Inflation

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Inflation is the percentage change in the value of the Price Index (PI) on a year-on year basis.

Various indices to measure inflation are:

a) WPI (Wholesale Price Index)

b) CPI (Consumer Price Index)

- The basic cause of inflation is the circulation of money in the market is more.
- Mild inflation is good for an economy.

Types of Inflation

- Demand Pull Inflation
- Cost Push Inflation
  - Demand-pull inflation occurs when demand exceeds supply.
  - Cost-push inflation happens when there is an increase in the cost of raw materials needed to produce the goods.

Important Terms

1. **Core Inflation:** It reflects the long-term trend in a particular price level. It is a measure of inflation that excludes certain items that face volatile price movements .

- It is most often calculated using Consumer Price Index (CPI), which eliminates products usually in the energy and food sectors.

2. **Hyperinflation:** When a country experiences very high and usually accelerating rates of inflation (usually 3 digits).

3. Stagflation: is a situation in which the inflation rate is high, the economic growth rate slows, and unemployment remains steadily high.

4. Deflation: is a contraction in the supply of circulated money within an economy, and therefore the opposite of inflation.

- Out of Inflation & Deflation, Inflation is better. Because during inflation, economy is growing.

Measures to Control Inflation

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1. Monetary Measures

a) CRR (Cash Reserve Ratio)
b) SLR (Statutory Liquidity Ratio)
c) Repo rate
d) Reverse repo rate

Monetary Measures

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- The government of a country takes several measures and formulates policies to control economic activities.
  - Monetary policy is one of the most commonly used measures taken by the government to control inflation.

2. Fiscal Measures

a) Increase in taxes

b) Decrease in expenditure

c) Increase in savings

Fiscal Measures

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- Apart from monetary policy, the government also uses fiscal measures to control inflation. The two main components of fiscal policy are government revenue and government expenditure.
- In fiscal policy, the government controls inflation either by reducing private spending or by decreasing government expenditure, or by using both.

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- It reduces private spending by increasing taxes on private businesses.
- When private spending is more, the government reduces its expenditure to control inflation.
- However, in present scenario, reducing government expenditure is not possible because there may be certain on-going projects for social welfare that cannot be postponed.

- Besides this, the government expenditures are essential for other areas, such as defense, health, education, and law and order.
- In such a case, reducing private spending is more preferable rather than decreasing government expenditure.
- When the government reduces private spending by increasing taxes, individuals decrease their total expenditure.