INFLATION

Dr. Dhaval J. Pandya
Head & Asst. Prof.,
Department of Economics,
Udhna Citizen Commerce College &
Surat people's Bank of Business Administration &,
Smt. Diwaliben Harjibhai Gondaliya College of B.C.A. & I.T.,
Surat

INFLATION

- Fluctuation in prices, create an atmosphere of uncertainty which is not very conducive to development activity.

- Since the dawn of the mid 1950s, price have continuously risen in India. The rate of price rise , of course, has not been the same throughout the period.

- Price stability is viewed as a necessary condition to ensure the desired development performance of the economy.

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MEANING & DEFINITIONS

- Inflation is commonly understood as a situation of substantial or rapid general increase in the level of prices & consequent deterioration in the value of money over a period of time.
- Crowther defines inflation as “a state in which the value of money is falling & prices are rising”.
- Harry Johnson defines inflation as “a substantial rise in prices”.
- Prof Samuelson puts it as, “inflation occurs when the general level of prices and costs is rising”.
- Edward Shapiro said – “…inflation can be simply defined as a persistent & applicable rise in the general level of prices”.
- Milton Friedman- “Inflation is always & everywhere a monetary phenomenon”.

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FEATURES OF INFLATION

1. Persistent rise in prices
2. Excessive supply of money in economy
3. Vicious circle of inflationary spiral

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INFLATION & RELATED CONCEPTS

Concepts	Description
Reflation	…is a situation of rising prices, deliberately undertaken to relieve a depression.
Inflation	…is a situation where the prices rise after the level of full employment.
Disinflation	…is a situation where the prices are falling due to anti-inflationary measures adopted by the authorities.
Deflation	…is a condition of falling prices accompanied by a decreasing level of employment, output & income.

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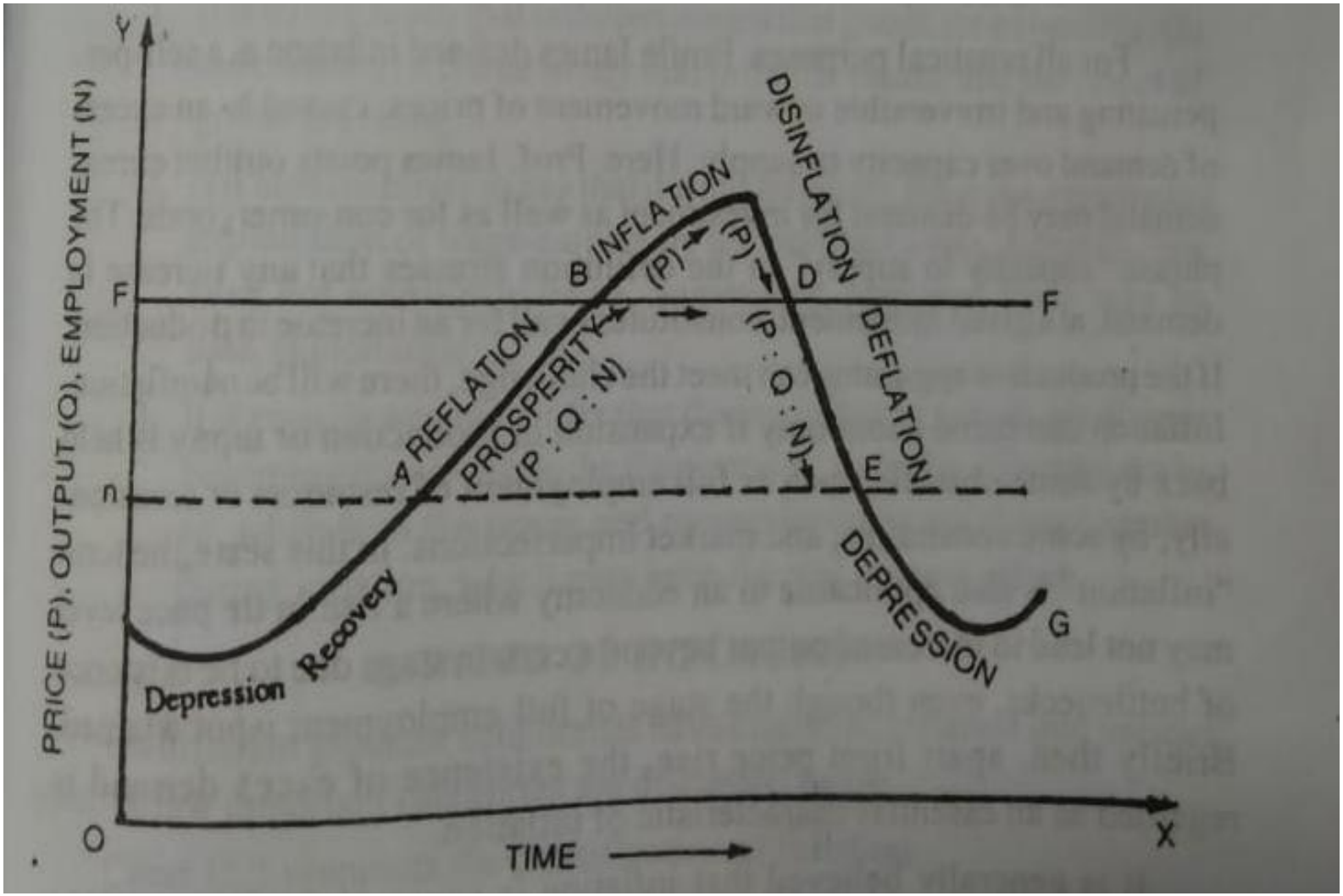
INFLATION & RELATED CONCEPTS



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MEASUREMENT OF INFLATION

- The variations in the price level in India are usually measured in terms of Whole Sale Price Index(WPI).But it can also be measured in terms of Gross Domestic Product Deflator(GDPD) or the Consumer Price Index(CPI).

