Inflation: An Analysis of the Causes and Remedies

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ABSTRACT: Economic growth is important for every country, even on the basis of the prevailing economic condition; the country has divided in to the developed, developing and under developed nation. The inflation and deflation is also a measure to know the trend of the growth and development of the economical aspect of any individual country. Inflation is an unavoidable phenomenon and always occurs in every country in different form. It is very difficult for the economist to predict the occurrence of the inflation but they can take the steps to minimise the effect of the inflation. The present paper discusses the types of the inflation and common causes to inflation in an economy because it is very important to address the cause of the inflation to control properly for the growth and development of the nation. The long presence of the inflation can reduce the rate of the growth; even it can cause the economy of the nation.

KEYWORDS: India, Inflation, Open economy, Fiscal deficit, Output growth.

INTRODUCTION

The global presence of the any nation depends upon the various factors such as overall growth, industrial development as well as economic stability. The dependency of these factors relate with way of utilization of the country's resources with the input of the good governance. The rates of the stable growth indicate that the resources available within the region is utilised fully. While framing the future steps for the economy of any country, one factor is always considered and kept the middle of the policy i.e. inflation. The inflation neither be a positive word nor a negative word, rather it is a relative word with the status or inclination of the economy. The inflation is the important part of the economic policy framed by the government. |the low inflation is considered as add on in the economy as it is increase the activities and growth of the economy.

It is act as an multi fold function as inflation causes the an increase in taxes on the public and other hand it also courses to reduce the saving with the people's bank account . The high inflation increases the common price of the general commodity in addition to the services, consequently, reduced the savings. The inflation is the key factors to control the market prices of the various commodities [1]. The general measuring unit of the inflation is the purchasing power of the people which is the actual capacity of the people to expand in the market. In fact, purchasing power shows the capacity of the people to be spent in market for purchasing the goods and services. If inflation increases it causes the depreciation in the money value.

Reasonable inflation is unwillingly acceptable other than elevated inflation require minute evaluation of all monetary factors as well as prevailing circumstances as it blow the profitability in addition to liquidity of the monetary entities in addition to have an effect on their operational capital straight. Its movement consequences into augmented acquiring power of money. It is a occurrence which exist in each financial system in different type of increase, defilation, hyperinflation or inflation. In current worldwide financial surroundings most of economy have framed besides adopt procedures to curtail blow of increase if rate of the inflation is not properly control. The economist have a common view that the rate of the inflation between the 2 to 3 percentage is quite normal for the economy and does not have too adverse effect on the economy , in fact this much inflation is necessary to keep a control over the economy [2].

Inflation is an economic aspect and has a significant and respectful position. No economic policy can be planned without inflation. Depending on the economic efficiency, it has permanent presence and exit in economies in various forms. India retains the saving distinction and is likewise highly prejudiced of high inflation. In general, policy manufacturers in India brand policies that distinguish savings as a mainstay to respond to possible financial uncertainties [3]. The past of inflation worldwide has been found to be enigmatic besides unpredictable. India's monetary history shows that India has undergone some extreme inflation, but not certainly a disease called hyperinflation, which container cause economic model of the nation to break down.

Worldwide records of the economical fluctuation revealed that there are many Asian countries which have the worst records even than India, and there are various reasons which have been justified the worst performance than the India. In 1923, the Germany have recorded the worst ever hyperinflation which causes the price increases to 2500 percent in just a month and consequently results come as the monetary break down . The similar condition have encountered in the Japan in 1945 and remembered as the year of the economic defeat as the year of 1945 is the year of the war as well as the nuclear destruction. The inflation had increased as much as it increases the level of the 567 percentages.

Global economic heritage shows proof that greedy politics led to an increase in World War II to make the nation their subservient but that almost the entire world had been facing an economic catastrophe and that most nations became victims of inflation, recession as well as hyperinflation as a result of this greed. Whether they are active participants in war or victims of war, every nation wants to control the price [4]; it is essential for their survival, political stability and governance. The modern history of wars shows the fact that India participated actively in both world wars and the combined effect of the time forced the price that became uncontrollable and transformed into inflation during the period it also went through struggle for independence.

