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Inflation in Contemporary Times

Manisha A. Prajapati

B.P COLLEGE OF BBA (Kadi Sarva vishwavidyalaya, Gandhinagar)

"Inflation may be defined as a general raise in the prices in a persistent manner". It causes a loss in the purchasing power of a currency. It happens when many price increases simultaneously. This means that it is not necessary that prices of all the goods and services are rising. It is likely that even during periods of high inflation, some prices may be relatively constant and some maybe falling.

"We measure inflation by looking at a large number of goods and services and calculating the average increase in their prices during some periods of time".

THE EFFECT OF INFLATION ON PEOPLE IN THE PRESENT SITUATION

When prices raise, consumer generally switches from costly to affordable goods. Sometimes foreshadow future changes in consumer, it is considered to be a leading indicate of the future consumer prices. Shopkeepers have to recalculate and report prices frequently, and this takes time that could be used more efficiently. Restaurant owners, producers, and much other business that must post prices will have to incur cost to change their prices because of inflation.

People will hold less real cash balance when there is inflation. IF they hold less cash, they must visit the bank/ATM more frequently because they will run out of cash sooner. Such additional wear and tear necessary to hold less cash is categorized as shoe-leather cost. In practice, our tax system and financial system so not adjust even to fully anticipated inflation. Inflation lowers the real after-tax return because the tax system is based on nominal income and not real income.

For example, workers who set nominal wages based on expected inflation would earn a lower real wages. Buyers with nominal contract, such as firms setting nominal wages, would gain.

If a society experience anticipated inflation, individuals and institutions will change their behaviour if unanticipated inflation becomes extreme; individuals spend more of their time trying to profit from inflation rather than working at productive jobs. The economy becomes less efficient when people take actions based on beating inflation. Whether one gains or looser during a period of inflation depends on whether his/her income rises faster or slower than the prices of things purchased. People living on fixed income are most often mentioned while discussing the impact of inflation. If the income is fixed and prices rise, the ability to purchase goods and services falls proportionately.

Most economies in the world today are suffering from this problem of inflation. The prices may raise either because of an increase in the cost.

The aggregate demand is the sum of consumer's spending on consumer goods and services, governments spending on consumer goods and services and investment of the entrepreneurs. The producers pass on this rise in cost of the consumer by increase the price of their goods and services. Rising per unit production costs squeeze profit and reduce the amount of output that the firms are willing to supply at the existing price levels. As a result, the economy wide supply of goods and services declines.

When firms are making their price/output decisions, their expectations of future prices may affect their current decisions. If a firm expects that its competitors will raise their prices, in anticipation it may raise its own price. Expectations can lead to an inertia that makes it difficult to stop an inflationary spiral.

If prices have been raising and if people's expectation are adaptive i.e. if they form their expectations on the basis of past pricing behavior, than firms may continue raising price even demand is slowing or contracting.