- WPI: The WPI is computed for all commodities & the major groups & sub groups of commodities.WPI is made available on weekly basis. This index does not cover non commodity producing sectors(Services & non taxable commodities are not included in the WPI)

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MEASUREMENT OF INFLATION

- GDPD: is statistically derived from national income data released by the CSO. It encompasses entire spectrum of activities including services, the coverage of GDPD is far more than WPI or CPI. However, GDPD is available in India only annually with a lag of over one year & thus has limited use for the conduct of policy.

- CPI: measures inflation in terms of cost of living of industrial workers. It is computed on the basis of changes in the retail price of the goods & services which are consumed by the homogeneous group of all industrial workers.

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INFLATION RATE

Rowan suggest the following formula to measure the percentage rate of inflation.

$$P(t) = \Delta P(t) / P(t\text{-}1) * 100$$

Where, P = price level ; t , t-1 = periods of calendar time to which the observation are made.

Year	WPI	Inflation Rate $\Delta P(t) / P(t\text{-}1) * 100$
1980-81	257	-
1980-85	281	281-257/257*100 = 9.3
1990-91	289	289-281/281*100 = 2.9
2000-01	316	316-289/289*100 = 9.3
2005-06	350	350-316/316*100 = 10.7
2015-16	400	400-350/350*100 = 14.2

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Classification of Inflation

- **Time based**
  - Creeping
  - Walking
  - Running
  - Hyper/ Galloping
- **Nature of occurrence based**
  - War time
  - Post war time
  - Peace time
- **Scope based**
  - Comprehensive
  - Sporadic
- **Govt. Reaction**
  - Open
  - Repressed
- **Cause based**
  - Credit
  - Scarcity
  - Deficit
  - Profit
  - Tax
  - Demand pull
  - Cost push

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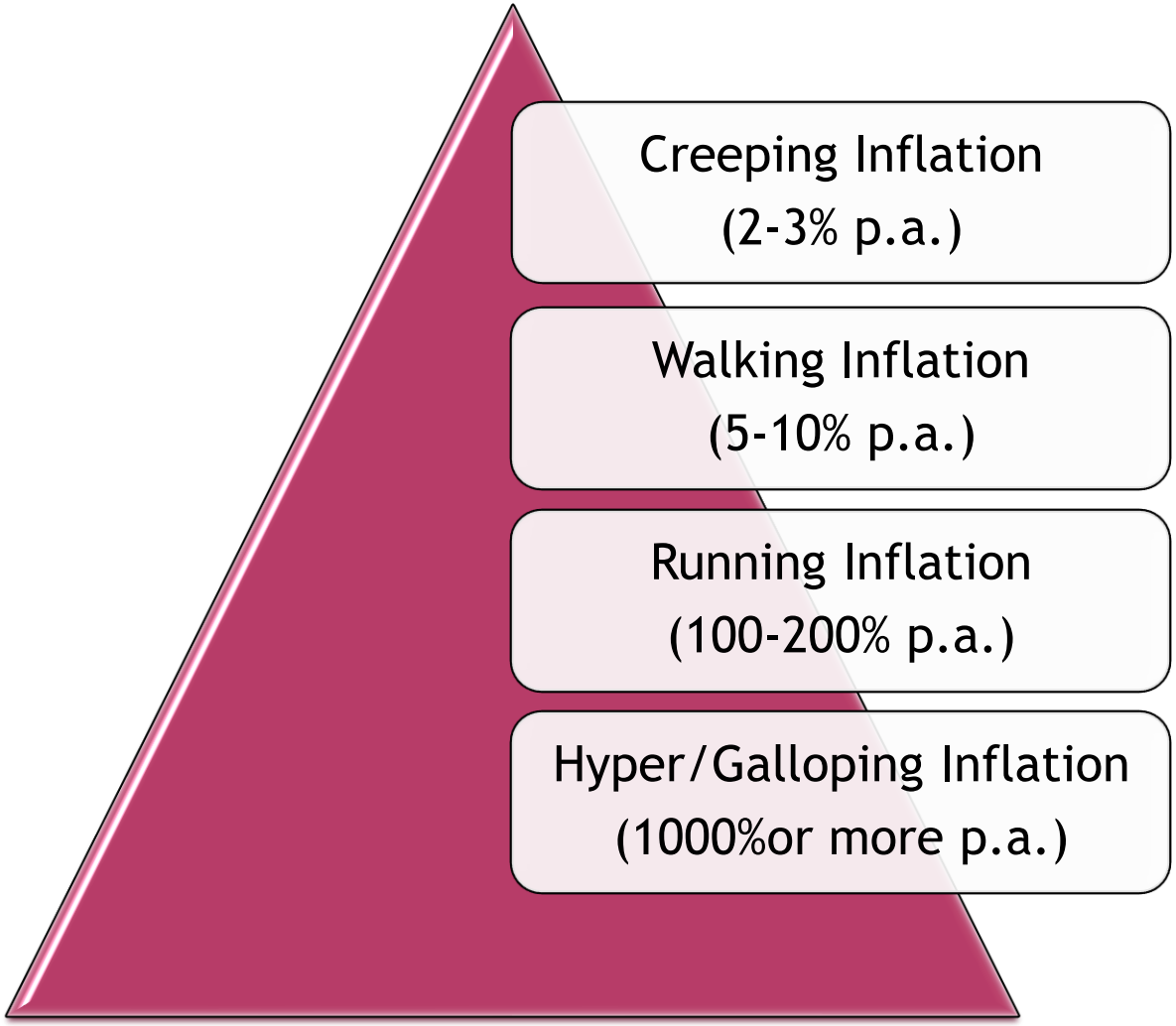
TIME BASED INFLATION



