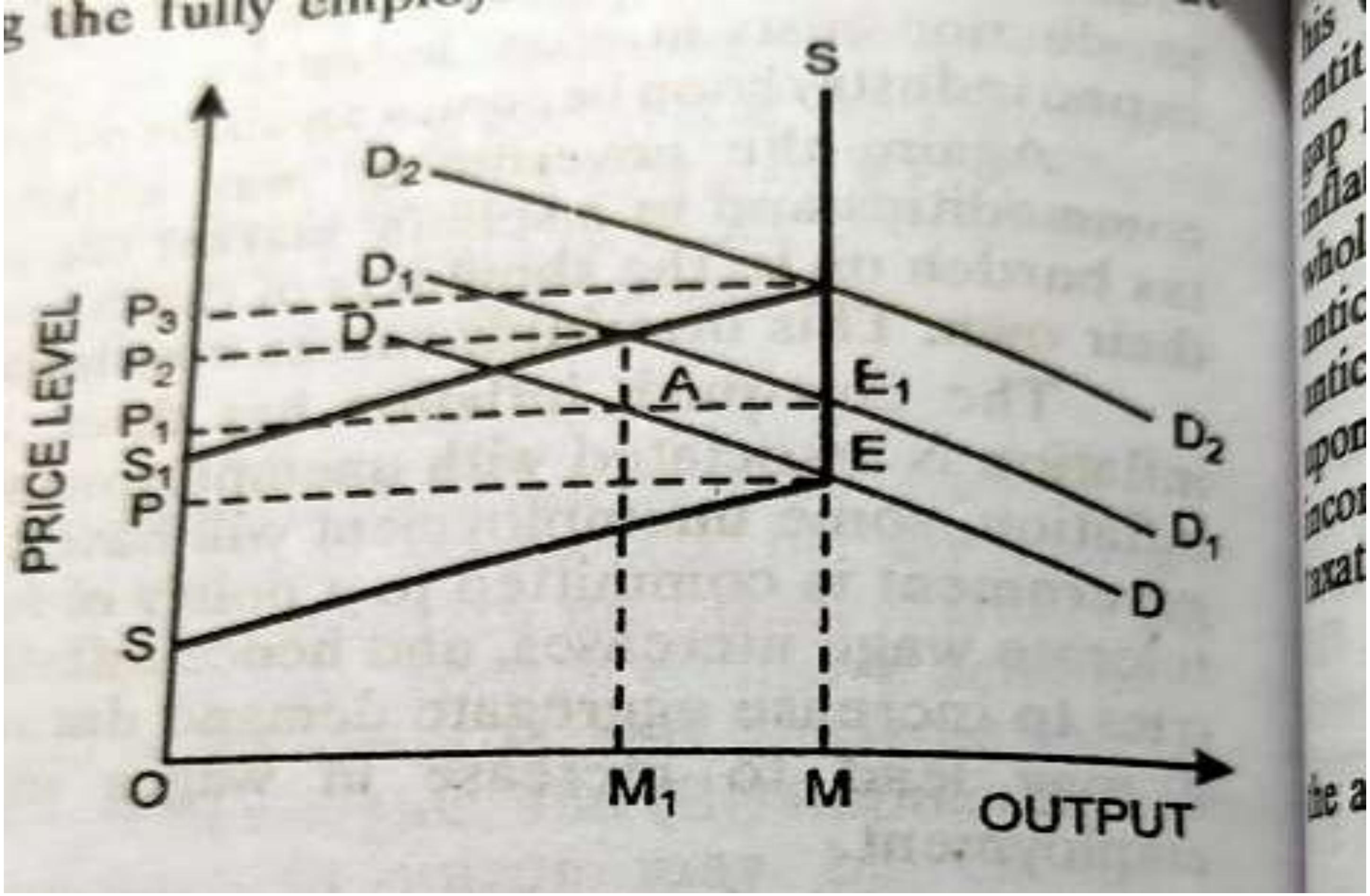




DEMAND PULL INFLATION

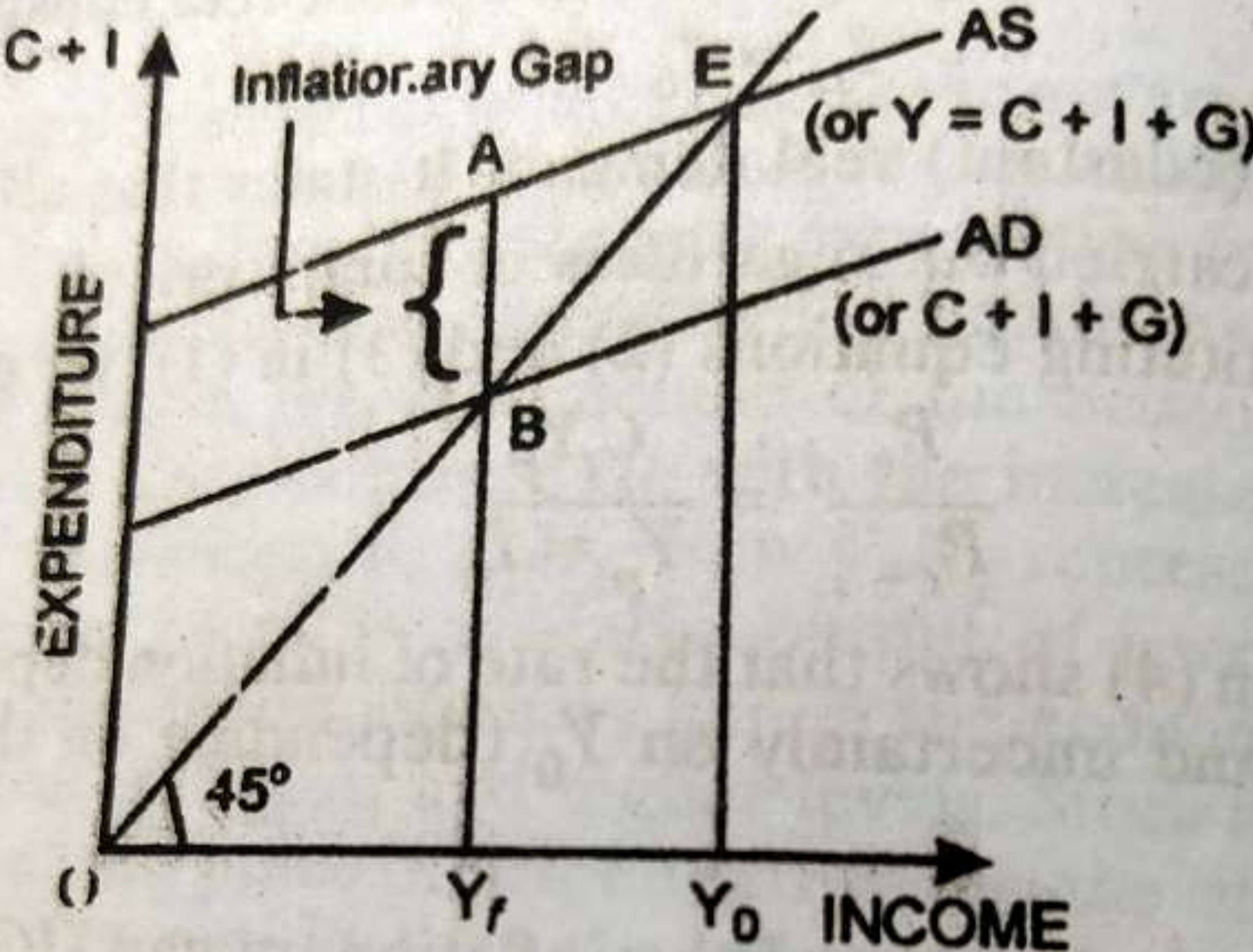


COST PUSH INFLATION



MIXED INFLATION

D.


C + I
Inflatior.ary Gap
E
AS
(or Y = C + I + G)
A
AD
(or C + I + G)
B
EXPENDITURE
45°
O
Y_f
Y_0
INCOME

Other types

- Suppressed/repressed inflation: inflation under control by govt. Intervention
- Reflation : moderate degree of controlled inflation
- Disinflation : decline in the rate of inflation to normalcy.
- Sporadic inflation: sectoral inflation
- Mark up inflation: inflation due to rise in cost as due to adding a minimum mark up/profit margin by the corporations
- Profit induced inflation: govt does not allow price to decrease to maintain profit of firms
- Demand shift inflation: shift of demand to other sectors leading to demand pull inflation
- Open inflation: inflation due to free forces of market i.e. Demand and supply and auto corrects ,no need of govt intervention.

