



# **INTRODUCTION TO ECONOMICS**

**FIZZA AFTAB**

Reference Book : Economics by Paul A. Samuelson



**INFLATION**

# INFLATION

Inflation means a sustained increase in the general price level. Inflation has consequences for people and firms throughout the economy, in their roles as lenders and borrowers, wage-earners, taxpayers, and consumers.

## Calculating Inflation....

we calculate inflation by using price indexes—weighted averages of the prices of thousands of individual products.

CPI (inflation proxy) →

**Basket of Goods**

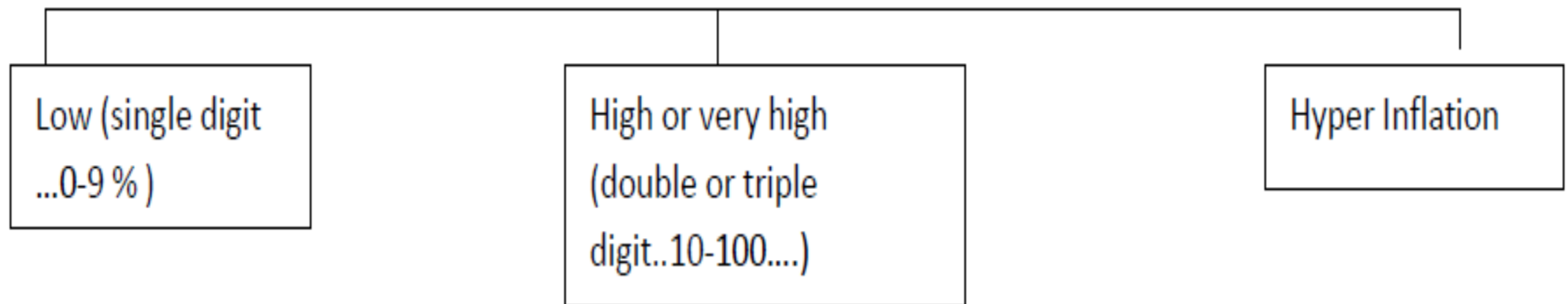


Weighted avg prices  
of thousands of  
individual products

$$\text{Rate of inflation in year } t = 100 \times \frac{P_t - P_{t-1}}{P_{t-1}}$$

Items:	W	Price( t)
Food	.40	xx
Education	.20	xx
Health care	.25	xx
Shelter	.15	xx
Total	1.0	xxx

# Three Strains of Inflation



# What Is the Optimal Rate of Inflation?

Inflation rate (% per year)	Growth of per capita GDP (% per year)
−20−0	0.7
0−10	2.4
10−20	1.8
20−40	0.4
100−200	−1.7
1,000+	−6.5

**TABLE 30-1. Inflation and Economic Growth**

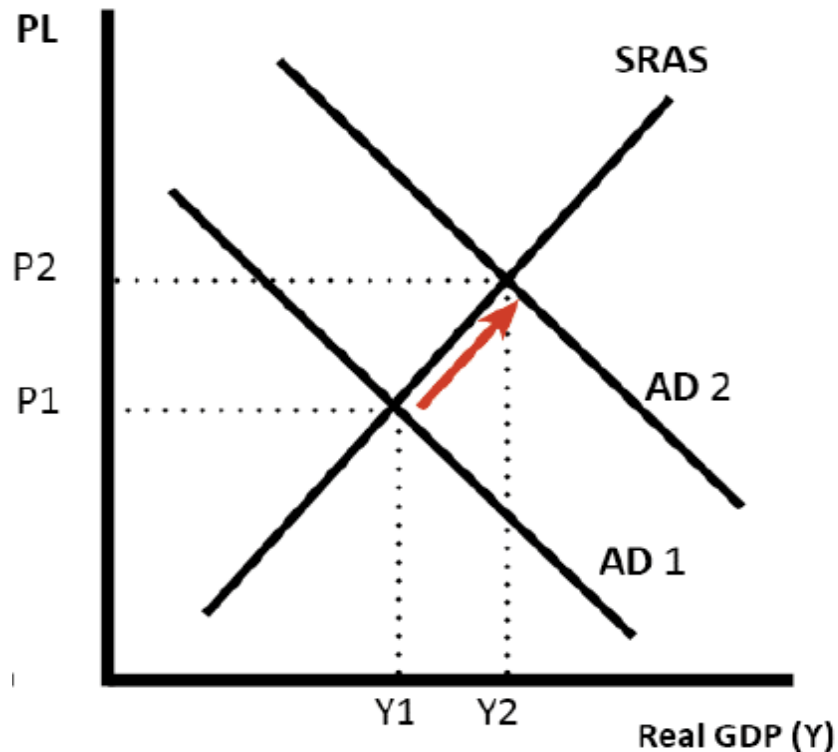
The pooled experience of 127 countries shows that the most rapid growth is associated with low inflation rates. Deflation and moderate inflation accompany slow growth, while hyperinflations are associated with sharp downturns.



