Inflation:

Few topics of macroeconomics are as baffling for global analysts as inflation and deflation. In some country, inflation is too high and officials struggle to reduce it and in others, it is too low and officials struggle to increase it.

Inflation denotes a rise in general level of prices. More specifically, inflation refers to the rate of general prices of goods and services increase over a period of one year.

It has been observed that inflation worldwide has generally remained in the positive territory, implying that the general price level typically rises. There have however been exceptions, when there have been sustained decline in the price level of goods and services which we call deflation.

Inflation historically has destroyed entire economies and changed the course of human history. It was one of the forces that unravelled the Roman Empire two millennia ago and the empire of the Soviet Union two decades ago. The impact of severe inflation often extends far beyond the economy. In the most telling story in modern history, the horrific inflation triggered by the Weimer Republic in Germany at the end of World War I caused prices to rise to such stupendous levels that the exchange rate of the German Mark to the Dollar exceeded three trillion to one!

Types of inflation on the basis of its causes

Demand-pull inflation is used to describe what happens when price levels rise because of an imbalance in the aggregate supply and demand. When the aggregate demand in an economy strongly outweighs the aggregate supply, prices go up. Economists describe demand-pull inflation as a result of too many rupees chasing too few goods. It results from strong consumer demand. Many individuals purchasing the same good will cause the price to increase, and when such an event happens to a whole economy for all types of goods, it is called demand-pull inflation.

Six reasons for Demand-Pull Inflation:

a) Monetary stimulus to the economy: A fall in interest rates may increase the investment of the economy due to decrease in the cost of fund for business sector and it also enhances the buy-on-credit behaviour for household due to cheaper interest rate for available loan. This activity stimulates the aggregate demand by raising demand for loans.

b) Higher demand from a fiscal stimulus: If government expenditure or public borrowings increases then it creates extra demand in the circular flow of income. In another channel if disposable income increases due to the reduction of direct and indirect taxes then aggregate demand will rise which might be another reason of demand pull inflation.

c) A depreciation of the exchange rate: It increases the price of imports and reduces the foreign price of a country's exports. If consumers buy fewer imports than exports, aggregate demand (explained in chapter 3) will rise. Due to depreciation of currency if export earnings increases then it enhances the consumption and investment demand for economy which also have positive impact on aggregate demand.

d) Fast growth in other countries: If there is a boost on export growth due to higher growth rate of other counties (economic expansion of other countries aggravates the demand for imported goods and services) then export earnings will increase and it also provide an extra flow of money into circular flow of income.

e) Population: The size of the population is one of the determinants of demand. In many developing countries population is large in size and still increasing. India provides an example where demand outstrips supply due to the large and increasing population.

5.2.2**. Cost push inflation:**

Inflation may take place independent of demand forces. Given the demand, price level may go up due to an increase in cost or supply price. This termed as cost push inflation. In this case, the overall price level increases due to higher costs of production which reflects in terms of increased prices of goods and commodities which majorly use these inputs. This is inflation triggered from supply side. Apart from rise in prices of inputs, there could be other factors leading to supply side inflation such as natural disasters or depletion of natural resources, monopoly, government regulation or taxation, change in exchange rates, etc.

Four reasons of Cost push inflation:

1. Supply Shock: When there is a large increase in prices of such necessary commodities like crude oil, this results in higher transport costs and all firms would see a rise in costs.

2. Higher Wages: Wages form a large percentage of costs for firms. Strong labour unions can influence inflation as they push for higher wages, which will lead to an increase in costs of production for the firm and hence higher priced goods.

3. Higher Taxes: An increase in indirect taxation like higher GST and excise duties will increase the prices of goods and services. Taxes on cigarettes and alcohol were meant to lower demand for these unhealthy products. That may have happened, but more importantly, it raised the price and created inflation.

4. Imported Inflation: A devaluation or depreciation of the currency would result in higher prices of imported goods. If country imports intermediate goods or it imports necessary products like crude oil, machinery etc. then the higher price of imported goods increases the cost of production, therefore to keep the profit margin intact price level goes up.

5. Natural Disasters: Natural disasters cause inflation by disrupting supply. A good example is right after Japan's earthquake in 2011. It disrupted the supply of auto parts. It also occurred after Hurricane Katrina. When the storm destroyed oil refineries, gas prices soared.

The depletion of natural resources is a type of natural disaster. It works the same way, by limiting supply and causing inflation.

6. Monopoly: Companies that achieve a monopoly over an industry create cost-push inflation. A monopoly reduces supply to meet its profit goal.

Types of inflation in terms of its intensity

a**) Creeping Inflation**: When the rate of inflation is less than 3 percent per annum, it is termed as creeping inflation. This is considered as mild inflation and it is said to be a tolerable one. A mild inflation is said to be good for the economy as the rise in price will lead to more profits leading to more investment. (When total revenue increases due to marginal increase in prices and total cost remain constant then producers get more incentives to invest)

b) **Walking Inflation**: When prices rise moderately and the annual inflation rate is a single digit (3%-10%) it is called walking or trotting inflation. Inflation at this rate is a warning signal for the government to control it before it turns into running inflation. Prof. Samuelson clubbed creeping and walking inflation together and termed it as moderate inflation. In general moderate inflation is a single digit inflation. According to him moderate inflation should not be allowed to become running inflation. Peoples' confidence gets lost once moderately maintained rate of inflation goes out of control and the economy is then caught with the higher rate of inflation.

c) **Running Inflation**: When prices rise rapidly like the running of a horse at a rate of speed of above 10% to 20% per annum, it is called running inflation. Its control requires strong monetary and fiscal measures, otherwise it leads to galloping inflation.

Galloping Inflation: 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 it's another name.

e) **Hyperinflation:** Hyperinflation refers to 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.