

Pinky Rani
Guest Faculty
Department of Economics
Maharaja College
Veer Kunwar Singh University, Ara
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Topic: Types of Inflation

Types of Inflation:

As the nature of inflation is not uniform in an economy for all the time, it is wise to distinguish between different types of inflation. Such analysis is useful to study the distributional and other effects of inflation as well as to recommend anti-inflationary policies. Inflation may be caused by a variety of factors. Its intensity or pace may be different at different times. It may also be classified in accordance with the reactions of the government toward inflation.

Thus, one may observe different types of inflation in the contemporary society:

A. On the Basis of Causes:

(i) Currency inflation:

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

(ii) Credit inflation:

Being profit-making institutions, commercial banks sanction more loans and advances to the public than what the economy needs. Such credit expansion leads to a rise in price level.

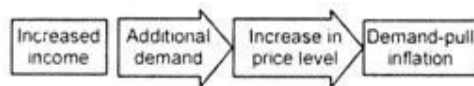
(iii) Deficit-induced inflation:

The budget of the government reflects a deficit when expenditure exceeds revenue. To meet this gap, the government may ask the central bank to print

additional money. Since pumping of additional money is required to meet the budget deficit, any price rise may be called the deficit-induced inflation.

(iv) Demand-pull inflation:

An increase in aggregate demand over the available output leads to a rise in the price level. Such inflation is called demand-pull inflation (henceforth DPI). But why does aggregate demand rise? Classical economists attribute this rise in aggregate demand to money supply. If the supply of money in an economy exceeds the available goods and services, DPI appears. It has been described by Coulborn as a situation of “too much money chasing too few goods.”



Keynesians hold a different argument. They argue that there can be an autonomous increase in aggregate demand or spending, such as a rise in consumption demand or investment or government spending or a tax cut or a net increase in exports (i.e., $C + I + G + X - M$) with no increase in money supply. This would prompt upward adjustment in price. Thus, DPI is caused by monetary factors (classical adjustment) and non-monetary factors (Keynesian argument).

DPI can be explained in terms of Fig. 4.2, where we measure output on the horizontal axis and price level on the vertical axis. In Range 1, total spending is too short of full employment output, Y_F . There is little or no rise in the price level. As demand now rises, output will rise. The economy enters Range 2, where output approaches towards full employment situation. Note that in this region price level begins to rise. Ultimately, the economy reaches full employment situation, i.e., Range 3, where output does not rise but price level is pulled upward. This is demand-pull inflation. The essence of this type of inflation is that “too much spending chasing too few goods.”

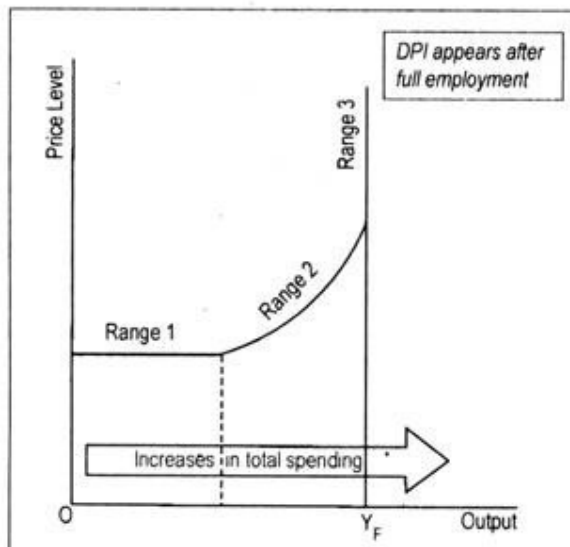


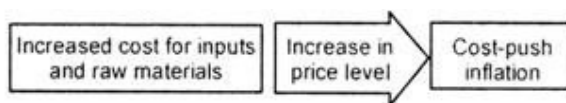
Fig. 4.2: Demand-pull Inflation

(v) Cost-push inflation:

Inflation in an economy may arise from the overall increase in the cost of production. This type of inflation is known as cost-push inflation (henceforth CPI). Cost of production may rise due to an increase in the prices of raw materials, wages, etc. Often trade unions are blamed for wage rise since wage rate is not completely market-determined. Higher wage means high cost of production. Prices of commodities are thereby increased.

A wage-price spiral comes into operation. But, at the same time, firms are to be blamed also for the price rise since they simply raise prices to expand their profit margins. Thus, we have two important variants of CPI wage-push inflation and profit-push inflation.

Anyway, CPI stems from the leftward shift of the aggregate supply curve:



B. On the Basis of Speed or Intensity:

(i) Creeping or Mild Inflation:

If the speed of upward thrust in prices is slow but small then we have creeping inflation. What speed of annual price rise is a creeping one has not been stated by the economists. To some, a creeping or mild inflation is one when annual price

rise varies between 2 p.c. and 3 p.c. If a rate of price rise is kept at this level, it is considered to be helpful for economic development. Others argue that if annual price rise goes slightly beyond 3 p.c. mark, still then it is considered to be of no danger.

(ii) Walking Inflation:

If the rate of annual price increase lies between 3 p.c. and 4 p.c., then we have a situation of walking inflation. When mild inflation is allowed to fan out, walking inflation appears. These two types of inflation may be described as 'moderate inflation'.

Often, one-digit inflation rate is called 'moderate inflation' which is not only predictable, but also keep people's faith on the monetary system of the country. Peoples' confidence get lost once moderately maintained rate of inflation goes out of control and the economy is then caught with the galloping inflation.

(iii) Galloping and Hyperinflation:

Walking inflation may be converted into running inflation. Running inflation is dangerous. If it is not controlled, it may ultimately be converted to galloping or hyperinflation. It is an extreme form of inflation when an economy gets shattered."Inflation in the double or triple digit range of 20, 100 or 200 p.c. a year is labelled "galloping inflation".

(iv) Government's Reaction to Inflation:

Inflationary situation may be open or suppressed. Because of anti-inflationary policies pursued by the government, inflation may not be an embarrassing one. For instance, increase in income leads to an increase in consumption spending which pulls the price level up.

If the consumption spending is countered by the government via price control and rationing device, the inflationary situation may be called a suppressed one. Once the government curbs are lifted, the suppressed inflation becomes open inflation. Open inflation may then result in hyperinflation.