# PRICES IN THE AS-AD FRAMEWORK/ *Causes of Inflation:*

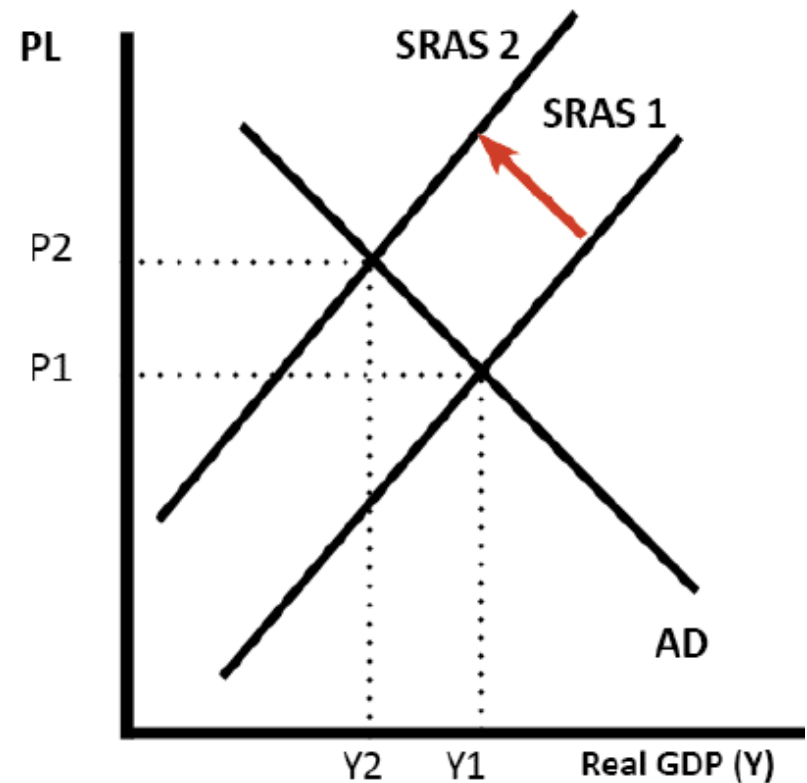
## A. Demand-Pull Inflation

Movement along SRAS curve



## B. Cost-push Inflation

SRAS shift to the left



**A. Demand-Pull Inflation** \_ is the type of inflation brought about by the excess demand pulling prices up.

**Possible causes of Demand-pull inflation:**

1. Government fiscal/or monetary expansion, it occurs when governments engage in deficit spending and rely on the monetary printing press to finance their deficits. The large deficits and the rapid money growth increase aggregate demand, which in turn increases the price level.
2. An increase in the demand for exports, in turn caused by higher inflation



**B. Cost-Push Inflation** is the type of inflation where increases in the costs of production push prices up.

**Possible causes of Cost-push inflation:**

1. Component costs
2. A fall in the exchange rate
3. Higher indirect taxes imposed by the government

# Effects of Inflation

1. Unequal Distribution of Income
2. Lower Standard of Living
3. Value of Currency Fall

# Measures for Controlling Inflation

## Contractionary Fiscal Policy

**(a)** Reduction in Unnecessary Expenditure

**(b)** Increase in Taxes