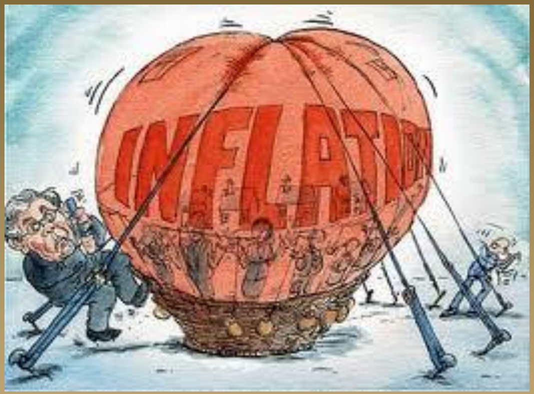


INFLATION

HS202

DEFINITION

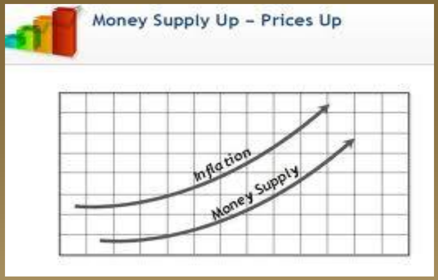
- CROWTHER- VALUE OF MONEY IS FALLING, PRICES ARE RISING.
- FRIEDMAN- A PURELY MONETARY PHENOMENON
- QUANTITY THEORISTS – INCREASE IN MONEY STOCK MAIN CAUSE OF PRISE RISE
- KEYNES- TRUE INFLATION ONLY AFTER FULL EMPLOYMENT. LITTLE RISE IN INFLATION GOOD FOR ECONOMY.

Fisher Equation (FE)

- The equation of exchange, or the FE named after its founder Irving Fisher in 1911, states the following: **MV = PT**
- M is the money supply, the amount of money available in the economy for transactions. Let us assume that M = 500
- V is the velocity of circulation. The velocity of circulation refers to the number of times the stock of money changes hands in purchasing transactions over a period of time
- P is the price level
- T is the number of transactions
- 500 x 50 = p x 200
- 25,000 = 200p
- P = 125
- This tells us that the average price of each good that changed hands was 125.

TYPES OF INFLATION

- CREEPING INFLATION -VERY SLOW
- WALKING INFLATION- WHEN FORMER CONTINUES FOR A DECADE
- RUN-AWAY OR GALLOPING INFLATION- A 100% INCREASE IN PRICES
- HYPER INFLATION –TOTAL DISEQUILIBRIUM



Demand Pull and Cost Push Inflation

- DEMAND-PULL = TOO MUCH MONEY CHASING FEW GOODS.
- INFLATIONARY GAP IS CREATED BETWEEN EXPENDITURE ON THE ONE HAND AND SHORT SUPPLY OF GOODS AND SERVICES.
- COST-PUSH = BECAUSE OF WAGE INCREASES, PROFITS IN SELLERS MARKET LEADS TO MONOPOLIES, CARTELS.

CAUSES OF INFLATION

- INCREASE IN MONEY SUPPLY,
- INCOME
- INCREASED GOVERNEMNT EXPENDITURE-DEVELOPMENT PROJECTS, DEFENCE
- DEFICIT FINANCING
- BLACK MONEY
- DEMONSTRATION EFFECT
- LOWERING TAX RATES OF INCOME

EFFECTS OF INFLATION

ON PRODUCTION

- DISCOURAGES SAVINGS,
- ENCOURAGES SPECULATION,
- ENTREPRENEURS AVOID RISKS,
- INVESTMENT SHIFTS FROM CONSUMER GOODS TO LUXURY GOODS FOR THE RICH

ON CONSUMPTION

- DEBTORS ARE GAINERS,
- CREDITORS ARE LOSERS, SALARIED ARE HIT,
- FARMERS GAIN WHEN PRICES OF FOODGRAINS RISE BUT FOR INPUTS THEY LOSE,
- COSTS INCREASE.

MONETARY MEASURES TO CONTROL INFLATION

- CONTROLLED EXPANSION OF CREDIT
- INCREASE BANK RATE
- SECURITIES AND BONDS SOLD
- SELECTIVE CREDIT CONTROLS
- INCREASE SLR
- REDUCE DEFICIT FINANCING

SELECTIVE CREDIT CONTROLS

Margin Requirements

Proportion of the value of security against which loan is not given is named as **Margin .Margin** against a particular security is reduced/increased in order to encourage or to discourage the flow of credit to a particular sector.

REGULATION OF CONSUMER CREDIT- EMIs INSTALMENT BASIS-INCREASE LIMIT OF DOWN PAYMENTS FROM CONSUMERS

RATIONING OF CREDIT

Moral Suasion and Publicity

Issue of Directives

Direct Action

Bank Rate, CRR and SLR

- Bank Rate- This is the rate at which central bank (RBI) lends money to other banks or financial institutions. If the bank rate goes up, long-term interest rates also tend to move up, and vice-versa.
- CRR means Cash Reserve Ratio. Banks are required to hold a certain proportion of their deposits in the form of cash with central Bank.
- SLR stands for Statutory Liquidity Ratio. This term is used by bankers and indicates the minimum percentage of deposits that the bank has to maintain in form of gold, cash or other approved securities. Thus, we can say that it is the ratio of cash and some other approved securities to liabilities (deposits) It is used to regulate the credit growth.

Deficit financing

Meaning of Deficit financing

- It is a practice in which a government spends more money than it receives as revenue, the difference being made up by borrowing or minting new funds.
- Although budget deficits may occur for numerous reasons, the term usually refers to a conscious attempt to stimulate the economy by lowering tax rates or increasing government expenditures.

Some issues in DF

- The influence of government deficits upon a national economy may be very great. It is widely believed that a budget balanced over the span of a business cycle should replace the old ideal of an annually balanced budget.
- Some economists have abandoned the balanced budget concept entirely, considering it inadequate as a criterion of public policy.
- Deficit financing, however, may also result from government inefficiency, reflecting widespread tax evasion or wasteful spending rather than the operation of a planned countercyclical policy.

FISCAL MEASURES TO CONTROL INFLATION

- REDUCTION IN GOVT. EXPENDITURE
- INCREASE IN TAXES
- INCREASE IN PUBLIC BORROWINGS Through NEW ISSUES
- RATIONING THROUGH P.D.S.
- INCREASE IMPORTS
- REDUCE EXPORTS