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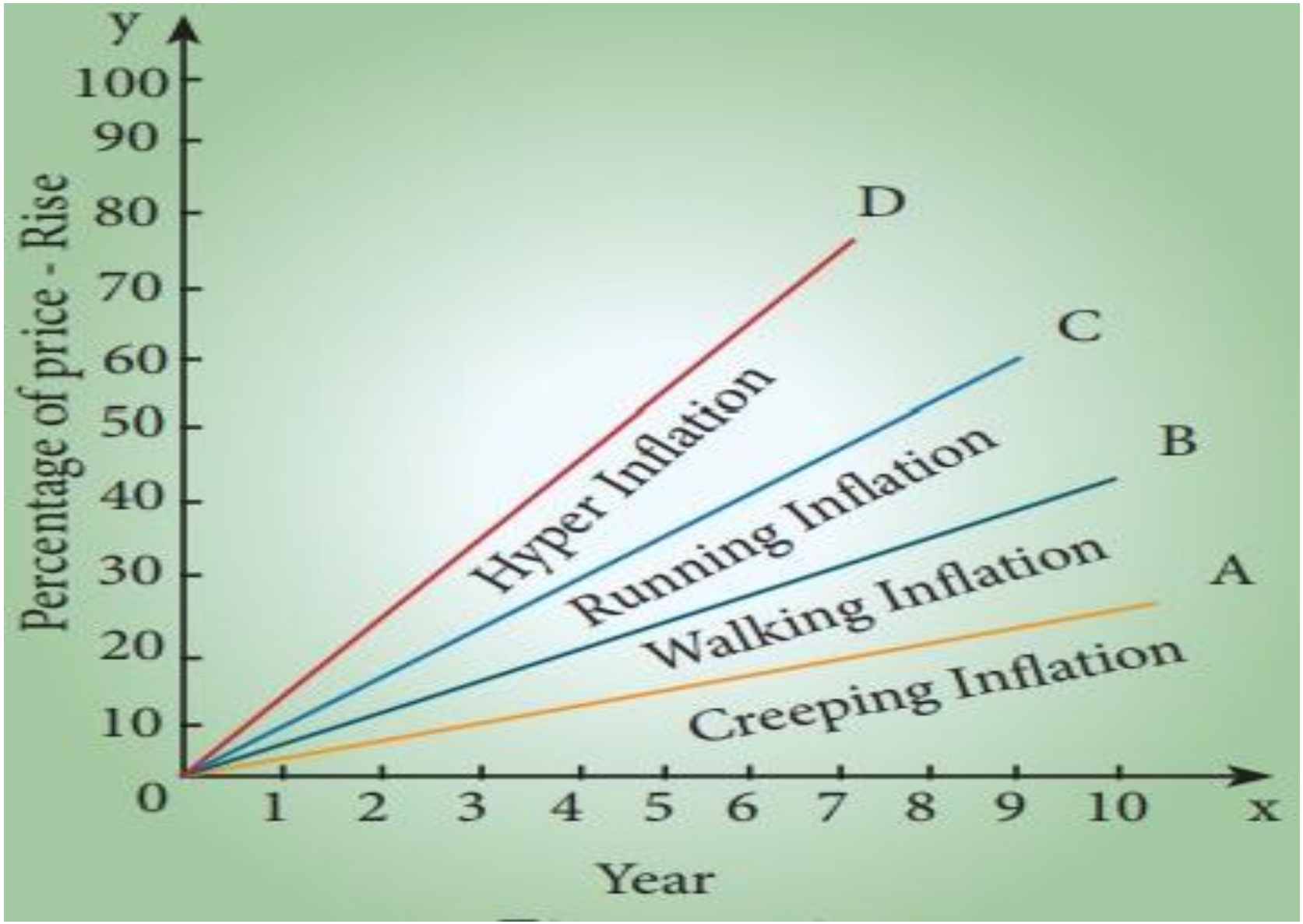
DIAGRAMMATICAL EXPLANATION



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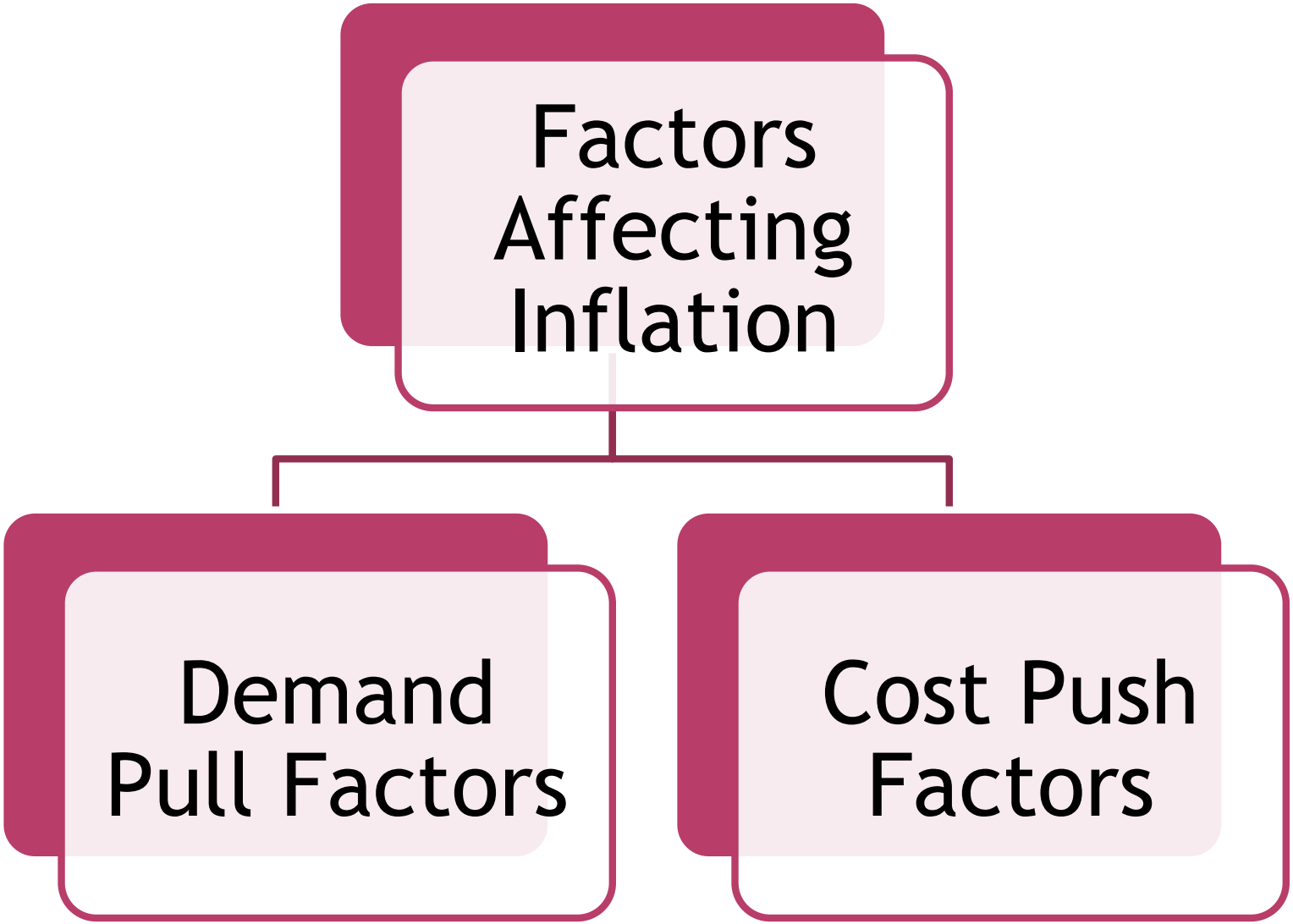
FACTORS THAT AFFECTS RISE IN PRICES IN INDIA (BASED ON TYPES)



