

② Inflation :

Coulborn "Too much money chasing too few goods."

* Inflation is a persistent increase in the general price level (or) a persistent decrease in the real income of people (value of money)

* Money Inflation leads to price inflation.

Concepts of Inflation

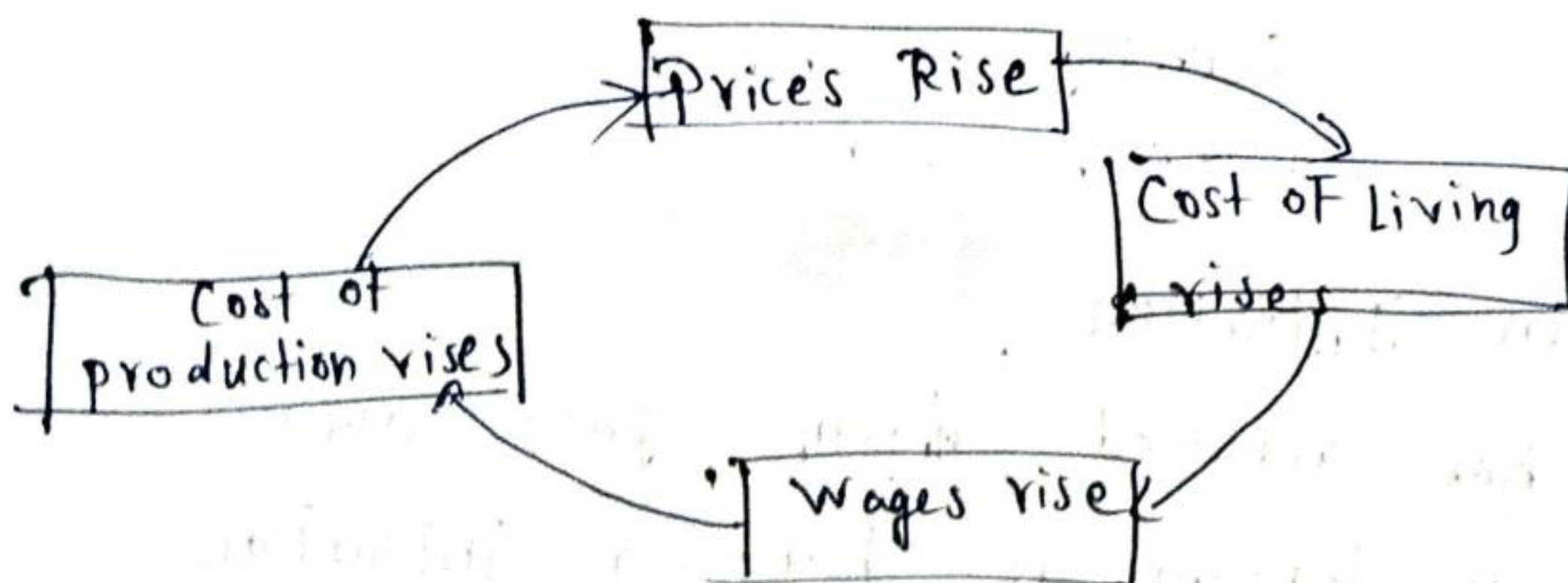
① Headline inflation - measure of total inflation within an economy.

② Hyper inflation - price \uparrow at such a speed that value of money \downarrow

③ Stagflation - a typical situation when stagnation and inflation co-exist.

④ Deflation - opposite to inflation. Prices fall persistently

Wage Price Spiral



④

Causes of Inflation

① Excess Money supply:

* It is the important cause of price rise because it can be directly linked with increase in aggregate demand.

② Demand pull Inflation

When aggregate demand increases due to any reason, and supply of output is unable to match this increased demand (i.e.) demand pulls prices up.

* Increase in money supply

* Increase in disposable income

* Increase in aggregate spending.

* Increase in population of the country.

③ Cost push Inflation

An increase in price of any of the inputs will increase the cost of production.

④ Low Increase in Supply

* If supply falls short of demand, price will increase.

→ Deficient machinery

→ Scarcity of resources.

→ Natural calamities.

⑤ Built in Inflation

* Has resulted from past events

* also known as hangover inflation.

Inflation and decision making.

① Impact on customers.

→ In price upsets the home budget.

② Impact on producers.

→ Producers as sellers are benefitted by inflation.

③ Impact on Government

Government act as the balancing force b/w consumers & sellers.

Measuring Inflation

① Price Index \Rightarrow numerical measure to compare how the prices of some class of goods and/or services differ b/w time periods (or) geographical locations.

$$P.I = \frac{\text{Current Year's Price}}{\text{Base Yr's Price}} \times 100$$

② * PPI (Producer Price Index) - measure average changes in prices received by domestic producers for their output.

