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Paper - MJC 6

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 the 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.

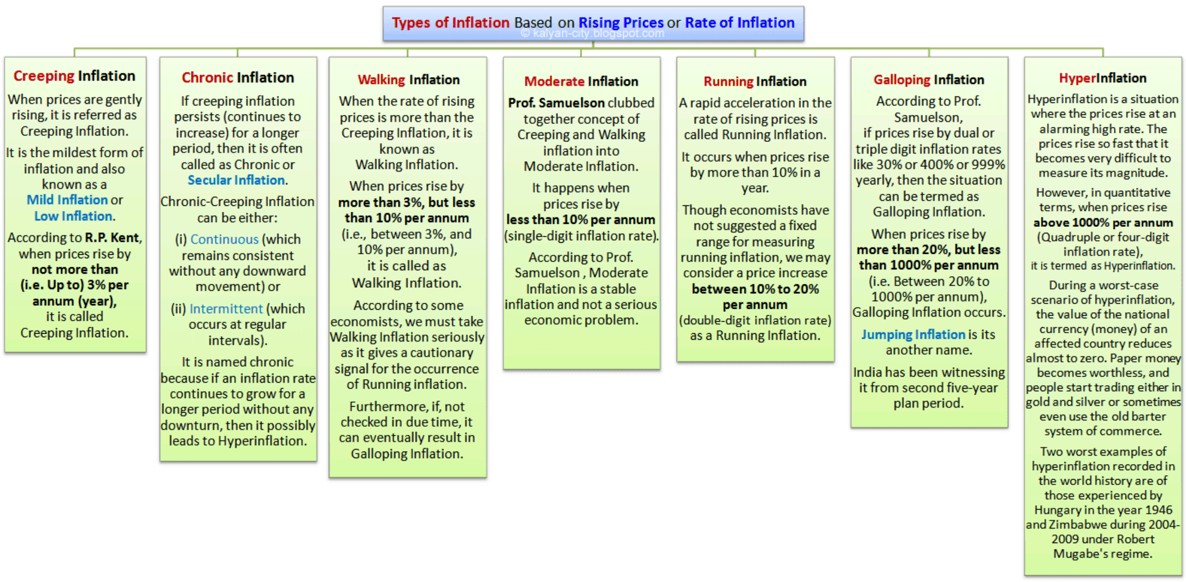
Measurement of Inflation :

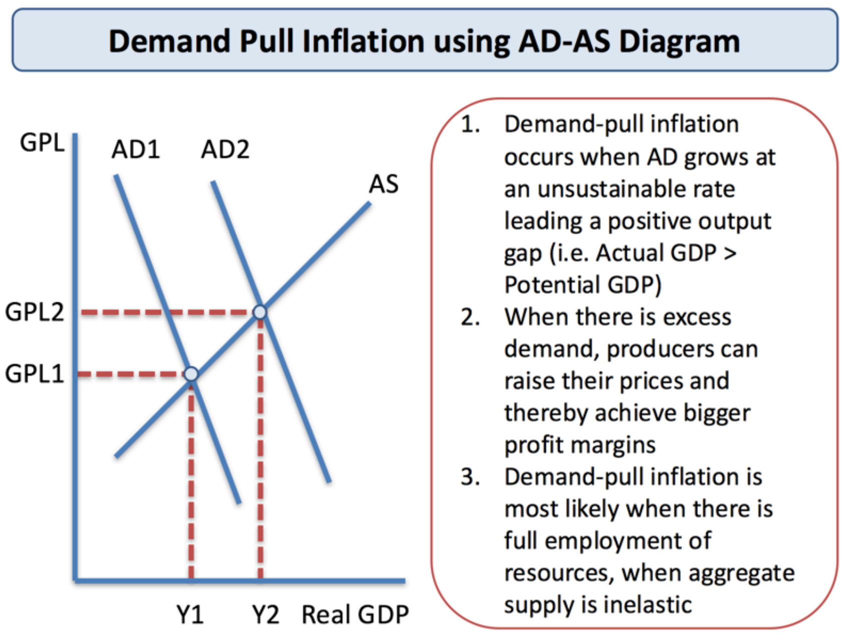
In order to measure inflation rate. Suppose, in December 2007, the consumer price index was 193.6 and, in December 2008, it was 223.8. Thus, the inflation rate during the last one year was

*223.8- 193.6/ 193.6 x 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 :





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