

Prelims Revision Notes: Inflation (Types and Effects)

Inflation

- The general rise in the price level of goods and services is called Inflation.
- It is estimated as the percentage rate of change in price index over the reference time period.
- In India, inflation rate is measured with the help of the Consumer Price Index-combined (Base year- 2012).
- Rate of Inflation= $(\text{Current period price index}-\text{Reference period price index})/(\text{Reference Period Price Index})\times 100$

Types of Inflation

Based on the rate of rising in Inflation

1. Creeping Inflation

- Price rise at the very small rate ($< 3\%$)
- It is considered safe and essential for the economy.

2. Walking or Trotting Inflation

- Price rise at moderate rate ($3\% < \text{Inflation} < 10\%$)
- Inflation at this rate is a warning signal for the Economy.

3. Running Inflation

- Price rise at high rate ($10\% < \text{Inflation} < 20\%$)
- It affects the economy adversely.

4. Hyperinflation or Galloping Inflation or Runway Inflation

- Price rise at very high rate ($20\% < \text{Inflation} < 100\%$) and sometime more than 100%.
- Hyperinflation brings the total collapse of the Economy.
- Examples: Venezuela (9900%), Zimbabwe (670%), Sudan (76%) etc.

Based on the causes

- **Demand Pull Inflation:** When Inflation arises due to higher demand for goods and services over the limited supply.
- **Cost-Push Inflation:** When Inflation arises due to higher input cost (Example- raw material, wages etc.) for goods and services over the limited supply.

Other definitions

1. Deflation

- It is opposite of Inflation.
- Reduction of general level of price in an economy.
- In this price index measured is negative.

2. Stagflation: When stagnation and inflation coexist in the economy. **Stagnation** is an economic condition where there is **low economic growth with high unemployment**.

3. Disinflation

- When the rate of Inflation is at a slower rate.
- Example:
If the Inflation of last month was 4 % and the rate of inflation in the current month is 3 %.

4. Reflation:

- Deliberate action of government to increase the rate of inflation to redeem the economy from a deflationary situation.

5. Core Inflation:

- It is a measure of price rise in the economy excluding the price rise of some products (whose price is volatile and temporary in nature).

Effects of Inflation

1. Redistribution of income and wealth

- Due to the effect of inflation, some group of people loses and another group of people gains.
- Example-
In case of debtors and creditors
Debtor- gainer
Creditor- loser
In case of Producers and Consumers
Producer- gainer
Consumer- loser

2. Effects on Production and Consumption

- Due to inflation, the demand decreases which curtails the production.
- People try to use fewer services which lead to a decrease in consumption.

3. Unfavorable Balance of Payments

- Export decreases and import increases from other countries which lead to a decrease in the forex reserve.

Measures to control Inflation

1. Credit control

- It is used by RBI.

2. Increase in Direct Taxes

- Due to the increase in direct taxes, people have less money available to them and low demand from them leads to a lower price.

3. Price Control

- By fixing the maximum price limit by authorities.

4. Trade measures

- Maintain proper supply in the economy by export and import of goods and services.