Chapter 31
Inflation and deflation

Key terms

1. Inflation : a sustained rise in price of goods and services over a period of time.
2. Deflation : a sustained fall in price of goods and services over a period of time.
3. Disinflation : a fall in the rate of inflation.
4. Consumer Price Index : a measure of the weighted average of the prices of a representative basket of goods and services.
5. Cost push inflation : rises in the price level caused by higher costs of production.
6. Demand-pull inflation : rises in the price level caused by excess demand.
7. Wage price spiral : wage rises leading to higher prices which in turn, lead to further wage claims and price rises.
8. Monetary inflation : rises in the price level caused by an excessive growth of money supply.
9. Monetarists : a group of economists who think that inflation is caused by the money supply growing more rapidly than output.
10. Hyperinflation : a very rapid and large rise in the price level.
11. Index-linking : changing payments in line with changes in the inflation rate.
12. Menu cost : costs involved in having to change prices as a result of inflation
13. Shoe-leather cost : costs involved in moving money around to gain high interest rate(search cost)

1. **Inflation**

: a sustained rise in price of goods and services over a period of time.

2. **How to measure Inflation and deflation**

: Consumer price Index (CPI) : a measure of the weighted average of the prices of a representative basket of goods and services.

3. **Causes of inflation**

Demand-Pull inflation	Cost-Push inflation
Eg. If people have more income : People are likely to spend more on goods and services : Consumption is likely to increase : AD increases and resulting in demand-pull inflation.	**Cost-Push inflation** : If raw material price is more expensive ,Firms have to maintain profit by raising in selling price.

4. **Consequences of inflation**

4.1 Advantages of low and stable inflation

- Inflation can push up demand and economic growth
- Firms will expand more production and create more job
- Borrowers will be beneficial from lower real cost of borrowing
- Workers may get higher wage.

4.2 Disadvantages of inflation

- Consumers have less purchasing power and lower standard of living
- Workers who have fixed income will be worsen.
- Savers and lender gain lower real benefits
- Inflation creates uncertainty.

5. **Policies to control inflation**

- Contractionary Fiscal policy
- Contractionary monetary policy

- Supply-side policy

6. The causes of deflation

- A reduction in aggregate demand eg. Consumers have lower consumer confidence
- An increase in aggregate supply. Eg. Education can lead to higher labour productivity and lower cost of production

7. Policies to solve deflation

- Expansionary fiscal policy
- Expansionary monetary policy