The general rise in prices of goods and services is known as inflation. Moderate inflation is healthy for economic growth, but high inflation is not good for the economy. Deflation occurs when there is a huge decrease in prices of goods and services.

Deflation is very bad for the economy because it will negatively impact the investments and production and thereby increase unemployment. When there is inflation but the economic growth is slow or stagnant and has a very high unemployment rate, then this is known as stagflation. Economists try to avoid both stagflation and deflation.

Inflation

On February 26, 2021, the Reserve Bank of India (RBI) published its 'Report on Currency and Finance (RCF) for the year 2020-21.' The report with its theme, 'Reviewing the Monetary Policy Framework' assumes topical relevance in the context of the review of the inflation target by March 2021 against the backdrop of structural changes in the macroeconomic and financial landscape that have prompted several central banks to undertake policy framework reviews. The report also studied the flexible inflation targeting (FIT) framework in India.

As per a another report by the RBI, the annual retail inflation rate rose 6.30% year-on-year in May, up from 4.29% in April and sharply above analysts' estimate of 5.30%. The wholesale price inflation rate rose 12.94%, its highest in at least two decades.

What is Inflation? In economics, inflation (or less frequently, price inflation) is a general rise in the price level of an economy over a period of time. When the general price level rises, each unit of currency buys fewer goods and services; consequently, inflation reflects a reduction in the purchasing power per unit of money – a loss of real value in the medium of exchange and unit of account within the economy.

As per RBI, an inflation target of 4 per cent with a +/-2 per cent tolerance band, is appropriate for the next five years (2021-2025).

Types of Inflation

The different types of inflation in an economy can be explained as follows:

Demand-Pull Inflation

This type of inflation is caused due to an increase in aggregate demand in the economy.

Causes of Demand-Pull Inflation:

- A growing economy or increase in the supply of money – When consumers feel confident, they spend more and take on more debt. This leads to a steady increase in demand, which means higher prices.
- Asset inflation or Increase in Forex reserves– A sudden rise in exports forces a depreciation of the currencies involved.
- Government spending or Deficit financing by the government – When the government spends more freely, prices go up.
- Due to fiscal stimulus.
- Increased borrowing.
- Depreciation of rupee.
- Low unemployment rate.

Effects of Demand-Pull Inflation:

- Shortage in supply

- Increase in the prices of the goods (inflation).
- The overall increase in the cost of living.

Cost-Push Inflation

This type of inflation is caused due to various reasons such as:

- Increase in price of inputs
- Defective Supply chain
- Increase in indirect taxes
- Depreciation of Currency
- Crude oil price fluctuation
- Defective food supply chain
- Low growth of Agricultural sector
- Food Inflation
- Interest rates increased by RBI

Cost pull inflation is considered bad among the two types of inflation. Because the National Income is reduced along with the reduction in supply in the Cost-push type of inflation.

Built-in Inflation

This type of inflation involves a high demand for wages by the workers which the firms address by increasing the cost of goods and services for the customers.

Remedies to Inflation

The different remedies to solve issues related to inflation can be stated as:

- **Monetary Policy (Contractionary policy)**

The monetary policy of the Reserve Bank of India is aimed at managing the quantity of money in order to meet the requirements of different sectors of the economy and to boost economic growth.

This contractionary policy is manifested by decreasing bond prices and increasing interest rates. This helps in reducing expenses during inflation which ultimately helps halt economic growth and, in turn, the rate of inflation.

- **Fiscal Policy**
    - Monetary policy is often seen separate from fiscal policy which deals with taxation, spending by government and borrowing. Monetary policy is either contractionary or expansionary.
    - When the total money supply is increased rapidly than normal, it is called an expansionary policy while a slower increase or even a decrease of the same refers to a contractionary policy.
    - It deals with the Revenue and Expenditure policy of the government.

Tools of fiscal policy

1. Direct Taxes and Indirect taxes – Direct taxes should be increased and indirect taxes should be reduced.
2. Public Expenditure should be decreased (should borrow less from RBI and more from other financial institutions)

- **Supply Management measures**

    1. Import commodities that are in short supply
    2. Decrease exports
    3. Govt may put a check on hoarding and speculation
    4. Distribution through Public Distribution System (PDS).