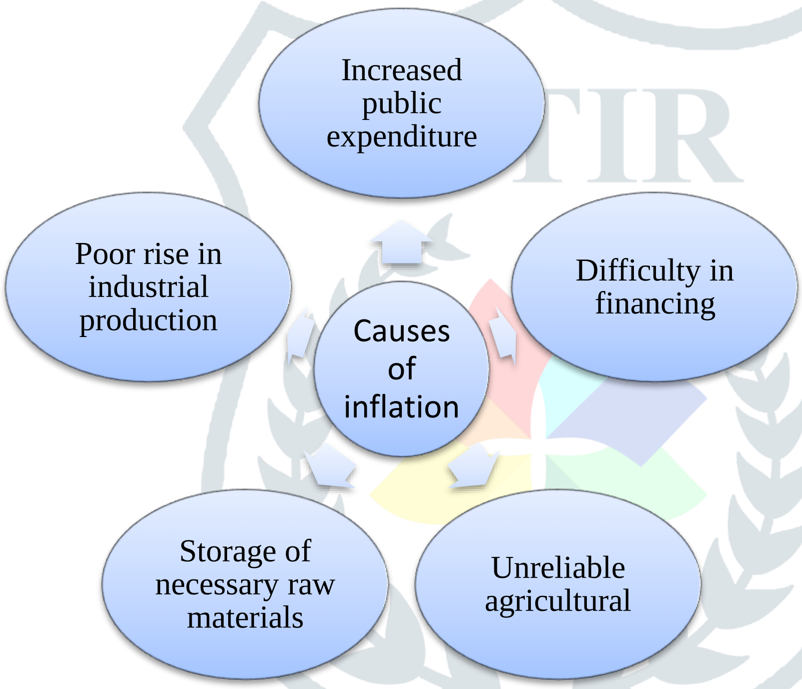

Figure 1: Causes of inflation in India

In contrast to other countries, the cautious policy of curbing inflation and saving Indian people's habits successfully controlled inflation. India's economic history reveals as India has achieved better rivals and neighboring Asian countries, together with Japan, Malaysia, China, Pakistan, and Indonesia. It is found that India has confronted inflation every seventh year in which price spiraled nonetheless inflation stayed below 20 percent. Holding inflation below 22% demonstrates the improved economic efficiency, good governance strength of India and its ability to manage inflation that distinguishes it from supplementary nations. Figure 1 has been showing the causes of the inflation.

The Indian economy also had faced the same problem in this year of 1958, 1969 and 1972 but with the better policy frame work , the Indian economist not only successfully control the inflation but also handle the foreign defaults properly . The economies on the world level have been categorized in to three parts as the developed economies, developing countries and under developed countries and all the rigorously involve in to the task of making their individual economy enough robust in order to produce the strength to face the inflation to have a economical growth without any hurdle [5].

According to an economist, the world has had financial crises since the middle Ages. For almost all countries, serial defaults is a common rite of passage through history as they move through the process of growth of the emerging economy, and they have said that h

igh inflation and currency humiliation are just as worldwide rite of passage as a successive default. India has handled inflation and rampant inflation with distinction, most financial historians have found. Compared with the developed economies, it handled financial crises effectively with an adequate growth rate and iron rules. If you want to live smoothly, it is the fundamental duty of the government to manage inflation.

India had seen the inflation in the year of 1970 and it had reached up to the 20 percent and the effect of the inflation was in prevalence for approximately 2 year. The present governor of the reserve bank of the India had thrown the effective price mechanism. Inflation is currently fluctuating often for roughly time when it comes across the binary digit, approximately time when it drops below 10%. The Indian government enacted the same instrument that was used during the 70s to control this volatility, which is tariff barriers and moral suasion for holding prices and commodity markets such as iron besides steel [6]. And apart beginning these initiatives, there is a comparison need to push concentration rates. As a developing economy, India has to be thoughtful in inflation targeting as India has the world's largest homeless people earn half a dollar a day to survive.

REVIEW OF LITERATURE

Barro, Robert J. has studied about the inflation and about 100 countries have been included for the investigation the effect of the inflation on the performance of the economical aspect. The impacts of the country performance for the economical fluctuation had observed and a percentage reduction in the inflation noticed and a regression analysis have conducted for the collect data. Since statistical methods use plausible inflation tools, there is also some reason to assume that these relationships react to the causal influences of spending and innovation from inflation. However, only when rising inflation perspectives are included in sample do statistically meaningful results emerge. Although inflation’s negative impact on growth appears small, the long-term impact on standard of living is significant. A change in financial policy , for example, which raises long-term average inflation by 10 percent on average per year, is projected to reduce the level of real GDP by 4-7 percent after 30 years, and enough to justify a keen interest in stable prices[3].

