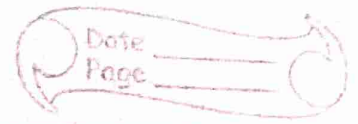


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Q-2 Define Inflation. Explain the various theories of inflation in detail.

Ans-2. Inflation refers to a general increase in the prices of goods and services in the economy over time that corresponds with a decrease in value of money.

Some key points about Inflation are:-

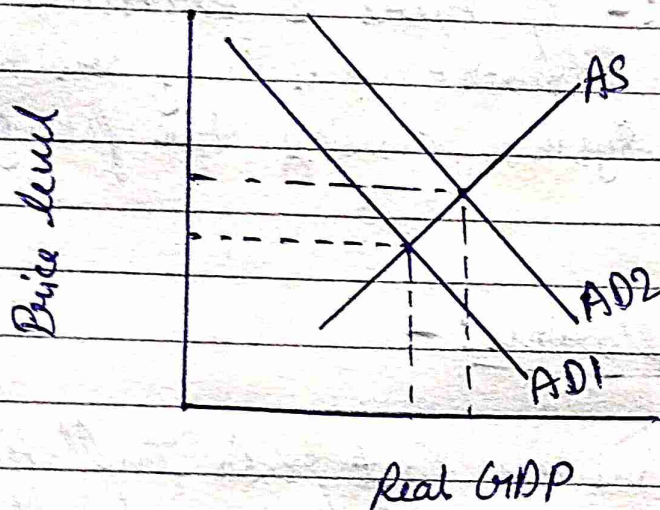
- 1) Inflation is a general increase in the price level of goods and services in the economy over time.
- 2) It's caused by demand-pull or cost-push inflation.
- 3) It can hurt everyday consumers, savers, and fixed-income investors, but it can help borrowers and lenders in certain circumstances.

★ Various Theories of inflation are:-



1.) Demand - Pull Inflation:-

The term demand-pull inflation usually describes a widespread phenomenon. That is when consumer demand outpaces the available supply of many types of consumer goods, demand-pull inflation sets in, forcing an overall increase in the cost of living.



• Demand Pull inflation Graph

⇒ There are 5 Causes of Demand-Pull Inflation.

a) Consumption:- If there is a sharp increase in consumption and investment along with extremely positive business atmosphere, then there will be a rise in Aggregate-Demand.

b) Exchange rate:- A depreciation of the exchange rate increases the price of imports and reduces the price of country's exports.

c). Government Spending:- An enormous increase in government spending will drive up Aggregate Demand.

d). Expectations:- The expectation that inflation will rise often leads to a rise in inflation.

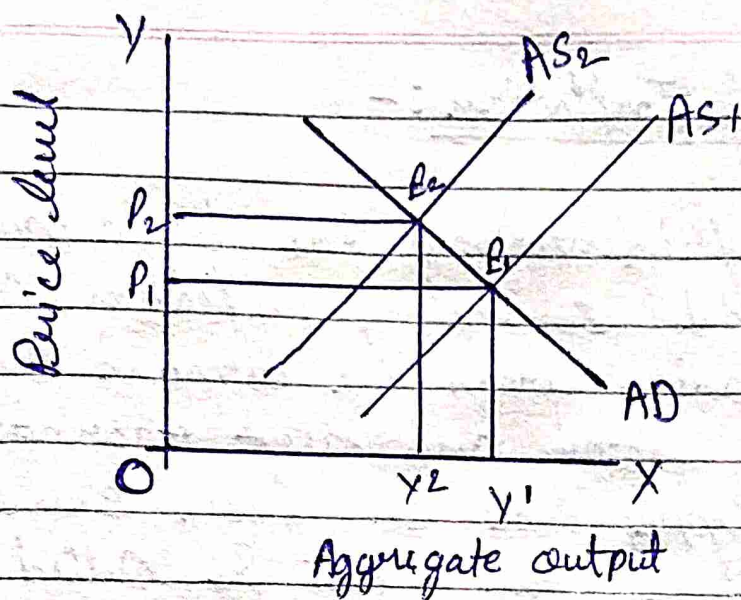
e). Monetary Growth:- If there is excessive monetary growth - when there are too much money in the system chasing too few goods.

2). Cash - Push Inflation:-

Cash Push Inflation or Cost push Inflation, The most common cause of cost push inflation is starts with an increase in cost of production which may be expected or unexpected.

Cost-push inflation occurs when overall prices increase (inflation) due to increase in the cost of wages and raw materials.





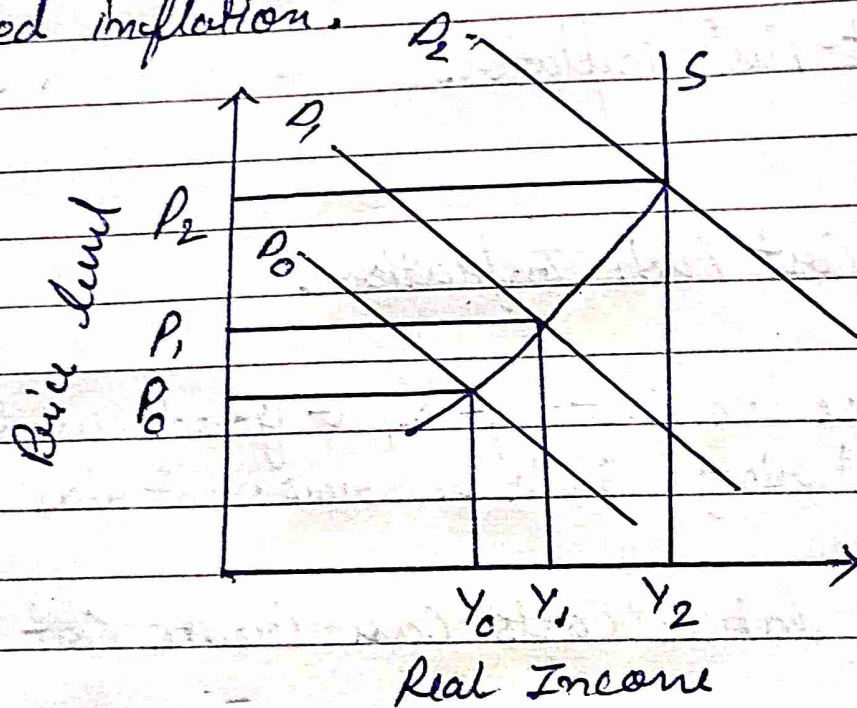
Cost-Push inflation

⇒ Causes of Cost Push Inflation.

- (a). An increase in cost of Input goods used in manufacturing, such as raw material causes it.
- (b). Increased labor costs can create cost-push inflation.
- (c). Natural disaster like floods, earthquake etc. also causes cost-push inflation.
- (d). Sudden change in government also causes cost-push inflation.

3). Mixed - Demand Inflation :-

The problem of identifying the basic nature and fundamental source of inflation continues. Does inflation arise from the demand side of the goods, factor and asset markets or from the supply side or from some combination of the two - the so called mixed inflation.



• Mixed demand inflation

And causes are as both demand and cost pull inflation's one.