CHAPTER 3

Economic Fluctuations And Their Impact On Economic Growth Structure

INFLATION

is the process of persistent increase in the price level.

common measures of inflation

1- Consumer Price Indexes (CPIs) which measure the price of a selected basket of goods by a "typical consumer"

2- Product Price Indexes (PPIs) measure the price received by a producer

3- Wholesale Price Indexes measure the change in the price of a selected basket of goods at wholesale prior to sales taxes. Used in India.

4- Commodity Price Indexes measure the change in price of a selection of commodities. In the case of the gold standard the sole commodity used was gold.

5- GDP deflator It is based on the ratio of the total amount of money spent on GDP to the inflation-corrected measure of GDP constant-price or "real" GDP. It is the broadest measure of inflation.

Keynesian view of Inflation

Semi-Inflation (Bottleneck Inflation)

- ✓ Increase in the quantity of money before full employment leads to increase in output and employment.

Open or Full Inflation (absolute inflation)

- ✓ Increase in the quantity of money after full employment leads to rise in the price-level.
- ✓ There is a true inflation when effective demand for consumer goods plus effective demand for investment goods exceeds the total value of output at full employment in terms of existing prices.

TYPES OF INFLATIONS

1- Based on the degree of government control

- **Open Inflation:** which no steps are taken to control rising prices.
- **Suppressed Inflation:** which rising prices are checked by administrative measures like price control.

2- Based on Political Conditions

- **War time inflation:** in order to meet war expenses government increases the supply of money.

- **Post-war inflation:** tendency of inflation persists even after the war due to government spending on the repair and reconstruction of damage property and increasing money supply than the production of goods and services.

- **Peace Time Inflation:** Under-developed countries need large resources for economic planning and development programs.

3- Based on Rate of Inflation

- **Creeping Inflation:** refers to that inflation wherein prices rise very slowly.
- **Walking Inflation:** refers to that inflation wherein prices rise quickly.
- **Running Inflation:** when there is a rapid increase in prices in differs period
- **Hyper Inflation:** It refers to a situation when prices rise at an unexpected rate.

4- Based on Scope

- **Sectoral Inflation:** When inflation affects only a particular part of the country or covers only one or two goods.

- **Comprehensive Inflation:** When inflation affects on ALL Parts of the country.

5- Based on Process

- **Wage Induced Inflation:** increasing wages results into higher cost of production and increased prices.
- **Profit Induced Inflation:** In developed countries like America, big companies add a given percentage of profit to the costs. So, goods prices rise very high.
- **Deficit Induced Inflation:** Such inflation is the outcome of deficit financing by the government.
- **Stagflation:** involves inflationary rise in prices and wages with a decrease in production and increase in unemployment due to fall in aggregate demand.

CAUSES OF INFLATIONS

Demand side

1. Increase in Public Expenditure
2. Deficit Financing
3. Cheap Monetary Policy

Supply side

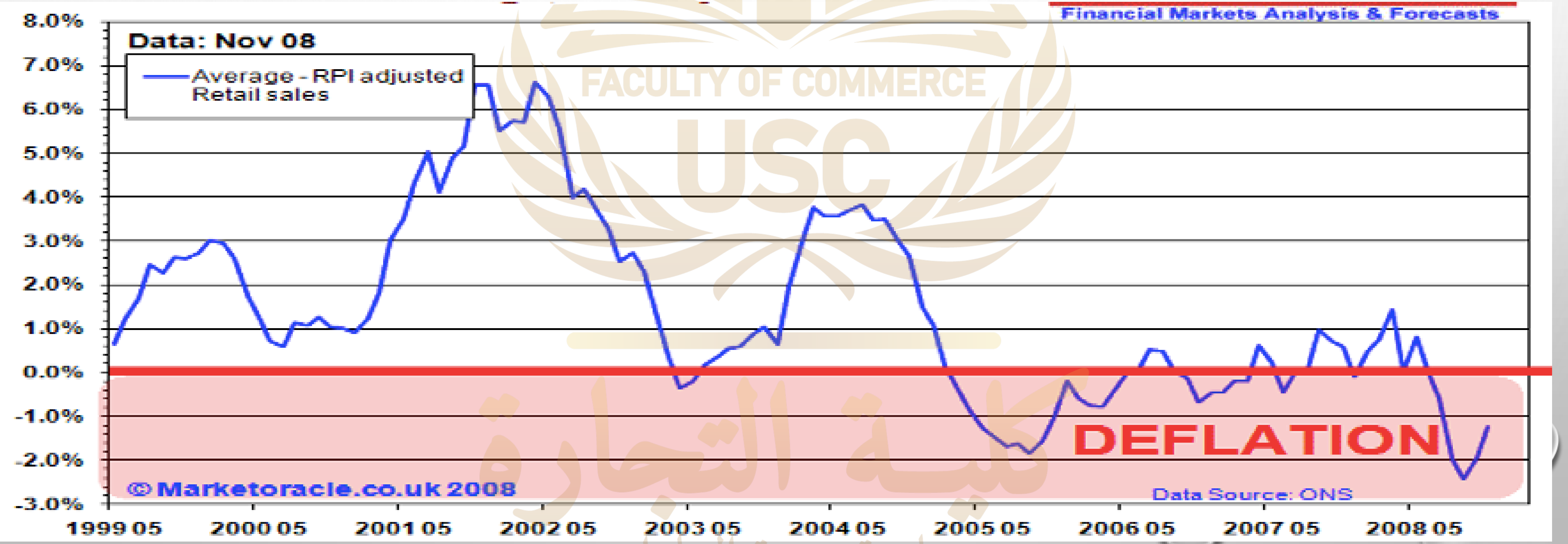
1. Less Production .
2. Artificial Scarcity
3. Taxation Policy of the Government

IMPACT OF INFLATION ON ECONOMIC GROWTH

(1) Effect on Debtors and Creditors
(2) Effect on Investors
(3) Effect on Fixed Salaried Class

DEFLATION

a situation where prices of essential goods and services decline over time.