Degrees of inflation

- Creeping :mild, less than 3 percent inflation rate
- Walking: 3-6%
- Running:10%
- Galloping: hyperinflation,most dangerous > 10 %

Measures of Inflation

- Consumer price index(cpi method)

- Wholesale price index(wpi method)(service not included).

- Producer price index method(ppi method)

- Comprehensive consumer price index(ccpi method)

  used in India.

- Gdp deflator method(most comprehensive ,covers all commodities and services)

WPI *Vs.* CPI
Composition of the Indicators

Title	CPI-IW	CPI-AL	CPI-RL	WPI	CPI*
Base	2001	1986-87	1986-87	2004-05	2012
Lag**	1 month	18 days	18 days	14 days	18 days
Elementary items	320	260	260	676	200 weighted items#
Weight of food products (%)	48·47	69·15	66·77	24·3	45·86
Weight of energy products (%)	7·43	8·35	7·9	14·91	6·84
Weight of miscellaneous items, which primarily include services (%)	23·26	11·73	11·87	Services not included	28·32
No. of collection centres	78 Urban	600 Rural	600Rural	Centralised collection	1181 Villages and 310 Towns

Note : Weights do not include all categories.

* The new CPI comprises Consumer Price Index for urban areas, rural areas and a combination of both. It has Pan, Tobacco & Intoxicants (2·38%) and Clothing (6·53%) and Housing (10·07)

** Days since the end of the reference month.

\# Weighted items have various varieties within each item depending on usage in a particular state.

- Price index: A price index is a weighted average of individual prices where weight of an each commodity's price reflects the economic importance of that commodity.
- GDP deflator: ratio of nominal GDP to real GDP.
- Nominal GDP : GDP calculated at current prices
- Real GDP : GDP calculated at some base year price.(currently 2012)

Causes of inflation

1. Factors causing increase in demand

- Increase in money supply
- Increase in disposable income
- Increase in community aggregate spending
- Increase in population
- Speculation and hoarding for profiteering
- Increase in exports

2. Factors causing decrease in supply and structural factors of economy

- Deficiency of capital equipment
- Scarcity of other complementary factors of production
- Increase in exports
- Decrease in imports
- Hoarding by traders
- Natural calamities
- Rise in cost of production
- Mark up and profiteering tendency
- Agricultural bottlenecks
- Govt budget constraint
- Foreign exchange bottleneck
- Taxation policies
- Import substitution

Effects of inflation

- Decrease in purchasing power capacity of money/income i.e. erosion of real value of money/income
- Hence loans become cheaper debtor
- And saving fetches less return for saver
- The phenomenon is called fisher effect:
- Real interest rate = nominal interest rate - inflation rate.
- Redistribution of wealth from wage earners and fixed income group to profit recipients hence causes inequality and social unrest ultimately leading to stagflation and recession.

- Misallocation of resources
- Hoarding and black marketing
- Reduction in saving
- Decrease in export leading to hindering of foreign capital and rise in forex rate hence adverse BoP.
- Encourages speculation
- Real burden of public debt decreases
- Govt revenue rises but production cost also rises
- Initially unleashes animal spirit and boom in economy due to rising expectation of future prospective yields for entrepreneur but at the end Social unrest and lack of morale

Measures to control inflation

- Reducing fiscal deficit : decreasing public expenditure(,subsidy,salary) and raising public revenue(tax)
- Monetary tightening: Reducing money supply in economy by increasing repo rate, reverse repo rate,CRR,SLR,MSF,margin requirement to make loan costly and saving attractive.
- Increasing real supply of goods in economy by strengthening infrastructure , managing imports and rationing
- Freezing rise in salary and wages to cool off demand
- Legislative measures to strengthen agriculture marketing and supply chain and discourage black marketing and hoarding as well as price control under essential commodities act


Thank you