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B.A. Economics
B.A. Part - 2
Paper - 1 (Macroeconomics)
Topic : Inflation

Inflation

Definition :

Inflation is often defined in terms of its supposed causes. Inflation exists when money supply exceeds available goods and services. Or inflation is attributed to budget deficit financing. A deficit budget may be financed by the additional money creation. But the situation of monetary expansion or budget deficit may not cause price level to rise. Hence the difficulty of defining 'inflation'.

In other words, Inflation may be defined as 'a sustained upward trend in the general level of prices' and not the price of only one or two goods.

G. Ackley defined inflation as 'a persistent and appreciable rise in the general level or average of prices'. It is a state of rising prices, but not high prices.

Measurement of Inflation :

In order to measure inflation rate. Suppose, in December 2007, the consumer price index was 193.6 and, in December 2008, it was 223.8. Thus, the inflation rate during the last one year was

$$223.8 - 193.6 / 193.6 \times 100 = 15.6$$

*As inflation is a state of rising prices, **deflation may be defined as a state of falling prices but not fall in prices.** Deflation is, thus, the opposite of inflation, i.e., a rise in the value of money or purchasing power of money. Disinflation is a **slowing down of the rate of inflation.***

Types of inflation :

Types of Inflation Based on Rising Prices or Rate of Inflation

Creeping Inflation
When prices are gently rising, it is referred as Creeping Inflation. It is the mildest form of inflation and also known as a **Mild Inflation** or **Low Inflation**. According to **R.P. Kent**, when prices rise by **not more than (i.e. Up to) 3% per annum (year)**, it is called Creeping Inflation.

Chronic Inflation
If creeping inflation persists (continues to increase) for a longer period, then it is often called as Chronic or **Secular Inflation**. Chronic-Creeping Inflation can be either:
(i) **Continuous** (which remains consistent without any downward movement) or
(ii) **Intermittent** (which occurs at regular intervals). It is named chronic because if an inflation rate continues to grow for a longer period without any downturn, then it possibly leads to Hyperinflation.

Walking Inflation
When the rate of rising prices is more than the Creeping Inflation, it is known as Walking Inflation. When prices rise by **more than 3%, but less than 10% per annum** (i.e., between 3%, and 10% per annum), it is called as Walking Inflation. According to some economists, we must take Walking Inflation seriously as it gives a cautionary signal for the occurrence of Running Inflation. Furthermore, if, not checked in due time, it can eventually result in Galloping Inflation.

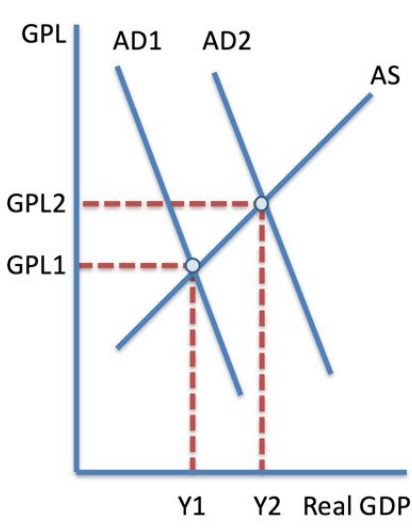
Moderate Inflation
Prof. Samuelson clubbed together concept of Creeping and Walking inflation into Moderate Inflation. It happens when prices rise by **less than 10% per annum** (single-digit inflation rate). According to Prof. Samuelson, Moderate Inflation is a stable inflation and not a serious economic problem.

Running Inflation
A rapid acceleration in the rate of rising prices is called Running Inflation. It occurs when prices rise by more than 10% in a year. Though economists have not suggested a fixed range for measuring running inflation, we may consider a price increase **between 10% to 20% per annum** (double-digit inflation rate) as a Running Inflation.

Galloping Inflation
According to Prof. Samuelson, if prices rise by dual or triple digit inflation rates like 30% or 400% or 999% yearly, then the situation can be termed as Galloping Inflation. When prices rise by **more than 20%, but less than 1000% per annum** (i.e. Between 20% to 1000% per annum), Galloping Inflation occurs. **Jumping Inflation** is its another name. India has been witnessing it from second five-year plan period.

HyperInflation
Hyperinflation is a situation where the prices rise at an alarming high rate. The prices rise so fast that it becomes very difficult to measure its magnitude. However, in quantitative terms, when prices rise **above 1000% per annum** (Quadruple or four-digit inflation rate), it is termed as Hyperinflation. During a worst-case scenario of hyperinflation, the value of the national currency (money) of an affected country reduces almost to zero. Paper money becomes worthless, and people start trading either in gold and silver or sometimes even use the old barter system of commerce. Two worst examples of hyperinflation recorded in the world history are of those experienced by Hungary in the year 1946 and Zimbabwe during 2004-2009 under Robert Mugabe's regime.

Demand Pull Inflation using AD-AS Diagram



1. Demand-pull inflation occurs when AD grows at an unsustainable rate leading a positive output gap (i.e. Actual GDP > Potential GDP)
2. When there is excess demand, producers can raise their prices and thereby achieve bigger profit margins
3. Demand-pull inflation is most likely when there is full employment of resources, when aggregate supply is inelastic

Cost-Push Inflation using AD-AS Diagram

Cost-push inflation occurs when firms respond to rising costs by increasing their prices to protect profit margins

Can be caused by:

1. Rising unit labour costs
2. Higher prices for important components/raw materials
3. A depreciation in the exchange rate causing a rise in import costs
4. An increase in business taxes e.g. VAT or environmental taxes such as a carbon tax

