1

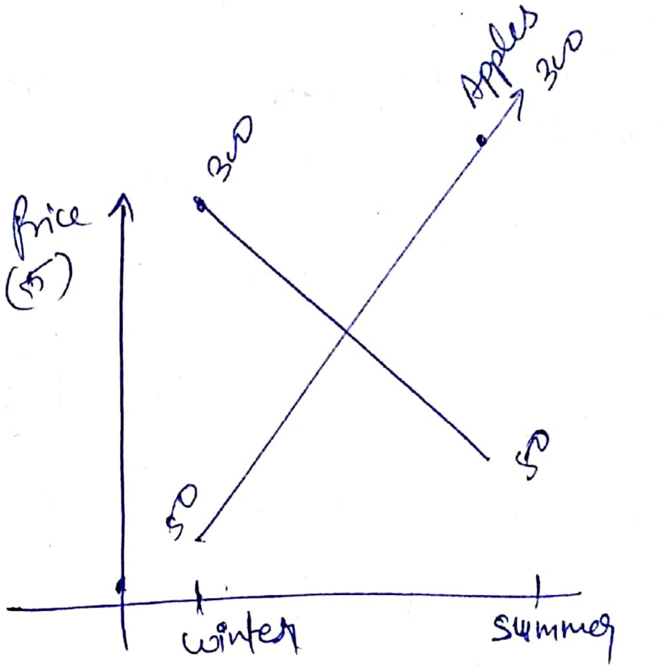
Date
12-10-2020

Economy

Inflation in India

Q. July ₹ 20/kg
Oct ₹ 80/kg

a) inflation
b) deflation
c) stagflation
d) Skew flation. ✓



# Month	2019 Price	2020 GPL (General Price level)
Jan	10	10
feb	11	11
mar	12	12
⋮	⋮	⋮
Dec	20	20

Inflation

A Sustained increase in the General Price level (GPL) in a market or economy.

Inflation is represented in terms of a percentage rate which computes the annual change in the rate of general price level from the preceding year to the following year.

Inflation vs. Inflation Rate

Economic Condition — Annual Rate of change

GPL ↑ — 3 %

Inflation is calculated for a basket of goods & services that typical consumers buy for their consumptions. It is a serious problem having social economic and political domain because it impacts the poor population very badly.

Value of ₹

Purchasing Power — ₹ = ? G/S

Cost of Living

Forex Rate — ₹ = ? $

Some economics believed that when too much money ~~to~~ chases too few goods. (Quantitative theory of money)

₹ > GDP

Too much — Too few

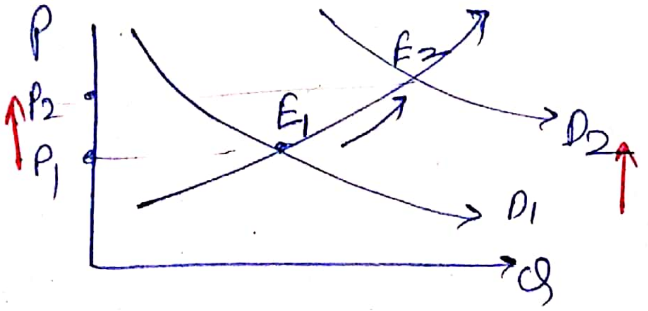
↑ (Money supply)

In the time of Inflation the central banks follow contractionary monetary policy or dear money policy, which requires increase in the rate of interest, apart from other tools.

Seasonal changes or flactuations emphasis are not taken as inflation. Similarly increase in price of one or few items is called as skewed flation.

Types / Causes of Inflation

Demand Pull Inflation | Cost Push Inflation



Demand Pull Inflation

When the Aggregate demand for goods & service exceeds the aggregate supply then it leads to demand pull inflation. The factors behind the demand side include the following.

1. Increase in money supply.
2. Increase in public expenditure by government.
3. Increase in personal Income
4. Increase in population.
5. Decrease in the taxes
6. Black Money increase
7. Hoarding, Speculation, Black Marketing.

Cost Push Inflation

When the producer and sellers increase the prices of finish and goods & services to coverup the increase in cost of inputs including raw material wages fuel etc. Then it is called the cost push inflation

Effects of Inflation

Effects of Inflation

Positives

→ Benefit to economy as it can increase the prices for producer causing increase in profits, wages and even employment

→ Benefit to producers, sellers, farmers, and service providers.

→ Benefit to borrowers or Debtors because purchasing power of currency would be lesser at the time of repayment.

→ Benefit to importer as prices go up in local market assuming global price to be constant.

→ Benefit to tax department as increaseto prices may bring more of indirect taxes.

Negatives

→ Harm to economy as purchasing power of currency decreases and Hoarding and black market increases.

→ Harm to consumers particularly low income population.