Measurement of Inflation

1. Wholesale Price Index (WPI) – It is estimated by the Ministry of Commerce & Industry and measured on a monthly basis.
2. Consumer Price Index (CPI) – It is calculated by taking price changes for each item in the predetermined lot of goods and averaging them.
3. Producer Price Index – It is a measure of the average change in the selling prices over time received by domestic producers for their output.
4. Commodity Price Indices – It is a fixed-weight index or (weighted) average of selected commodity prices, which may be based on spot or futures price
5. Core Price Index – It measures the prices paid by consumers for goods and services without the volatility caused by movements in food and energy prices. It is a way to measure the underlying inflation trends.
6. GDP deflator – It is a measure of general price inflation.

Effect of Inflation on the Economy

The effect of inflation on the economy can be stated as:

1. The effect of inflation is not distributed evenly in the economy. There are chances of hidden costs for different goods and services in the economy.
2. Sudden or unpredictable inflation rates are harmful to an overall economy. They lead to market instability and thereby make it difficult for companies to plan a budget for the long-term.
3. Inflation can act as a drag on productivity as companies are forced to mobilize resources away from products and services to handle the situations of profit and losses from inflation.
4. Moderate inflation enables labour markets to reach equilibrium at a faster pace.

- Why is inflation bad for the economy?
- Inflation erodes purchasing power of the people due to sustained increase in prices of goods and services within a period.
- Who decides inflation rate in India?
- The amended RBI Act also provides for the inflation target to be set by the Government of India, in consultation with the Reserve Bank, once in every five years. However, the Reserve Bank of India is the authority to control inflation through monetary policies which it does by increasing bank rates, repo rates, cash reserve ratio, buying dollars, regulating money supply and availability of credit.

What is Inflation, Deflation, Stagflation

What is Inflation or What is the meaning of Inflation :

In economics inflation means, a rise in general level of prices of goods and services in a economy over a period of time. When the general price level rises, each unit of currency buys fewer goods and services. Thus, inflation results in loss of value of money. Another popular way of looking at inflation is "toomuch money chasing too few goods". The last definition attributes the cause of inflation to monetary growth relative to the output / availability of goods and services in the economy.

In case the price of say only one commodity rise sharply but prices of other commodities fall, it will not be termed as inflation. Similarly, in case due to rumors if the price of a commodity rise during the day itself, it will not be termed as inflation.

What are different types of inflation :

Broadly speaking inflation is divided into two categoires i.e.

(a) DEMAND - PULL INFLATION: **In this type of inflation p**rices increase results from an excess of demand over supply for the economy as a whole. Demand inflation occurs when supply cannot expand any more to meet demand; that is, when critical production factors are being fully utilized, also called Demand inflation.

(b) COST - PUSH INFLATION: This type of inflation occurs when general price levels rise owing to rising input costs. In general, there are three factors that could contribute to Cost-Push inflation: rising wages, increases in corporate taxes, and imported inflation. [imported raw or partly-finished goods may become expensive due to rise in international costs or as a result of depreciation of local currency]

What is Deflation ? :

Deflation is the opposite of inflation. Deflation refers to situation, where there is decline in general price levels. Thus, deflation occurs when the inflation rate falls below 0% (or it is negative inflation rate). Deflation increases the real value of money and allows one to buy more goods with the same amount of money over time. Deflation can occur owing to reduction in the supply of money or credit. Deflation can also occur due to direct contractions in spending, either in the form of a reduction in government spending, personal spending or investment spending. Deflation has often had the side effect of increasing unemployment in an economy, since the process often leads to a lower level of demand in the economy.

What is Stagflation :

Stagflation refers to economic condition where economic growth is very slow or stagnant and prices are rising. The term stagflation was coined by British politician Iain Macleod, who used the phrase in his speech to parliament in 1965, when he said: "We now have the worst of both worlds - not just inflation on the one side or stagnation on the other. We have a sort of 'stagflation' situation." The side effects of stagflation are increase in unemployment- accompanied by a rise in prices, or inflation. Stagflation occurs when the economy isn't growing but prices are going up. At international level, this happened during mid 1970s, when world oil prices rose dramatically, fuelling sharp inflation in developed countries.