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Study of Characteristics of inflation

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Abstract

When the price of goods and services rises, the economy experiences inflation, and when they fall, the economy experiences deflation. Both inflation and deflation are equally undesirable outcomes. Since the economy may rapidly shift from one situation to the other in response to inflation and deflation, it is crucial to keep the two in check. By means of interest rate setting and other monetary policy tools, the Reserve Bank of India monitors and regulates price increases and decreases inside India.

Key words: Inflation, Services, India, budget etc.

Introduction

Many attempts to describe inflation focus on theorised root causes. When the quantity of money grows larger than the market for goods and services, inflation results. The fiscal deficit may also be blamed for inflation. "The newly created funds might be used to cover a budget shortfall. Still, situations like monetary growth or budget deficit might not always result in a higher price level. Hence, it's hard to pin down exactly what inflation means. For some, inflation is defined as a rise in the price level across all products and services, not only those that have had a recent increase. Defining inflation as a consistent and noticeable rise in the overall level or average of prices, as G. Ackley did, is useful. Inflation, then, is a condition in which prices rise but are not excessive.

Definition Of Inflation

According to CROWTHER,

Inflation is a state in which the value of money is falling ,i.e. prices are rising.

According to KEYNES,

The rise in the price-level after the point of full employment is true inflation.

CHARACTERISTICS OF INFLATION

These are defined on the basis of following circumstances:

1.When volume of currency is increasing and production is fixed.

2.When volume of currency is fixed and production is reducing.

3.When volume of currency is decreasing and production is falling but volume of production is decreasing rapidly.

4.When volume of currency and production are increasing but rate of increase of production is less.

5.When volume of production and currency are fixed but volume of currency is more than enough.

Effect of inflation

Everyone reacts differently to fluctuations in the value of money. Creditors, company owners, and investors in publicly traded companies often benefit from rising prices, whereas wage and salary earners, landlords, and others who rely on consistent earnings are hurt. The following are some of the most tangible consequences of inflation for various sectors of society:

1.Effect on redistribution of income and wealth:

A. Consequences for Buyers
B. Repercussions for those earning a living income and those in the paid professions
C. Repercussions for farmers Repercussions for creditors and borrowers
D. The Repercussions for Business Owners and Operators
E. impact on fixed income investors
F. Affecting Factors for Investors
G. Consequences for society and morality

2. Effect on production;

A. Poor resource distribution
B. Alteration to the mode of trade Deterioration of quality
C. Stockpiling and illicit trade
D. Foreign investment is stymied when saving rates drop.
E. Prompts speculative thinking

3. Other effects:

A. A. The Government's Trade Balance
B. The Social and Political Implications of a Collapse in the Exchange Rate

Types of Inflation:

Understanding the differences between the various forms of inflation is important since the nature of inflation changes over time and among economies. This sort of research is helpful for understanding inflation's broader implications and designing effective countermeasures. There

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are several potential causes of inflation. Its tempo or level of intensity may change at certain points. One such way to categorise it is by the government's responses to inflation.

(i) Currency inflation:

This type of inflation is caused by the printing of currency notes.

(ii) Credit inflation:

For the sake of generating a profit, commercial banks often approve more consumer loans and business advances than the economy can reasonably absorb. The result of such a credit expansion is an increase in general inflation.

(iii) Deficit-induced inflation:

When government spending is higher than tax collection, a deficit appears in the budget. The government may request that the Federal Reserve issue more money to cover this shortfall. Any increase in prices may be attributed to deficit-induced inflation given the need for increased monetary output to close the budget gap.

(iv) Demand-pull inflation:

When total consumer demand exceeds supply, prices go up. This type of inflation is referred to as demand-pull inflation (henceforth DPI). However, why does total demand increase? This increase in aggregate demand was attributed by classical economists to an increase in the money supply. DPI occurs when there is a surplus of money compared to the supply of goods and services in an economy. It's been defined as too much money chasing too few things, which is exactly how Coulborn put it.

