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# Theoritical aspects of Inflation

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***Abstract:*** *In economics, inflation is a general increase in the prices of goods and services in an economy. When the general price level rises, each unit of currency buys fewer goods and services; consequently, inflation corresponds to a reduction in the purchasing power of money. The opposite of inflation is deflation, a sustained decrease in the general price level of goods and services. The common measure of inflation is the inflation rate, the annualized percentage change in a general price index. As prices do not all increase at the same rate, the consumer price index (CPI) is often used for this purpose. The employment cost index is also used for wages in the United States.*

Economists believe that high levels of inflation and hyperinflation—which have severely disruptive effects on the real economy—are caused by persistent excessive growth in the money supply. Views on 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. Moderate inflation affects economies in both positive and negative ways. The negative effects include an increase in the opportunity cost of holding money, uncertainty over future inflation which may discourage investment and savings, and if inflation were rapid enough, shortages of goods as consumers begin hoarding out of concern that prices will increase in the future. Positive effects include reducing unemployment due to nominal wage rigidity, allowing the central bank greater freedom in carrying out monetary policy, encouraging loans and investment instead of money hoarding, and avoiding the inefficiencies associated with deflation.

Today, most economists favour a low and steady rate of inflation. Low (as opposed to zero or negative) inflation reduces the severity of economic recessions by enabling the labor market to adjust more quickly in a downturn, and reduces the risk that a liquidity trap prevents monetary policy from stabilising the economy, while avoiding the costs associated with high inflation. The task of keeping the rate of inflation low and stable is usually given to monetary authorities. Generally, these monetary authorities are the central banks that control monetary policy through the setting of interest rates, by carrying out open market operations and (more rarely) changing commercial bank reserve requirements

The term inflation appeared in America in the mid-nineteenth century, "not in reference to something that happens to prices, but as something that happens to a paper currency". Today, however, it is understood as referring to a sustained increase in the general price level (as distinct from short-term fluctuations).

Related concepts. Other economic concepts related to inflation 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 high unemployment; reflation – an attempt to raise the general level of prices to counteract deflationary pressures; and asset price inflation – a general rise in the prices of financial assets without a corresponding increase in the prices of goods or services; stagflation – an advanced increase in the price for food and industrial agricultural crops when compared with the general rise in prices.

More specific forms of inflation refer to sectors whose prices vary semi-independently from the general trend. “House price inflation” applies to changes in the house price index while “energy inflation” is dominated by the costs of oil and gas.

Classical economics. By the nineteenth century, economists categorised three separate factors that cause a rise or fall in the price of goods: a change in the value or production costs of the good, a change in the price of money which then was usually a fluctuation in the commodity price of the metallic content in the currency, and currency depreciation resulting from an increased supply of currency relative to the quantity of redeemable metal backing the currency. Following the proliferation of private banknote currency printed during the American Civil War, the term "inflation" started to appear as a direct reference to the currency depreciation that occurred as the quantity of redeemable banknotes outstripped the quantity of metal available for their redemption. At that time, the term inflation referred to the devaluation of the currency, and not to a rise in the price of goods. This relationship between the over-supply of banknotes and a resulting depreciation in their value was noted by earlier classical economists such as David Hume and David Ricardo, who would go on to examine and debate what effect a currency devaluation (later termed monetary inflation) has on the price of goods (later termed price inflation, and eventually just inflation).

Historically, when commodity money was used, periods of inflation and deflation would alternate depending on the condition of the economy. However, when large prolonged infusions of gold or silver into an economy occurred, this could lead to long periods of inflation.

The adoption of fiat currency by many countries, from the 18th century onwards, made much larger variations in the supply of money possible. Rapid increases in the money supply have taken place a number of times in countries experiencing political crises, producing hyperinflations— episodes of extreme inflation rates much higher than those observed in earlier periods of commodity money. The hyperinflation in the Weimar Republic of Germany is a notable example. Currently, the hyperinflation in Venezuela is the highest in the world, with an annual inflation rate of 833,997% as of October 2018.

However, since the 1980s, inflation has been held low and stable in countries with independent central banks. This has led to a moderation of the business cycle and a reduction in variation in most macroeconomic indicators - an event known as the Great Moderation.

Rapid increases in the quantity of money or in the overall money supply have occurred in many different societies throughout history, changing with different forms of money used. For instance, when silver was used as currency, the government could collect silver coins, melt them down, mix them with other metals such as copper or lead and reissue them at the same nominal value, a process known as debasement. At the ascent of Nero as Roman emperor in AD 54, the denarius contained more than 90% silver, but by the 270s hardly any silver was left. By diluting the silver with


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other metals, the government could issue more coins without increasing the amount of silver used to make them. 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 the relative value of each coin would be lowered. As the relative value of the coins becomes lower, consumers would need to give more coins in exchange for the same goods and services as before. These goods and services would experience a price increase as the value of each coin is reduced.

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