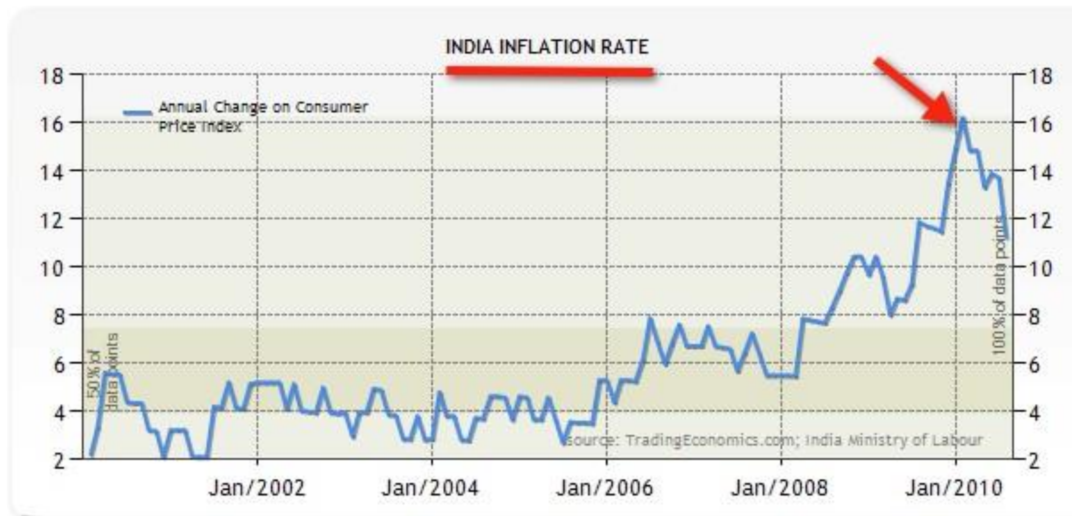
TOPIC- INFLATION M.B.A. (B.E.)

Inflation refers to the rise in the prices of most goods and services of daily or common use, such as food, clothing, housing, recreation, transport, consumer staples, etc. **Inflation** measures the average price change in a basket of commodities and services over time.



There are four main types of inflation, categorized by their speed. They are creeping, walking, galloping, and hyperinflation.

Creeping Inflation

Creeping or mild inflation is when prices rise 3% a year or less. According to theories, when prices increase 2% or less, it benefits economic growth. This kind of mild inflation makes consumers expect that prices will keep going up. That boosts demand. Consumers buy now to beat higher future prices. That's how mild inflation drives economic expansion.

Walking Inflation

This strong, or destructive, inflation is between 3-10% a year. It is harmful to the economy because it heats-up economic growth too fast. People start to buy more than they need to avoid tomorrow's much higher prices. This increased buying drives demand even further so that suppliers can't keep up. More important, neither can wages. As a result, common goods and services are priced out of the reach of most people.

Galloping Inflation

When inflation rises to 10% or more, it wreaks absolute havoc on the economy. Money loses value so fast that business and employee income can't keep up with costs and prices. Foreign investors avoid the country, depriving it of needed capital. The economy becomes unstable, and government leaders lose credibility. Galloping inflation must be prevented at all costs.

Hyperinflation

Hyperinflation is when prices skyrocket more than 50% a month. It is very rare. In fact, most examples of hyperinflation occur when governments print money to pay for wars. Examples of hyperinflation include Germany in the 1920s, Zimbabwe in the 2000s, and Venezuela in the 2010s. The last time America experienced hyperinflation was during its civil war.

OTHER TERMINOLOGIES IN INFLATION-

Stagflation

Stagflation is when economic growth is stagnant, but there still is price inflation. This combination seems contradictory, if not impossible. Why would prices go up when there isn't enough demand to stoke economic growth?

It happened in the 1970s when the United States abandoned the gold standard. Once the dollar's value was no longer tied to gold, it plummeted. At the same time, the price of gold skyrocketed.

Stagflation didn't end until Federal Reserve Chairman Paul Volcker raised the fed funds rate to the double-digits. He kept it there long enough to dispel expectations of further inflation. Because it was such an unusual situation, stagflation probably won't happen again.

Core Inflation

The core inflation rate measures rising prices in everything *except* food and energy. That's because gas prices tend to escalate every summer. Families use more gas to go on vacation. Higher gas costs increase the price of food and anything else that has high transportation costs.

