INFLATION

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Meaning of Inflation

Inflation is often defined in terms of its supposed causes. Inflation exists when money supply exceeds available goods and services. Or inflation is attributed to budget deficit financing. A deficit budget may be financed by the additional money creation. But the situation of monetary expansion or budget deficit may not cause price level to rise. Hence the difficulty of defining ‘inflation’.

Types of Inflation

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 the 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."

(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-determinded. Higher wage means high cost of production. Prices of commodities are thereby increased.

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.

How is Inflation Measured?

It can be measured through the following indexes:

- Consumer Price Index (CPI)
- Wholesale Price Index (WPI)

CPI	Points of Difference	WPI
It is the average change in prices of the goods and/ or services over time that the consumer pays for a basket of goods and/ or services	**Meaning**	It measures the changes in the prices of goods sold and traded in bulk by the wholesale businesses to other businesses.
The RBI and other statistical agencies study the CPI in order to understand the price change of various commodities and keep inflation under control.	Uses	It is used to measure inflation. The rate of inflation is the difference between the WPI calculated at the start and end of a year.
Ministry of Statistics and Program Implementation	Computed by	Ministry of Commerce & Industry
CPI = (Cost of basket divided by Cost of basket in the base year) multiplied by 100	**Formula**	(WPI of end of year – WPI of beginning of year)/WPI of beginning of year x 100

THANKS