Faust, Jon et al discussed about recent developments in inflation forecasting are discussed in this section. Among a great set of traditional besides recently developed predicting approaches, we conduct a horse-race and deliberate a number of philosophies that ascend from exercise. It is find that, often by a wide margin, condemnatory survey predictions outstrip model-based ones. A very modest prediction that is just a slither path between current quarter inflation survey assessment and the long-term forecast value of survey turns out to be competitive with the actual forecast of survey and thus does about as well or better than model-based estimates. We examine in greater detail strengths in addition to weaknesses of some precise prediction methods, including predictions constructed on the Phillips curve and based on dynamic stochastic general equilibrium models. Inflation expectation measures taken from financial markets and tradeoff between forecasting collections and disaggregation are also considered[7].

Malmendier, Ulrike studied about people’s expectations for future inflation .It has been suggest that people experienced morbidly obese inflation all through their lifetimes. This method modifies integrated application supervised learning to allow, in reply to inflation upsets, for age-dependent revamping of perceptions. Since past actions account for a bigger proportion of their accrued lifetime history, younger people update their aspirations more strongly than older adults. We receive help for these forecasts using 57 years of estimates derived from the Reuters / Michigan survey conducted on inflationary pressures. Experience distinctions due entirely expectation distinctions, including significant disagreements between adults and kids in periods of pretty unstable inflation, such as the 1970s. It also describes the conduct of household borrowing and lending, along with the choice of mortgages[5].

DISCUSSION

1. Types of the inflation

In economical term, inflation defined as the term where an increment has notice in the price level over duration of time, consequently , the resulting effect have seen in decreasing purchasing power of people . It has seen that a sudden prices level increment reduced the value of the currency and reduced the quantity of the commodity purchased in each unit of the currency. The opposite scene of the inflation is known as the deflation, where the value of the money for each unit has the tendency of the increment and quantity of the commodity to be purchased in a single unit of the money has increased. The inflation is measured as the inflation rate that is calculated as the percentage of the general price index or consumer price index.

The scholars of the economics believe that increment rate of the inflation and hyperinflation is not good for the economy as it depreciate the value of the money for each unit. The effect of the inflation have seen in term of the supply of the goods and services as the value of each unit of money increased that will affect the demand of the people and people become less interested to purchase the goods and services as they have to give more money [8]. The effects of the inflation make an article costlier to an individual. It also seen that the long period of the inflation results in faster supply of the money but rate of economic growth reduced substantially.

The types of the inflation have seen by the experts in the economy given in the Figure 2 The common type of inflation are walking inflation ,creeping inflation, , galloping inflation, hyperinflation, stag increase, demand pull and cost push inflation etc. Creeping inflation may be defined as the slow rate of the inflation and it measured as the 3 percentage of less per year. Walking inflation is measured as the moderate rate of the inflation and measured as the 3 to 10 percentage of the inflation rate. Galloping inflation indicates the little bit more rate of the inflation than the walking inflation and rate is measured as the more than 10 percentage. Hyperinflation is measured as the rapid rate of the inflation and measured up to 50 of the inflation per month .in actual, hyperinflation is rare phenomenon to happen in the economy and it has seen only in Zimbabwe in the year of 2000 and Venezuela in the year of the 2004. The money supply in market has increase rapidly but it effect on the GDP is negative.

