Shoolini University

Indian Economy: ECON(H) 221

Lecture 15: Inflation

Some General Features of Inflationary Economy

- Continuously rising price trends
- Excess money supply in the economy (in relation to requisite production and exchange needs of the economy)
- Over expansion of credit by the banks
- Prevalence of higher interest rate in the unorganized sector of the economy than the one prevailing in the organized sector.
- Labour unrests, lock-outs etc.
- Large number of commodities are in short supply in the economy.

Inflation

- Commonly defined as the economic situation of continuously rising price levels (and falling value of money).
- Measured through Wholesale price index (WPI), Consumer price index (CPI)/ cost of living index
- Inflation rate = Percentage rise in price level in year ‘ t’ relative to price level in year’ t-1’

$$\Delta P(t) / P(t-1) \times 100$$

- Some views on inflation
  - when money supply exceeds normal absorbing capacity of the economy it leads to persistently high prices
  - Too much money chasing too few goods

Inflation

- **Reflation**: A rising prices situation deliberately undertaken to relieve a depression

- **Dis-inflation**: when prices fall due to anti inflationary measures (like decrease in money supply) with no corresponding level of employment, output and income.

- **Deflation:** continuous falling prices accompanied by decreasing level of employment, output and income.

- **Stagflation:** continuously rising prices, rise in rate of unemployment and stagnation of growth.

Inflation

- **Creeping Inflation (Low inflation)**: or mild inflation is when prices rise 3-4% a year or less. Could be good for the economy

- **Walking Inflation**: inflation is between 3-10% a year. It is harmful to the economy because it increase economic growth at faster rate. Demand exceeds supply

- **Galloping Inflation (jumping inflation, running inflation, hopping inflation):** When inflation rises to ten percent or greater. Money loses value so fast that it becomes difficult to keep up with costs and prices

Inflation

Hyper inflation

- Rapid increase in prices
- Increase in prices becomes out of control
- Inequalities increases in the economy
- Velocity of circulation of money very high

Inflation - kinds

Mainly of two kinds:

- Demand Pull Inflation
- Cost Push Inflation

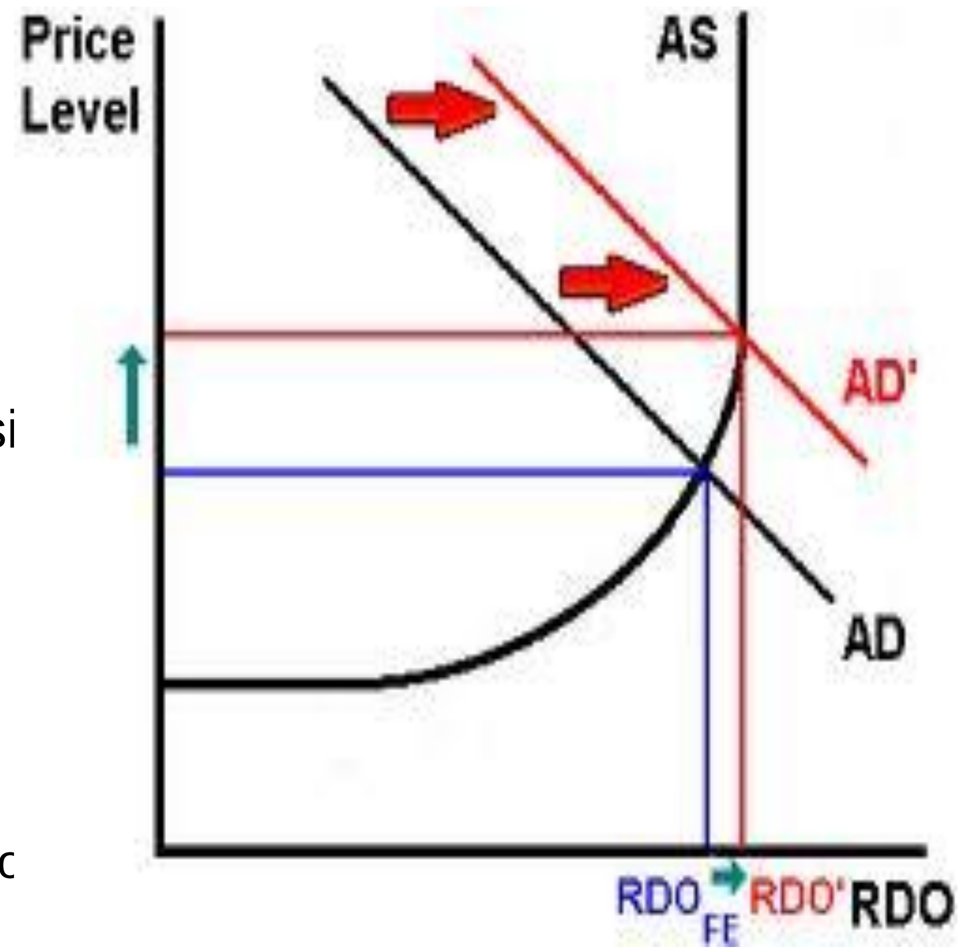
Demand-pull inflation

(In the Fig., AD = Aggregate Demand,

AS = Aggregate Supply and RDO = real domestic output)

Occurs due to:

- Increase in money supply and purchasing power and hence excessi demand in relation to supply
- Increase in govt. spending
- Increase in exports and surplus BoP
- Diversion of resources (say from Consumption goods sector to capital goc sector (e.g. in war times)



Cost-push inflation

May arise because of :

- ➢ Increase in money wage rate
- ➢ Increase in prices of raw materials.

⇒ a decrease in AS due to increase in costs of production