Inflation (Types and Effects)

Inflation

- The general rise in the price level of goods and services.
- It is estimated as the percentage rate of change in price index over the reference time period.
- Currently in India inflation rate is measured with the help of the Consumer Price Index- combined (Base year- 2012).
- Till April 2014, the Inflation rate was measured with the help of WPI (Wholesale Price Index).
- Rate of Inflation= (Current period price index-Reference period price index)/(Reference Period Price Index)×100

Type 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 % < Inflation < 10 %)
- Inflation at this rate is a warning signal for the Economy.

3. Running Inflation

- Price rise at high rate (10 % < Inflation < 20 %)
- It affects the economy adversely.

4. Hyperinflation or Galloping Inflation or Runway Inflation

- Price rise at very high rate (20 % < Inflation < 100 %)
- This situation brings the total collapse of the Economy.

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.
3. Stagnation: low national income growth and high unemployment.

4. 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 %.

5. Reflation:

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

6. 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 groups of people lose and another group of people gains.
- Example-
  In the 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 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 increased indirect 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.