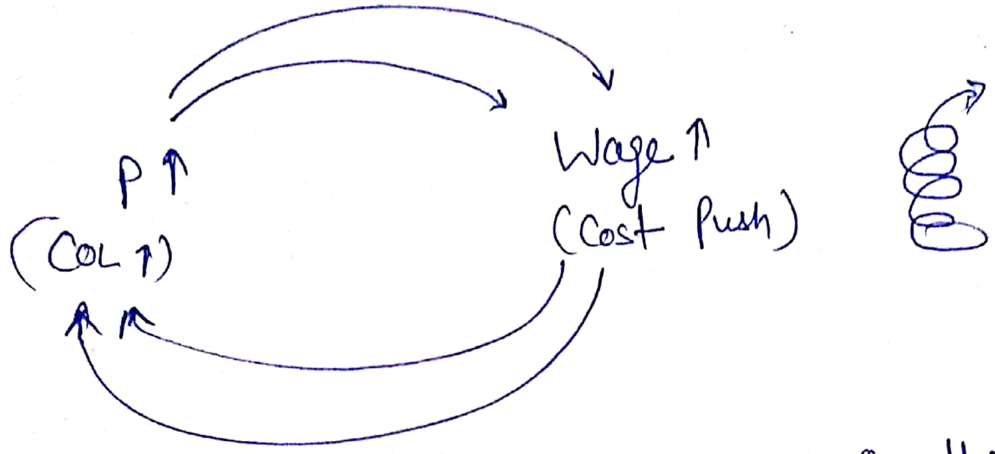
→ Harm to creditor / Lender

→ Harm to exporter

→ Harm to tax payer

Related term

(1) Wage Spiral (Wage Inflation Spiral)



When employees demand, higher wages in the inflationary time and the employers after increasing wages increase the prices of finish goods causing inflation to increase further. Then such cyclical process is called wage inflation spiral.

(2) Inflation Tax —— Burden

is Direct Tax ⊗
or Indirect Tax ⊗

Loss to the person holding cash in the time of Inflation because of decreasing purchasing power of the currency, is some time referred to as inflation tax. It is a burden but not actual tax. are payable to government.

3 Fisher effect

$$\boxed{i = r + \pi}$$

i — Nominal rate of interest; r — Real rate; π — Inflation Rate

1% premium

eg. $\boxed{6.5\% = ? + 3\%}$ → $\boxed{7.5 = ? + 4\%}$

Answer = 3.5 ✓

High inflation rate can lead to high rate of interest and the nominal rate of interest is the some of inflation rate and the real rate of interest.

If inflation rate increases from 3% to 4% people ~~aspect~~ expect 1% extra interest to maintain there level of income from the real interest, such extra interest is called inflation premium.

Inflation Targetting

Is Inflation good?

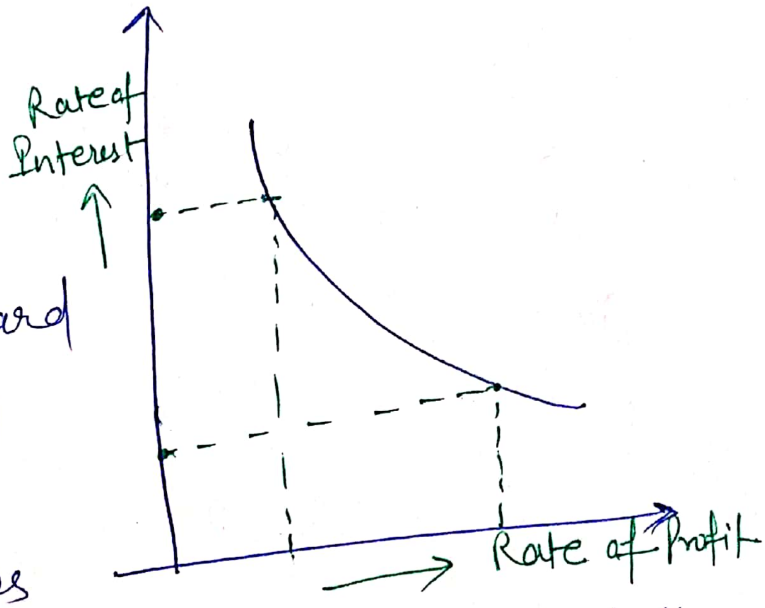
Yes if 4% (± 2%)

A policy to maintain moderate inflation in economy at some target rate to insentivise the stack (different) holders is called inflation targetting.

According to International monetary fund (IMF) the target inflation rate should be 2-3% for developed countries and 4-6% for the developing. In India the monetary policy committee of the RBI has given a target of 4% ± 2% at present.

↑ Inflation
↓
↑ Price to producers
↓
↑ Profits
↓
↑ Wages
↓
↑ employees

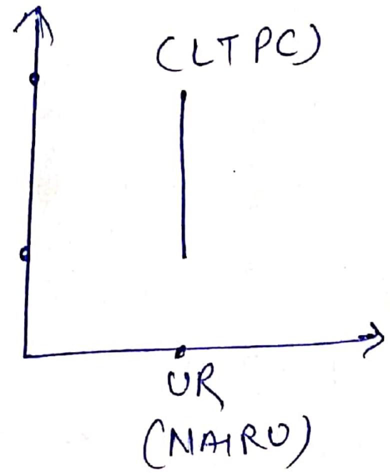
Phillips Curve



It shown by a downward sloping curve called Phillips curve.

According to A.W Phillips the problem of unemployment can be solved at the cost of Inflation.

This theory was critisised by Economics like Milton freidman who claimed that in the long run the unemployement remain constant at its normal rate (NAIRU). At NAIRU irrespective of the rate of inflation, because the higher inflation will increase unemployement because of wage spiral.



Note:
NAIRU means non-accelerating inflation rate of unemployement.

Reflation
If modernate rate of inflation is maintained deliberately through the government policy to incentive side, sellers etc, then it is called reflation. It is similar to inflation targeting but under reflation there is no rigid target rate.

Deflation vs Disinflation

10
11
12 Inflation
13

20
30 Higher
50 Disinflation Inflation

60
66 Lower

70
65 Deflation.
60
50

When Inflation rate goes down from a higher level
to lower level. say from one digit rate to two
digit rate. but inflation remains then it is
called disinflation. On the other hand when prices
start falling and the inflation rate become negative
then it is called deflation.