Definition of inflation

Inflation is a quantitative economic measure of a rate of change in prices of selected goods and services over a period of time. Inflation indicates how much the average price has changed for the selected basket of goods and services. It is expressed as a percentage. Increase in inflation indicates a decrease in the purchasing price of the economy.

Types of inflation

The three types of Inflation are Demand-Pull, Cost-Push and Built-in inflation.

Demand-pull Inflation: It occurs when the demand for goods or services is higher when compared to the production capacity. The difference between demand and supply (shortage) result in price appreciation.

Cost-push Inflation: It occurs when the cost of production increases. Increase in prices of the inputs (labour, raw materials, etc.) increases the price of the product.

Built-in Inflation: Expectation of future inflations results in Built-in Inflation. A rise in prices results in higher wages to afford the increased cost of living. Therefore, high wages result in increased cost of production, which in turn has an impact on product pricing. The circle hence continues.

Causes of inflation

Monetary Policy: It determines the supply of currency in the market. Excess supply of money leads to inflation. Hence decreasing the value of the currency.

Fiscal Policy: It monitors the borrowing and spending of the economy. Higher borrowings (debt), result in increased taxes and additional currency printing to repay the debt.

Demand-pull Inflation: Increases in prices due to the gap between the demand (higher) and supply (lower).

Cost-push Inflation: Higher prices of goods and services due to increased cost of production.

Exchange Rates: Exposure to foreign markets are based on the dollar value. Fluctuations in the exchange rate have an impact on the rate of inflation.