Deflation can due to

- The fall in supply of money
- The rise in supply of other goods and services
- The increase in demand for money
- the fall in supply of other goods and services

CAUSES OF DEFLATION

1. **Growth Deflation:** arises due to increase in efficiency and productivity.

2. **Cash-Building Deflation:** When the demand for money increase.

3. **Bank Credit Deflation:** the central bank can limit the power of commercial banks to create money by maintaining high cash reserve ratio, then money supply will decline, and the purchasing power will decrease causes deflation(recession).

4. **Confiscatory Deflation:** It was a forced deflation imposed upon people by exercising political power.

IMPACT OF DEFLATION ON ECONOMIC GROWTH

1. Impact On Production:

Deflation is a situation of falling prices.

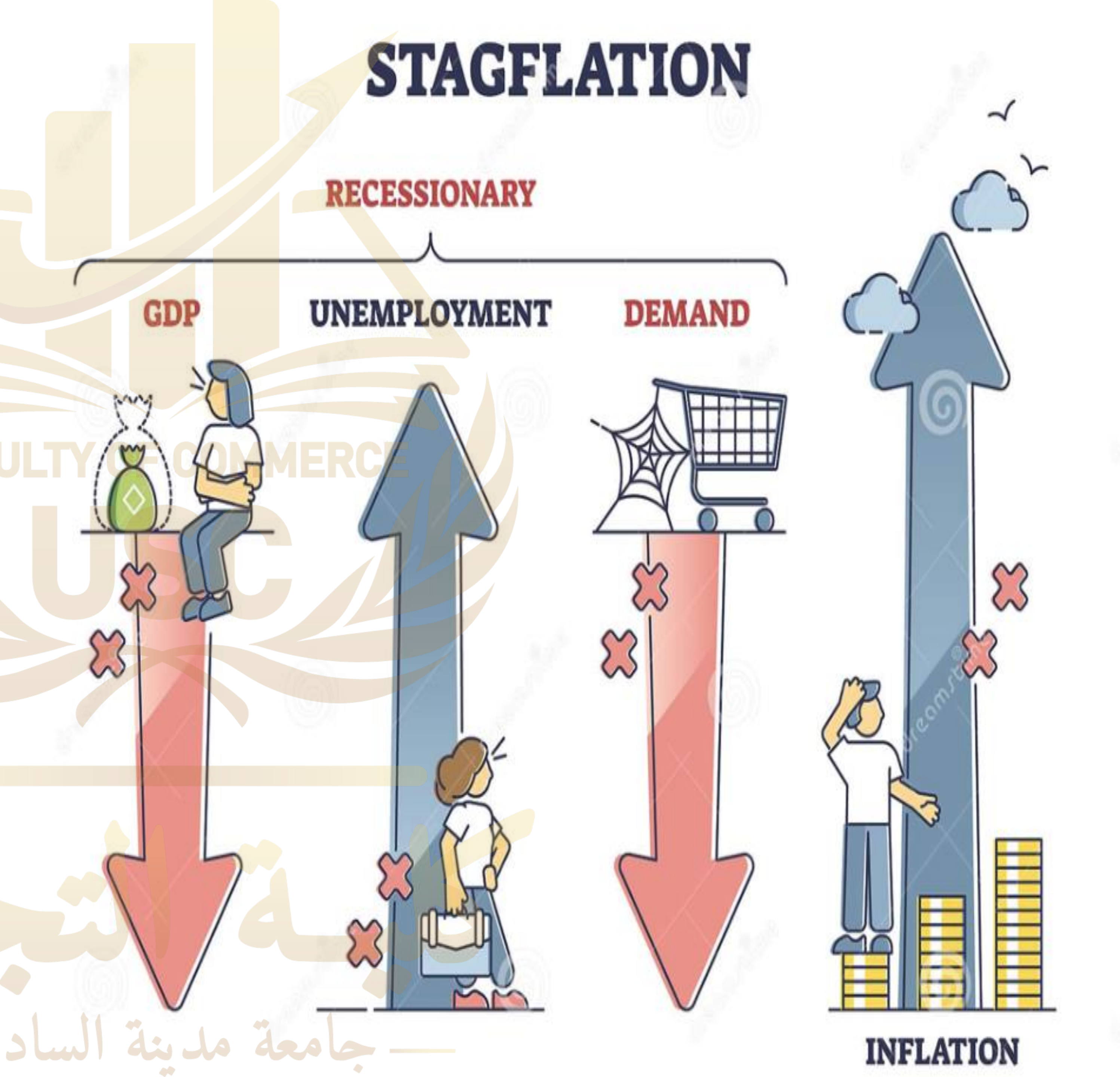
2. Impact of Debt Payers:

Due to fall in prices, the value of money in real terms appreciates and making debts in money more costly.

STAGFLATION

- refers to economic condition where economic growth is very slow, and prices are rising.

- It's a combination of stagnation(Recession or deflation) and inflation.



IMPACT OF STAGFLATION ON ECONOMIC GROWTH

1. The stability of the real value of the domestic currency.

2. Increasing Savings and investments