Inflation: a monetary phenomenon?

Meaning :

Inflation is a general rise in price level of economy as a whole. Demand is greater than supply. Worth of money came down . Purchasing power of money came down.

Aggregate demand = consumption+Investment+Govt. Expenditre.

Thus, Inflation is statistically measured in terms of percentage Increase in the price index, as a rate per cent per unit of time- usually a year or a month.

NATURE:

Inflation is a Pure Monetary Phenomenon :

Monetrists in genral regard inflation as a purely monetary phenomenon. It is held that when money supply exceed the normal absorbing capacity of the economy, it leads to persistently rising prices .

A Keynesian Understanding :

Although inflation by its commonly conceived as a monetary phenomenon , a group of economists, including Pigou and Keynes , regarded inflation as a phenomenon of full employment .

Incidentally Keynes mentions four related terms while discussing the concept of inflation :

(i)Reflation, (ii) Inflation, (iii)Disinflation, (iv) Deflation.

Demand-pull inflation

According to the Demand Pull theory , prices rise in the response to an excess of aggregate demand over existing supply of goods and services. The demand pull theories point out that inflation might be caused in first place, by an increase in the quantiy of money , when economy is operating at full-employement level. As the quantity of money increases , the rate of interest fall and consequently , investment will increase.

Causes of Demand Pull Inflaion:

Increase in public expenditure.

Increase in investment.

Increase in marginal propensity to consume.

Increase in Exports and surplus balance of payments.

Diversification resources.

Cost-push inflation

Process of inflation is initiated not by an excess of general demand but by an increase in costs, as factors of production try to increase their share of the total product by raising their prices. Thus, it has been viewed that a rise in prices is initiated by growing factor costs. Therefore, such a price rise is termed as â€Å“ cost-pushâ€ inflation as prices are being pushed up by the rising factor costs.

Measurs to correct Inflation :

Fiscal Policy :

Fiscal policy refers to budgetary policy of the government or the policy related to revenue and expenditure of the government with a view to correcting the situations of excess demand or deficient demand in the economy.

Fiscal policy is the policy concerning the revenue, expenditure and debt of the government for achieving definite objectives.

Instruments of Fiscal Policy:

Fiscal Instruments related to government expenditure.

Fiscal measures related to government revenue or financing or expenditure or Public (Govt.) Revenue, Taxation, public debt and deficit financing.

The inflation rate of India in July 2012 was recorded is 6. 87. And currently the rate is recorded over 9%.

In India Inflation rate from 1969 to 2012-09-08 with the average of 8 percent .

Consumer Price Index is the best tool to measure the Inflation in whole Domestic economy.

Here is the chart of CPI(consumer Price Index)

– CPI inflation India 1991 (yearly basis) to 2012.

Consumer Price Index

infl-chart-2-1-56-1991. jpg

Inflation of India in 1991 average : 13. 88%

GOLD PRICES ARE LINKED TO THE VALUE OF US DOLLAR

There is definitely correlation between gold price and US dollor, if US Dollor become weak in relation to rest of the world currencies it means price of gold in US dollor rises.

If we assume that exchange rate between US dollor and rest of the world is 1 US Dollor = 1 rest of world currency. It implies that the value of Us dollor has gone down in relation to the rest of the world.

Price of Gold will remain same for the rest of the world , if there is a fall in value of US Dollor.

Oil Prices will rise for the U. S if US Dollor falls, on the other hand it will fall for other coutries, because of crude oil is primarily traded in US dollors.

Our monetary system is known as Flat Currency. It must be accepted as a means of payment.

Gold price from 1991 to 2010

In 1991 â€” the price was around 410$

In 1995- the price was 400$.

In 2000- the price was around 300$.

In 2005- the price was 700$.

In 2010- the price was 900$- 1900$.

It clearly shows the vast fluctuations in prices from year to year.

CRUDE OIL PRICE: YEARLY AVERAGE

2011 = $87. 48

2010 = $71. 21

2009 = $53. 56

2008 = $91. 48

2007 = $64. 20

2006 = $58. 30

2005 = $50. 04

2004 = $37. 41

2003 = $27. 69

2002 = $22. 81

2001 = $23. 00

2000 = $27. 40

1999 = $22. 26

1998 = $11. 91

1997 = $18. 97

1996 = $20. 46

1995 = $16. 75

1994 = $15. 66

1993 = $16. 74

1992 = $19. 25

1991 = $20. 19

The data shows the crude oil price from 1991 to 2011. It simply implies that lots of fluctuations on economy and disastourous rise in price or we can say hike in price four times from 1991 to 2011.

Impact of Inflation on Indian economy :

Through study of the changing trend from year to year basis that is from 1991 to 2012.

The inflation is rising day by day. There are four stages of inflation and in India the present inflation rate is over 9%. If it gradually increase it will definitely becomes problem for developing country like India.

As we saw co-relation between gold price-Crude oil-US Dollor it indicates that with changes of production or appreciation of US dollor the value of Indian currency goes down.

Hike in price of Crude oil is falls value of US Dollor which affects Indian economy as a whole as India is highly dependable on Developed countries like US.

Gold works on price parity, which means 10g of gold has the same value all over the world, hence international prices are important.

Dollor versus Indian Ruppes :

India is a largest consumer of gold in last year that is 2011. Especially Indian consumer deals in jewellery and investment , as their mind set to deal in gold for greater returns on them.

According to surveys in India around 933tonnes of gold consumption was there in compared with the Global consumption of 4, 067tonnes .

In 2011 supply of 1037tonnes were available in India and the imported quantity was 969tonnes

Even when the international gold price have corrected in last few months, domestic gold price have increased , it is just because of depreciation of Indian currency that is rupees and it is accounted 8% against the dollor since February this year. It simply implies Indian consumers have to pay much more to buy gold , other than duties and taxes.

So I feel, this assignment helps in many ways how economy relates with price of US Dollor, Crude Oil, Gold Price and Inflation.

Thanks to MITSOB for providing us the valuable study like cases and assignments inspite of regular syllabus.