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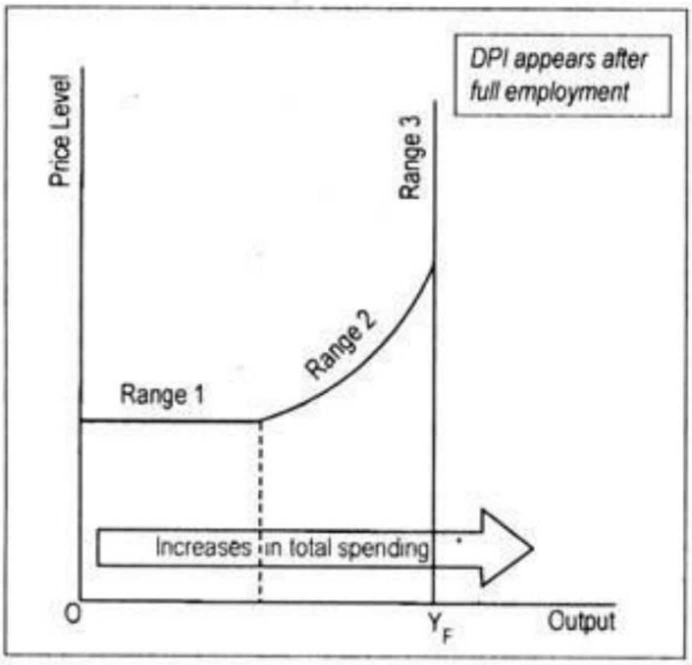

Cost-Push Inflation Theory:

The inflationary process is driven by both aggregate demand and supply. Inflation results from a movement to the left in the aggregate supply, thus the term CPI. Many economists believe that CPI is driven by variables other than money. The rise in CPI results from rising manufacturing costs. A rise in the price of raw materials or an increase in labour might drive up manufacturing costs. On the other hand, workers may be more productive if they receive salary increases. If this occurs, the AS curve will bend to the right, rather than the left. In this case, we assume that a pay rise will have no effect on productivity. When companies' costs go up, they have to charge customers more for their goods. As salaries rise, so do living expenses. As expenses increase, so do product costs. Additionally, labour unions once again seek salary increases because of growing prices.

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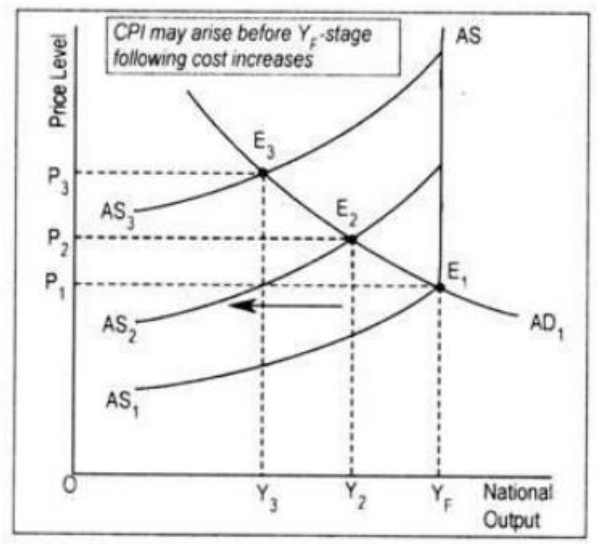

Fig: CPI Shift in AS Curve

To visualise this, let AS1 represent the first aggregate supply curve. This AS curve has a positive slope below full employment and becomes absolutely inelastic above that point. The price is set at the point where the AD1 and AS1 curves intersect (E1) (OP1). The aggregate supply curve has shifted to the left, toward AS2. This results in an increase in prices to OP2 and a decrease in production to OY2 in the absence of a change in aggregate demand. Employment falls or unemployment rises as a result of the drop in output. If the AS curve is shifted any more to AS3, an increase in pricing (OP3) and a decrease in production (Y3) will occur (OY3). Therefore, CPI may emerge prior to the YF stage of economic growth.