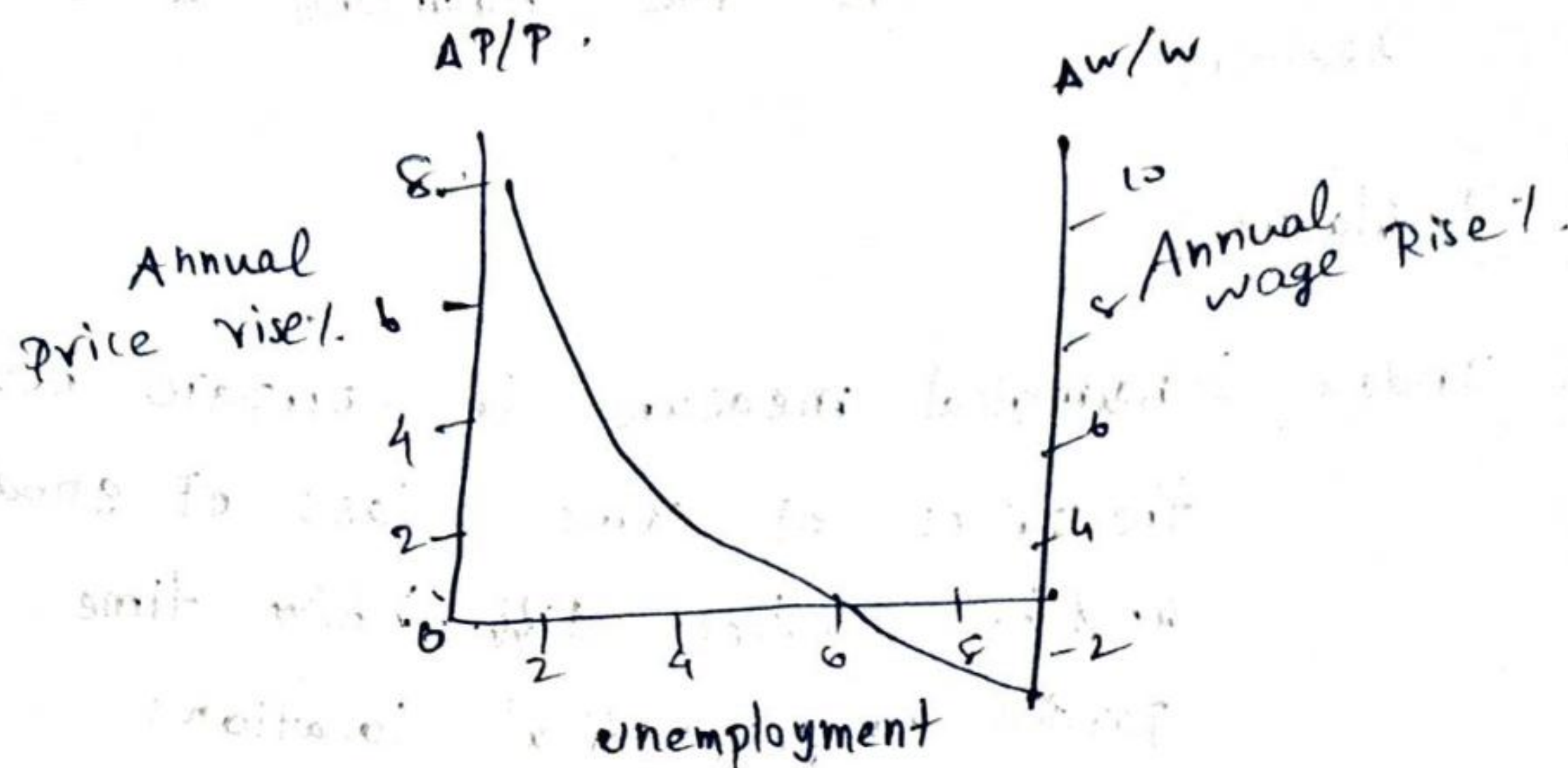
③ * WPI - measure wholesale prices of a wide variety of goods.
USA replaced WPI with PPI.

④ Consumer Price Index (CPI) - measure the price of a selection of goods.

⑤ Cost of Living Indices (COLI) - used to adjust fixed incomes to maintain the real value of such incomes.

⑥ Service Price Index (SPI) - With the growing importance of service sector many countries have started developing SPI.

Philip's curve



Control of Inflation

Inflation erodes the value of money & discourage savings. So we need to control inflation.

① Monetary policy measures

② Fiscal policy

③ other measures.

① Monetary

1. Increasing the discount rate.

The central bank rediscounts the eligible papers.

2. Higher reserve ratios

└ Cash Reserve Ratio (CRR)

└ SLR (statutory liquidity Ratio)

3. Open market operations: directly sell government securities to public

4. Selective credit control.

② Fiscal policy measures

① Reducing public expenditure.

When government spends on activities like health, transport etc. income of individual increase, this in turn \uparrow the aggregate demand.

② Increasing public revenue.

* \uparrow income tax ~~and~~ ^{and} various types of taxes.