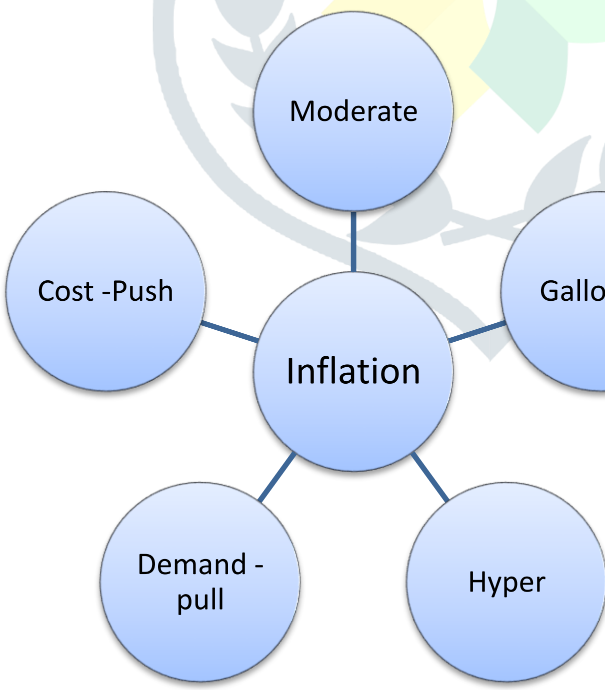

Figure 2: Types of the Inflation

Stag inflation is also a condition of the hyperinflation but it additionally associated with the high rate of the unemployment and also stagnant the economic growth. Deficit induced inflation caused due to the excessive development policy of the government or indulging in a war. Demand pull type of the inflation is associated with the limited supply of the goods and services that caused to increase the demand at the constant supply of the commodity that ultimately caused to increase the prices of the items and developed a condition of the inflation in the market. Cost push type of the inflation occur due to a sudden increment in the prices of the commodity and the reason might be an increase in the export duty or the increment in the prices of the raw material [8].

2. *Impact on the economy*

Inflation's decline has a positive effect as it improves the saving of the nation's common people and also supports lenders as banking industry. As increase in general drop, product prices imitate it at an equal rate in all segments. The inflation-free market means that the national economy is saturating and would have a more effect besides influence on other macroeconomic factors. As increase rises, it functions as secret tax and savings are decreased. Via its connection with the business income tax code, through tax deductible depreciation allowance for machinery in addition to construction, it impacts strategic decisions. Since depreciation is not inflation-adjusted, a rise in the inflation rate favors investment in accounts including short-lived apparatus.

Many capital-intensive companies have depended excessively on and sustained losses from long-lived plants and equipment. Inflation distortions also exist in the taxation of capital gains. When unemployment is low, taxes account for a higher share of the total value of assets. Under such conditions, even corresponding advantage is sold without any deep indebtedness of its value, however the owner has to pay due taxes since higher taxes on wealth gains have to be charged on the actual worth of the properties. The tax structure does not adjust after inflation policy in general, and citizens face extra tax burden along with secret tax 'inflation' consecutively. As the fall in inflation expenditure rises, the consumption of FDI inflow decreases, demand decreases, buying power decreases.

If it continued for a long period of time, then unemployment starts to rise at the required stage. The underlying value of goods besides services remains same regardless of inflation. Its 1.0 percent raise denigrates currency in terms of goods and services we import by 10 percent. Increased inflation is destabilizing currency. It affects the companies' profitability besides liquidity and directly affects their working capital. Its decline is positive for the economy to the point that if it deteriorated and converted negative, then it is bad for economy again.

Inflation has an effect on businesses that have surplus funds. It affects shareholders, especially investors, who have immovable income investments and live on fixed-generated returns. Stockholders that have invested in inventories have to wait a long time to recover their investment in the returns of profitability are originate to be exaggerated. Businesses appear to be prospering despite the high inflation period, although inflation is seen to be the main reason behind their rising. This affects the nominal rate of interest and the actual interest rate. Treasury bonds are influenced by inflation, since these fixed income securities pay the same dividend every year. If inflation rises faster than returns on properties, they would be less expensive [5].

The asset manager will rush to sell these reciprocally, so there will be another drop in asset value. When this condition happens, the government is compelled to sell them at all by offering higher treasury returns. Monthly mortgage rates are rising in this way. The value of assets is decreased by inflation. It also raises the expense of servicing the debt to the state by rising the interest payments per year. It is important to compensate for this increased budget expenditure by cutting the discretionary budget or rising taxation and budget deficits [9]. Both of these remedial steps are inconsistent with monetary policy and inevitably slow down economic development, turning it into a semi-standard of living. It destroys public confidence in opposition parties' reliability.

This affects savings and facilitates consumption. It affects spiritual virtues, a dominant work ethic, and delayed gratification prevails. Consumer spending rises because of inflation, which heats up an economy which later turns into spiraling inflation and lowers the standard of living. It also physiologically impacts mass, as individuals begin to anticipate inflation they start spending instantly rather than later. This affects financial assets such as CDs, insurance plans, stocks and bonds and makes measuring them more difficult. When inflation has become part of economic behavior, it is difficult to eradicate its influence and consequences.

CONCLUSION

When demand side factors dominate price inflation, policy makers must establish effective mechanisms for generating policy response, which eventually lead to the risk of spilling into a broader inflationary cycle. Lawmakers must therefore create systemic supply constraints in order to ease inflation control, to ensure that inflationary pressures do not become binding constraints in the longer term and render the task of inflation planning more complex. Government should restrict its wasteful spending and expenses in order to control inflation, it must regulate tax evasion. Government should discourage the borrowing of the fund other than which is utilize in only for production activities.

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