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DEMAND PULL & COST PUSH FACTORS

A. Demand Pull Factors (Demand Side)

1. Mounting Government Expenditure.
2. Deficit Financing & increase in money supply.
3. Role of Black money.
4. Growth of population.

B. Cost Push Factors (Supply Side)

1. Fluctuations (Increase) in output & supply.
2. Taxation as a factor in rising cost & prices.
3. Administered Prices.(e.g. Agriculture Price Policy)
4. Hoarding of essential products.
5. Inadequate rise in industrial production.

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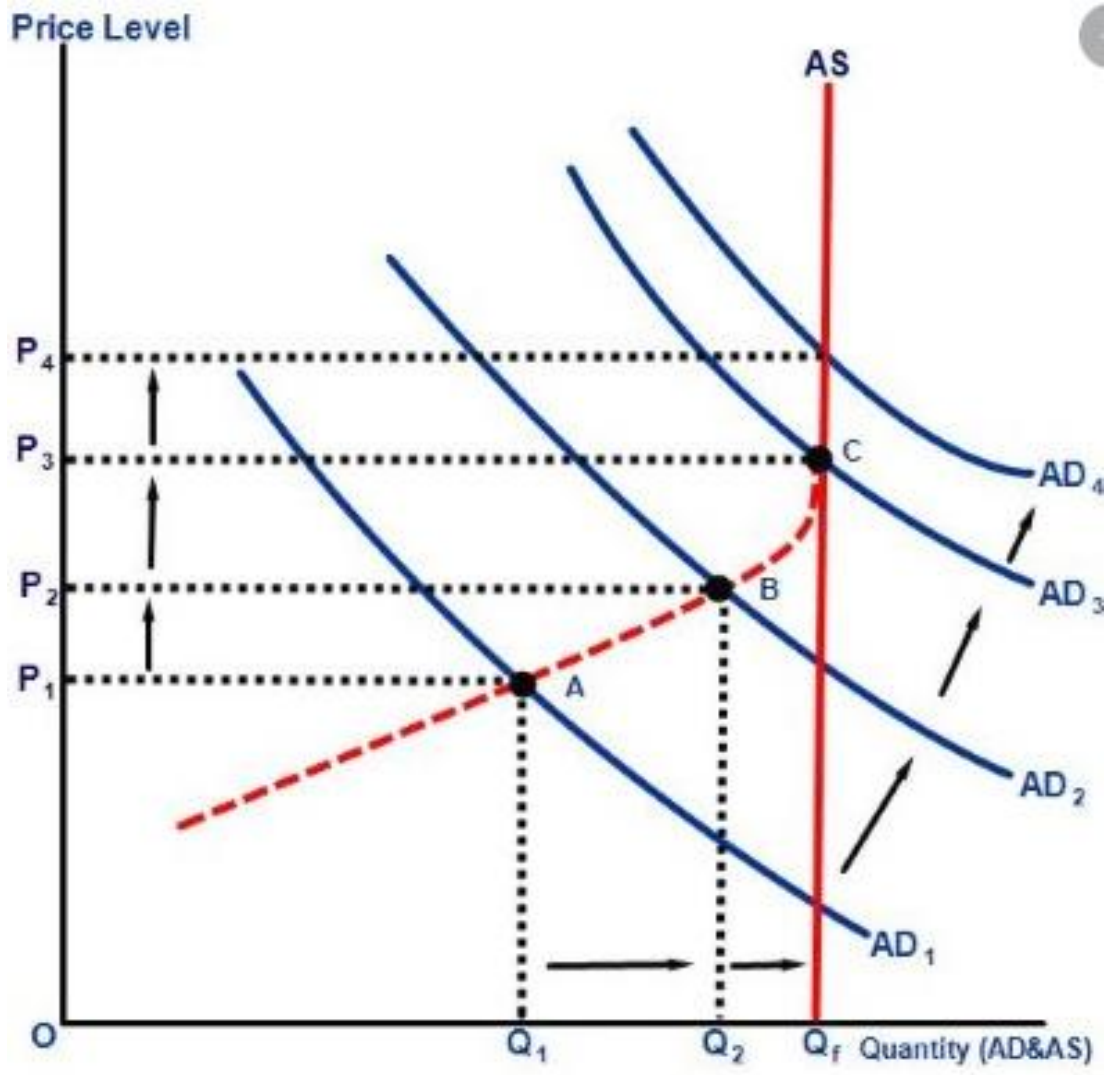
DEMAND PULL INFLATION