The Federal Reserve uses the core inflation rate to guide it in setting monetary policy. The Fed doesn't want to adjust interest rates every time gas prices go up.

Deflation

Deflation is the opposite of inflation. It's when prices fall. It's caused when an asset bubble bursts.

That's what happened in housing in 2006. Deflation in housing prices trapped those who bought their homes in 2005.In fact, the Fed was worried about the overall deflation during the recession. That's because deflation can turn a recession into a depression. During the Great Depression of 1929, prices dropped 10% a year. Once deflation starts, it is harder to stop than inflation.

Wage Inflation

Wage inflation is when workers' pay rises faster than the cost of living. This kind of inflation occurs in three situations. First is when there is a shortage of workers. Secondly, is when labor unions negotiate ever-higher wages. Thirdly is when workers effectively control their pay.

A worker shortage occurs whenever unemployment is below 4%. Labor unions negotiated higher pay for autoworkers in the 1990s. CEOs effectively control their pay by sitting on many corporate boards, especially their own. All of these situations created wage inflation.

Of course, everyone thinks their wage increases are justified. But higher wages are one element of cost-push inflation. That can drive up the prices of a company's goods and services.

Asset Inflation

An asset bubble, or asset inflation, occurs in one asset class. Good examples are housing, oil, and gold. It is often overlooked by the Federal Reserve and other inflation-watchers when the overall rate of inflation is low. But the subprime mortgage crisis and subsequent global financial crisis demonstrated how damaging unchecked asset inflation could be.

Inflation measurement in India

There are two main set of inflation indices for measuring price level changes in India – the Wholesale Price Index (WPI) and the Consumer Price Index (CPI). The WPI, where prices are quoted from wholesalers, is constructed by Office of Economic Affairs, Ministry of Commerce and Industries. In the case of CPI (prices quoted from retailers), there are several indices to measure it: CPI for industrial labourers (CPI-IL), agricultural labourers (CPI-AL) and rural labourers (CPI-RL) besides an all India CPI.

In addition, Gross Domestic Product (GDP) deflator and Private Final Consumption Expenditure (PFCE) deflator from the National Accounts Statistics (NAS) provide an implicit economy-wide inflation estimate.

1. **Consumer Price Index**

Two Ministries – Ministry of Statistics and Programme Implementation (MOSPI) and Ministry of Labour and Employment (MOLE) are engaged in the construction of different CPIs for different groups/sectors. CPI inflation is also called as retail inflation as the prices are quoted from retailers. Following are the various CPIs.

(a) CPI for all India or CPI combined.

(b) CPI for Agricultural Labourers (AL)

(c) CPI for Rural Labourers (RL); and

(d) CPI for Industrial Workers (IW)

(i) CPI by MOSPI (CSO)

The CSO, which comes under MOSPI, is constructing the rural, urban and the combined CPIs. They are published from 2011 onwards. Of these, the CPI combined is the most important of all the CPIs as it is relevant for all categories of people.

In April 2014, the RBI has selected the all India CPI (of CSO) as the inflation index to target inflation under its new inflation targeting monetary policy framework. RBI's decision has made the CPI as the prime inflation index.

(ii) CPIs by MOLE (Labour Bureau)

The Labour Bureau, Ministry of Labour and Employment (MOLE) is preparing different indices for various categories of people. These were CPI for Rural Laborares (CPI-RL), CPI for Agricultural Laborares (CPI-AL) and CPI for Industrial Workers (CPI-IW). There was a CPI For Urban Non-Manual Employees (CPI-UME), but it was discontinued from April 2010.

Since these CPIs were for specific categories of workers, it lacked the quality of an all India index.

Table : Different price indices in India

<table>
<tr><th>Index</th><th>Agency</th><th>Base Year</th><th>Number of Commodities</th></tr>
<tr><td>WPI</td><td>Office of Economic Affairs, Ministry of Commerce and Industries</td><td>2011-12</td><td>697</td></tr>
<tr><td>CPI All India, CPI -Urban and Rural</td><td>CSO, Ministry of Statistics and Programme Implementation</td><td>2012</td><td>448 (rural)
460 (urban)</td></tr>
<tr><td>CPI-AL</td><td rowspan="3">Labour Bureau, Ministry of Labour and Employment</td><td>1986-87</td><td></td></tr>
<tr><td>CPI-RL</td><td>1986-87</td><td></td></tr>
<tr><td>CPI-IW</td><td>2001</td><td></td></tr>
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