Table 1: Inflation Rate in India: Medium to Long-term

Decades	WPI
1951-52 to 1960-61	1.9%
1961-62 to 1970-71	6.2%
1971-72 to 1980-81	10.3
1981-82 to 1990-91	7.1
1991-92 to 2000-01	7.8
2001-02 to 2009-10	5.4
1971-72 to 2009-10	7.7
1951-52 to 2009-10	6.4

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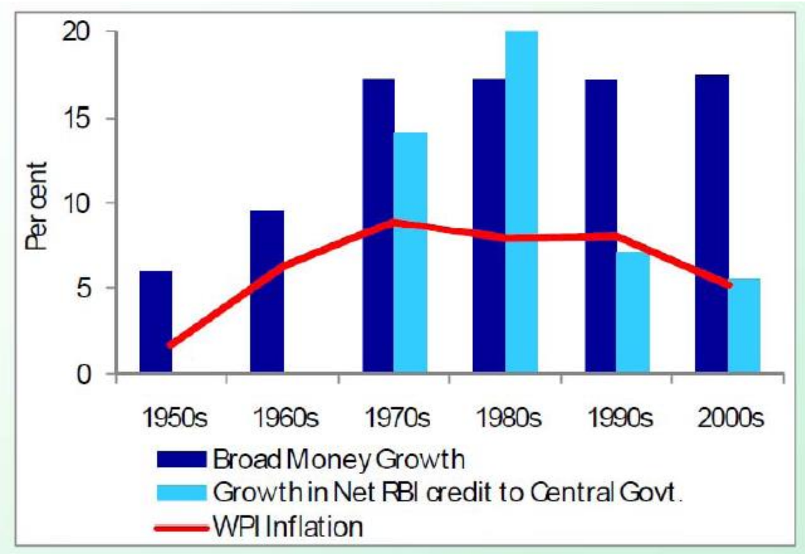
WPI = Wholesale Price Index

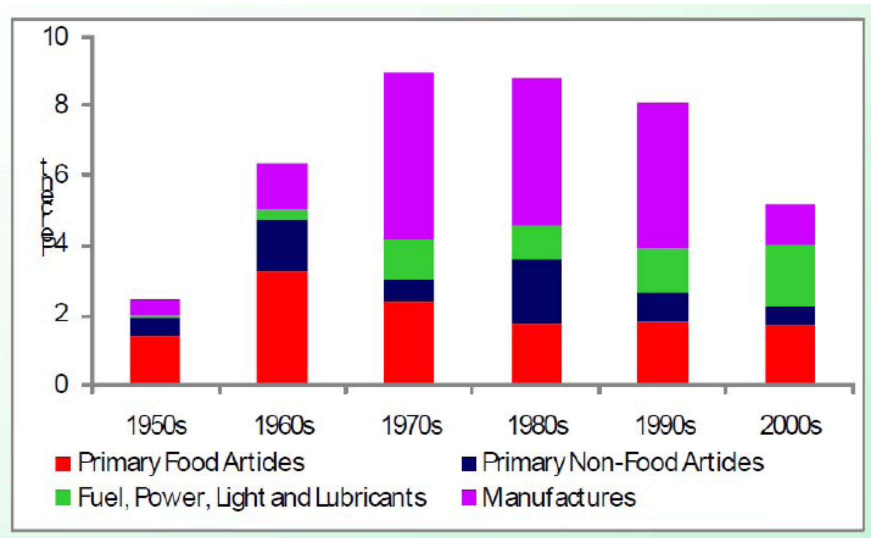
Source: Reserve Bank of India

Figure : Monetary and Fiscal Drivers of Inflation



Source: Gokarn (2010)

Figure : Sources of Inflation



Source: Gokarn (2010)

Conclusion

The rate at which consumer prices are rising is known as inflation. People's ability to spend money typically drops as a result of inflation." In order to keep their economies running smoothly, most central banks attempt to control inflation. When it comes to inflation, there are pros and cons to consider. When inflation occurs, the cost of living increases across the board, impacting everything from groceries to transportation to entertainment to necessities. The rate of inflation is calculated by looking at how much a standard basket of goods and services has increased or decreased in price over a given time period.

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