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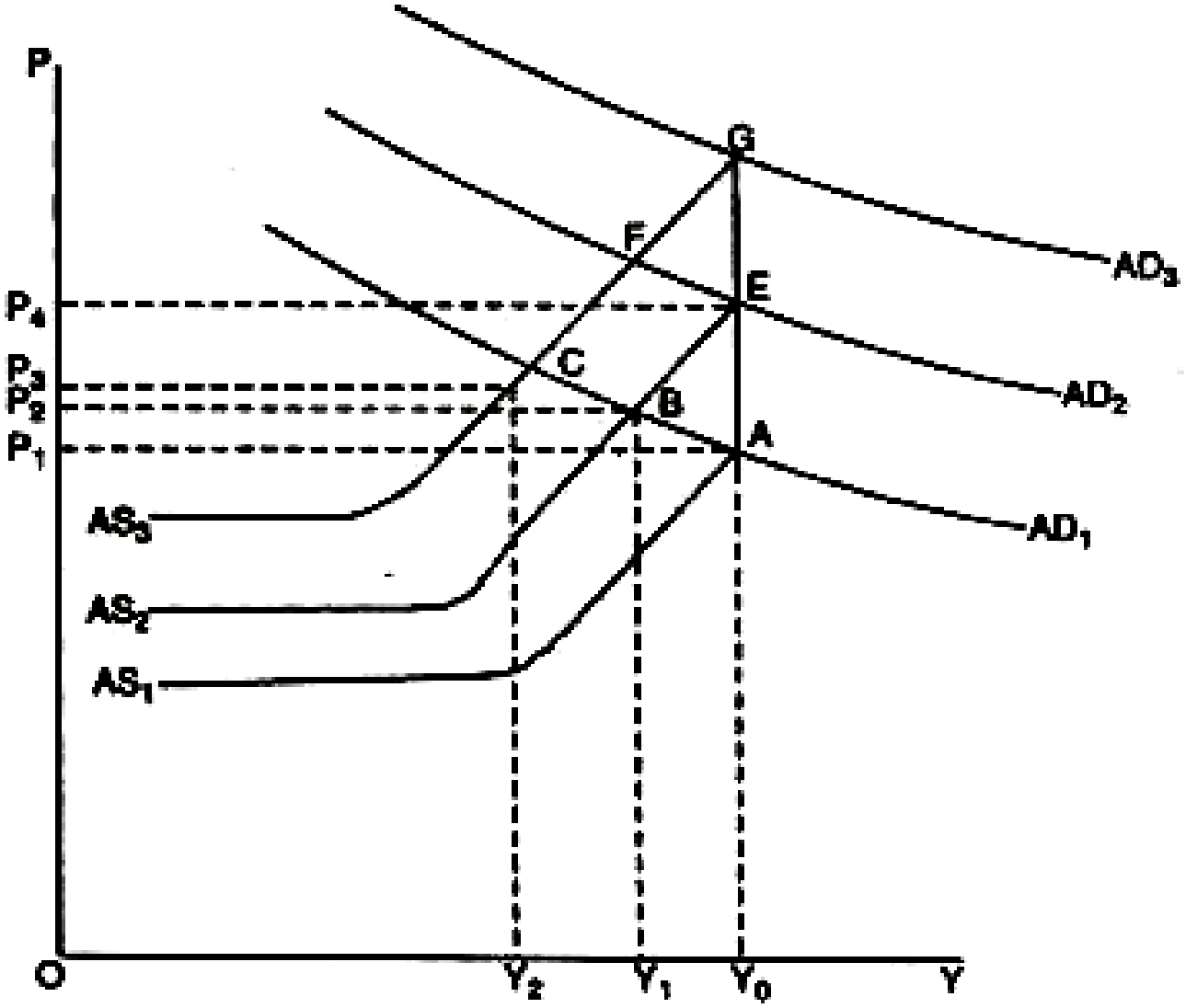
COST PUSH INFLATION



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CAUSES OF INFLATION

1. Over expansion of money supply.
2. Expansion of bank credit.
3. Deficit Financing.
4. Ordinary Monetary Factors-
   a. High non-development expenditure.
   b. Huge plan investment.
   c. Black money.
   d. High indirect taxes.(G.S.T.)
5. Non- Monetary Factors-
   a. High population growth.
   b. Natural calamities.
   c. Speculation & hoarding.
   d. High prices of imports.

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CAUSES OF INFLATION

e. Monopolies.

f. Under utilization of resources.

6. Gaps & Bottlenecks-

a. Market imperfections (factor immobility, price rigidity, ignorance of market conditions etc.)
b. Capital bottleneck.
c. Entrepreneurial bottleneck.
d. Food bottleneck.
e. Infrastructural bottlenecks.
f. Resource gap.
g. Foreign exchange bottlenecks. (R < P).

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CONSEQUENCE/ EFFECT OF PRICE RISE

1. General Consequences-

1. Increase in economic inequalities.
2. Hurdle for development.
3. Changes in relative prices.
4. Adverse effect on balance of payments.

