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Department of Economics
Online Lecture Series
2021-2022

Module I (Inflation)

Topic: The Economics of Depression, Hyperinflation; Inflation: Features and Causes

Introduction:

Great Depression (1929- up to 1939), was the longest and most severe depression ever experienced by the industrial countries. It induced fundamental changes into the economic institutions, macro economic policies and economic theories. This depression caused drastic declines in the output, severe unemployment and acute deflation in the world economies.

Causes of Decline

1. Fallen aggregate demand
2. Tight monetary policy followed by USA aimed to limit stock market speculations
3. Bank Insolvency increased the fear of depositors further and they started withdrawing their deposits, which put pressure on banking system and culminated into banking panics and announcement of the national bank holiday by President Franklin D. Roosevelt on 6th March 1933.
4. Large farm and machinery loans given by banks became NPAs after WW I.

Hyperinflation is a term to describe rapid, excessive, and out-of-control general price increases in an economy. While inflation is a measure of the pace of rising prices for goods and services, hyperinflation is rapidly rising inflation, typically measuring more than 50% per month. This is one of the type of inflation based on rate of increase in the general price level

Topic: The Economics of Depression, Hyperinflation; Inflation: Features and Causes Contd...

Although hyperinflation is a rare event for developed economies, it has occurred many times throughout history in countries such as China, Germany, Russia, Hungary, and Argentina.

Causes of Hyperinflation:

1. Excessive Money Supply, when government prints money to finance its excessive spending
2. Demand Pull Inflation, when demand outstrips supply of different goods and services

The most well-known example of hyperinflation was during the Weimar Republic in Germany in the 1920s.

Effects:

1. To keep from paying more tomorrow, people begin hoarding. people hoard perishable goods, like bread and milk. These daily supplies become scarce, and the economy falls apart.
2. People lose their life savings as cash becomes worthless. For that reason, the elderly are the most vulnerable to hyperinflation.
3. Banks and money lenders go bankrupts
4. Import become costlier
5. Unemployment increases
6. Tax revenue to the government reduces and government commit next mistake of printing more money to meet its expenses
7. Only Borrowers and Exporters are winner in such situation

Topic: The Economics of Depression, Hyperinflation; Inflation: Features and Causes Contd...

Types of Inflations (Apart from Hyperinflation)

Based on Rate or Speed of Inflation

1. **Creeping or Crawling Inflation:** when prices rise 3% a year or less. 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.
2. **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.
3. **Galloping or Running Away 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.

Other Types of Inflation based on Cause:

1. **Stagflation:** Stagflation is when economic growth is stagnant, but there still is price inflation.
2. **Core Inflation:** The core inflation rate measures rising prices in everything *except* food and energy.
3. **Deflation:** Deflation is the opposite of inflation. It's when prices fall. It's caused when an asset bubble bursts.
4. **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.

Topic: The Economics of Depression, Hyperinflation; Inflation: Features and Causes Contd...

5. **Asset Inflation:** An asset bubble, or asset inflation, occurs in one asset class. Good examples are housing, oil, and gold. For Example: USA Recession of 2008 due to sub prime mortgage crisis.

6. Asset Inflation of Gas, Oil, Food and Gold

Features of Inflation:

1. Persistent and generally irreversible rise in prices
2. Disequilibrium, state of the economy
3. It is scarcity resultant as well as oriented
4. Very dynamic and swift in nature
5. Excess demand over supply leads to inflation
6. Cost push inflation give advantages to input sellers
7. It is purely a monetary phenomenon
8. Pure inflation is the post full employment phenomenon
9. It causes decline in the purchasing power of money
10. Raised inflation expectations, government taxations and depreciating domestic currency contributes in inflation by raising cost

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Causes of Inflation:

1. **Increase in Demand:**

- Money supply Increases
- Government Expenses surpasses its revenue collection
- Overpopulation

2. **Increase in Cost of Production:**

- Oil, Raw Material becomes costlier
- Wage Rise

3. **Other Reasons:**

- Depreciating domestic currency makes imported raw material costlier
- Government Indirect Taxation policy changes
- Scarcity generates due to natural calamities or man made calamities

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Question: Discuss Types, Characteristics and Causes of Inflation.

THANKS