INFLATION

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Inflation is one of the most acute development problems of the economy practically in each country in the world. We have to understand the nature of inflation, its origins, and causes of appearance and consequences of it to act effectively against this socio-economic phenomenon.

Inflation is a rise in the general level of prices of goods and services in an economy over a period of time. Inflation can also be described as a decline in the real value of money.

Inflation originally referred to the debasement of the currency. When gold was used as currency, gold coins could be collected by the government, melted down, mixed with other metals such as silver, copper or lead, and reissued at the same nominal value. By diluting the gold with other metals, the government could increase the total number of coins. When the cost of each coin is lowered in this way, the government profits from an increase in seigniorage. This practice would increase the money supply but at the same time lower the relative value of each coin. As the relative value of the coins decrease, consumers would need more coins to exchange for the same goods and services.

Related economic concepts include: *deflation*, a fall in the general price level; *disinflation*, a decrease in the rate of inflation; *hyperinflation*, an out-of-control inflationary spiral; *stagflation*, a combination of inflation, slow economic growth and rising unemployment; and *reflation*, which is an attempt to raise the general level of prices to counteract deflationary pressures.

What causes inflation? There are a few different reasons that can account for the inflation in our goods and services:

- **Cost-push inflation** occurs when businesses respond to rising production costs, by raising prices in order to maintain their profit margins. There are many reasons why costs might rise:

1) rising imported raw materials costs;
2) rising labor costs;
3) higher indirect taxes imposed by the government.

- **Demand-pull inflation** is likely when there is full employment of resources and when short-run aggregate supply is inelastic. In these circumstances an increase in aggregate demand will lead to an increase in prices. Aggregate demand might rise for a number of reasons – some of which occur together at the same moment of the economic cycle:
  1) a depreciation of the exchange rate;
  2) a reduction in direct or indirect taxation;
  3) the rapid growth of the money supply;
  4) rising consumer confidence and an increase in the rate of growth of house prices;

Inflation is usually measured by calculating the inflation rate of a price index, usually the Consumer Price Index. The Consumer Price Index measures prices of a selection of goods and services purchased by a "typical consumer". The inflation rate is the percentage rate of change of a price index over time.

$$\Delta P_L = \frac{\sum_i p_{i1} q_{i0}}{\sum_i p_{i0} q_{i0}}$$

Where:

ΔP_L is the change in price level,

p_{i0} is the price of each good i in the first period,

q_{i0} is the quantity of each good i in the first period,

p_{i1} is the price of each good i in the second period.

An increase in the general level of prices implies a decrease in the purchasing power of the currency. The effect of inflation is not distributed evenly, and as a consequence there are hidden costs to some and benefits to others from this decrease in purchasing power. For example, with inflation lenders or depositors who are paid a fixed rate of interest on loans or deposits will lose purchasing power from their interest earnings, while their borrowers benefit. Individuals or institutions with cash assets will experience a decline in the purchasing power of their holdings. Increases in payments to workers and pensioners often lag behind inflation, especially for those with fixed payments. Uncertainty about future inflation may discourage investment and saving.