2. Specific Consequences-

1. Effect on Production.(Positive)
2. Effect on consumption & welfare (Negative)
3. Political effects.

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CONSEQUENCE OF PRICE RISE

3. Distributional Effects on various groups-
   a. Debtors & Creditors.(Debtors-Gains & Creditors- Lose)
   b. Business Community (Positive)
   c. Fixed Income Group (Negative)
   d. Investors (Positive & Negative)
   e. Farmers (Positive)
4. Other / Micillinious Effects-
   a. Deterioration in savings.(Negative)
   b. Distortions in budget.(Negative)
   c. Disturbance in planning.(Negative)
   d. Lowering international competitiveness.(Negative)
   e. Distortions in exchange rate. (Negative)

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MEASURES FOR CONTROL OF PRICE RISE ANTI INFLATIONARY POLICY

A. Demand management
1. Fiscal Measures.
2.Monetary Measures.

B. Supply management
1.Fixation of Maximum prices.
2.The system of dual price.
3.Increase in supply of food grains.
4.PDS & consumer protection.

C. Other Relevant Measures:
1.Adoption of Open General License.
2.Adjustment in trade & tariff policies.
3.Substantial reduction in excise duties.

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FISCAL MEASURES

- 1. Taxation policy.
- 2. Reduction in public expenditures.
- 3. Low Debts.

MONETARY MEASURES

1. Quantitative Measures:
   a. Bank Rate Policy.
   b. Open Market Operations.
   c. Cash Reserve Ratio.

2. Qualitative Measures:
   a. Margin Requirements.
   b. Consumer Credit Regulation.
   c. Rationing of Credit.
   d. Moral Suasion.
   e. Issues of Directives.
   f. Direct Action.

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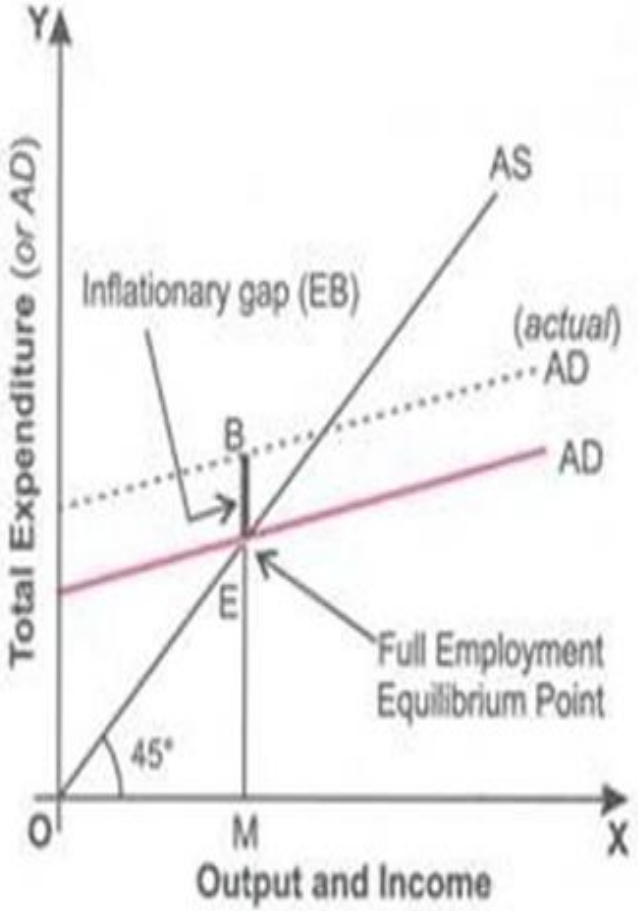
INFLATIONARY GAP

- An **inflationary gap** is a macroeconomic concept that measures the difference between the current level of real GDP and the gross domestic product (GDP) that would exist if an economy was operating at full employment.

- The concept of the inflationary gap was first given by John Maynard Keynes in his work *How to Pay for War?"(1940)* this method was basically employed to study and solve problems regarding war finance.



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STAGFLATION
STAGNATION + INFLATION

- In economics, **stagflation** or **recession-inflation** is a situation in which the inflation rate is high, the economic growth rate slows, and unemployment remains steadily high. It presents a dilemma for economic policy, since actions intended to lower inflation may exacerbate unemployment.

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PHILIPS CURVE

- The Phillips curve is a single-equation economic model, named after William Phillips, describing an inverse relationship between rates of unemployment and corresponding rates of rises in wages that result within an economy.
- There is a short run trade off between unemployment and inflation, it has not been observed in the long run.
- The long-run Phillips curve is a vertical line that illustrates that there is no permanent trade-off between inflation and unemployment in the long run.

