

INFLATION AND UNEMPLOYMENT



Inflation

Increase in the general level of prices of goods and services



Purchasing power decreases in case of inflation

$$\bullet \text{ GDP Deflator} = \frac{N}{R} \times 100$$

- Irwin Fisher: Money illusion concept

$$MV = PT$$

- During inflation the debtor/borrower benefits more than the lender



Cause of Inflation

Demand Pull

- Demand side inflation
- "Too many dollars chasing too few goods"

Cost Push

- Supply side inflation
- Increase in cost of any factors of production and input cost

Measurement of Inflation

WPI

Wholesale Price Index
More weightage to manufactured goods

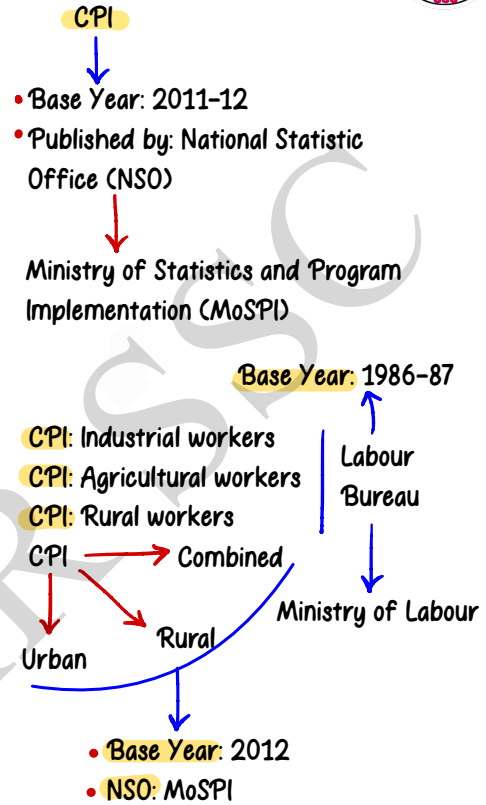
does not capture the changes in the prices of services

CPI

Consumer Price Index
More weightage to food items

Checked from consumers perspective

- Services ✓



• RBI uses CPI (combined) to target inflation

Types of Inflation

1. Creeping: 3-4%
2. Walking: 4-10%
3. Running: 10-20%
4. Galloping: 20-100%
5. Hyper: 100% →

Disinflation: Rate of inflation is decreasing

10% → 8% → 7% → 5%

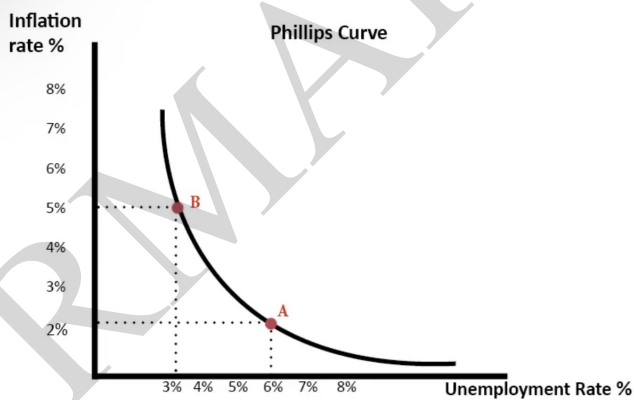
Deflation: opposite of inflation

- Fall in the general level of prices
- Purchasing power increases

- **IIP:** Index of Industrial Production
 - **Base Year:** 2011-12
 - **Published by:** NSO (MoSPI)
- 8 core industries have 40% contributions

1. Refinery products
2. Electricity
3. Steel
4. Coal
5. Natural Gas
6. Cement
7. Fertilizers
8. Crude Oil

- **Philips Curve:** Inflation \uparrow and Unemployment \downarrow have inverse relationship



- **Stagflation:** Inflation \uparrow Unemployment \uparrow
Phillips Curve \times
 \downarrow
No economic activity

- **Great Depression:** 1929-39
- **Great Recession:** 2007-2009

Types of Unemployment

1. **Structural unemployment**: there is a mismatch between worker's skill and availability of job

eg: technology advancement, like machinery replacing farmer labour

2. **Educated unemployment**: degree → unemployment, seen in Urban part of India

3. **Frictional Unemployment**: type of unemployment while searching for a new job

eg: an employee leaving current job to move to a better one (seen in Urban)

4. **Disguised Unemployment**: Hidden unemployment when some people seem to be employed but are not, marginal productivity is zero

eg: Agriculture sector

5. **Cyclical unemployment**: Recession in economy (upturn and downturn)

When economy revives, there is opportunity to employment, seen in Urban

eg: Great Recession

sub-type

• **Seasonal Unemployment**: Employment based on the seasonal basis

Seen more rural part of India

eg: Light or fireworks sellers during Diwali

- When some goods or productive factors are completely fixed in amount, regardless of price, the supply curve is vertical
- The value of the slope of a normal demand curve is negative
- The excess of total expenditure of Government over its total receipts, excluding borrowings, is known as Fiscal deficit
- According to John Maynard Keynes (Father of Macroeconomic) employment depends upon aggregate demand

Gave General theory of Unemployment