WHAT IS INFLATION ?

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In economics, inflation is a rise in the general level of prices of goods and services in an economy over a period of time. The term "inflation" once referred to increases in the money supply; however, economic debates about the relationship between money supply and price levels have led to its primary use today in describing price inflation. Inflation can also be described as a decline in the real value of money - a loss of purchasing power in the medium of exchange. When the general price level rises, each unit of currency buys fewer goods and services. A chief measure of price inflation is the inflation rate, which is the percentage change in a price index over time.

Inflation can cause adverse effects on the economy. For example, uncertainty about future inflation may discourage investment and saving. High inflation may lead to shortages of goods if consumers begin hoarding out of concern that prices will increase in the future.

Economists generally agree that high rates of inflation and hyperinflation are caused by an excessive growth of the money supply. Views on which factors determine low to moderate rates of inflation are more varied. Low or moderate inflation may be attributed to fluctuations in real demand for goods and services, or changes in available supplies such as during scarcities, as well as to growth in the money supply. However, the consensus view is that a long sustained period of inflation is caused by money supply growing faster than the rate of economic growth.

Most economists favor a low steady rate of inflation. Low inflation may reduce the severity of economic recessions by enabling the labor market to adjust more quickly in a downturn, and reducing the risk that a liquidity trap prevents monetary policy from stabilizing the economy. The task of keeping the rate of inflation low and stable is usually given to monetary authorities.