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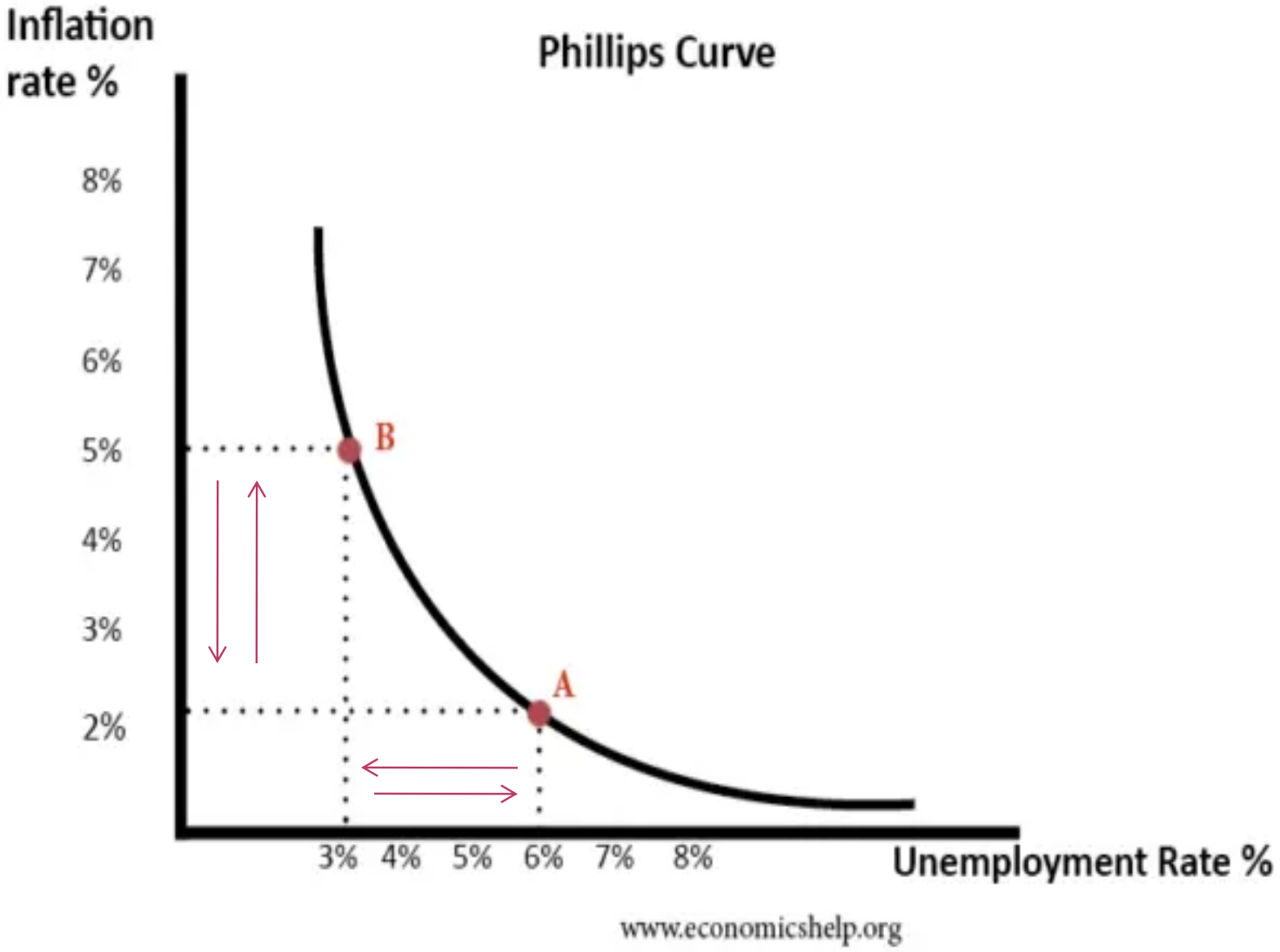
PHILIPS CURVE IN SHORT RUN



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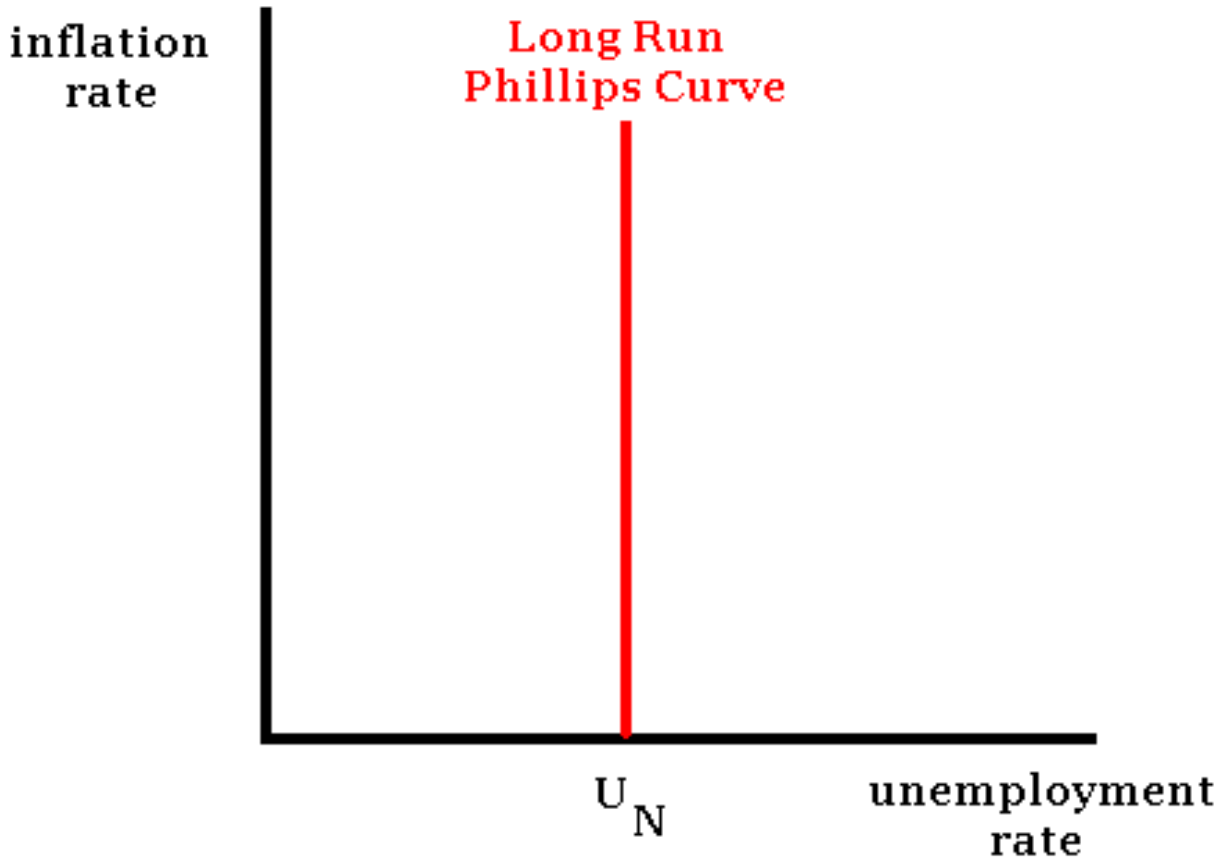
LONG RUN PHILLIPS CURVE



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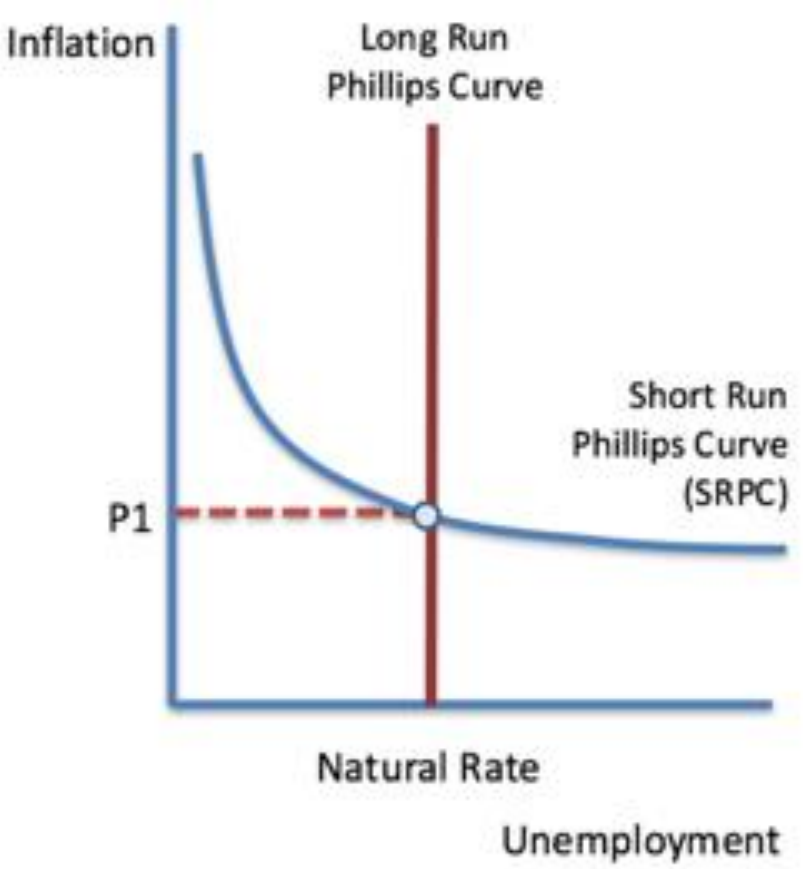
SHORT RUN & LONG RUN PHILLIPS CURVE



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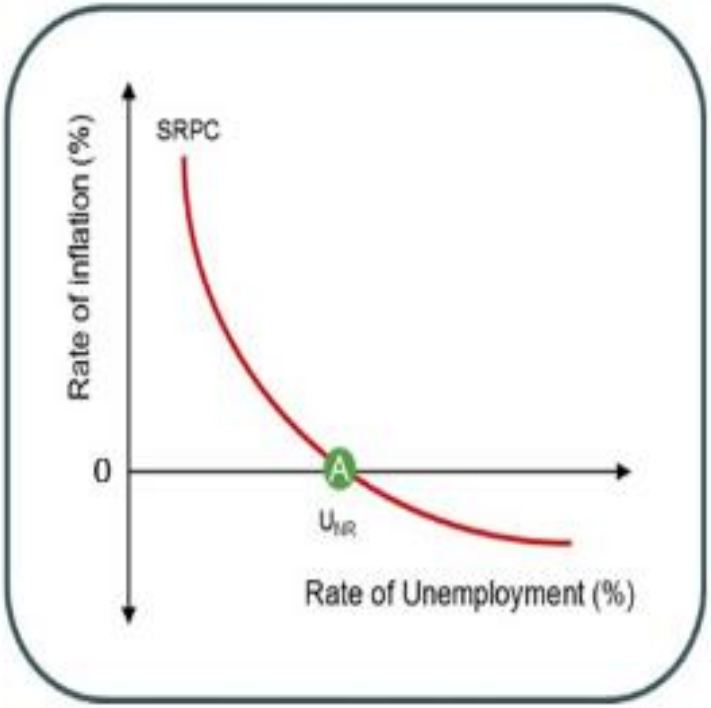
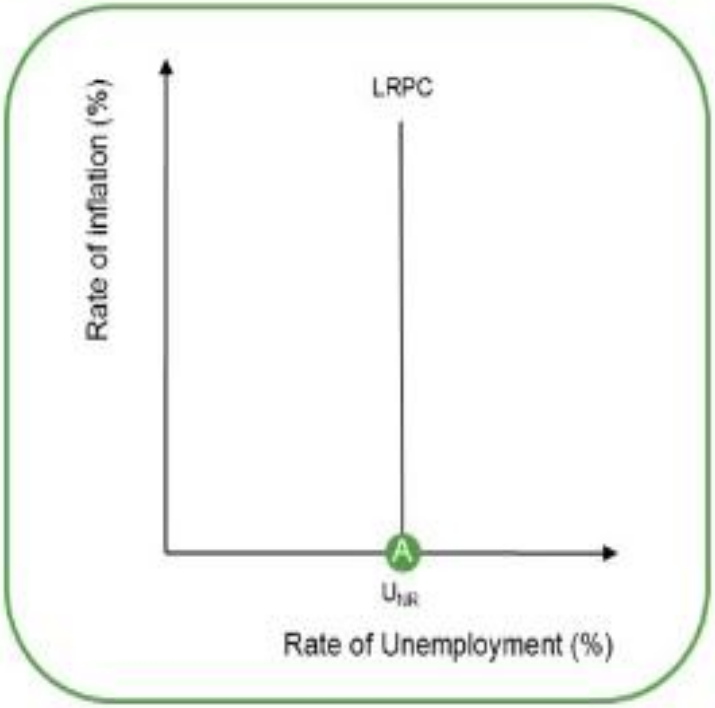
SHORT RUN & LONG RUN PHILLIPS CURVE

Short Run



Trade-off

Long Run



No Trade-off

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THANK YOU
ANY QUESTIONS ???

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