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Recapitulation of Demand-Pull Inflation & Cost-Push Inflation in An Economy

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Abstract

The primary purpose of this paper is to understand the dynamics of demand-pull inflation and its causes at macroeconomics level. It will also be going to establish distant relationship between cost push and demand-pull inflation threw different examples which will try to understand the effect caused by either of them on the economy. This study will make us understand the different factor effecting the demand to fluctuate based on demand driven economy which creates inflated market to the demand pushed beyond the full employment level and the limitation of scarcity of resources causing over of production cost to rise forcing the producer of goods & services to increase the cost of the good sold. Both these factors effect the inflationary condition in the given market causing the demand for money supply to increase and decrease accordingly.

Keywords: Inflation, Demand-Pull Inflation, Cost-Push Inflation.

INTRODUCTION

Inflation generally referred as the phenomenon causes due to the rate of increase prices over the specific time frame in the economy. The continuous increase in the inflationary conditions causes the over all cost of living in the country to skyrocket which results in the increased demand for money forcing the present value of money reduce significantly can led to the decline in the purchasing power of the currency.

An quantitative evaluation in the rate at which the purchasing power decline could be reflected in the increased price levels of the specific goods and services in an given economy over specific time frame.

The monetarism theory explains that there is an direct relationship between inflation and money supply in the economy. The increase in money supply through various monetary and fiscal measure could be the root cause of initiating inflationary condition in the market. However, some economist believes that by keeping inflation between 3% to 5% the economy can sustain the adequate pace of economic development but when the severity of inflation crosses this market it can bring nightmares for policy makers to take the remedial measure to control the inflationary situation.

In such cases money supply increase, the money losses it adequate purchasing power. The process of how inflation drives the economy can be classified in three types: Demand Pull Inflation, Cost Push Inflation and Built In Inflation. In this paper we going to study the demand-pull inflation and cost pull inflation along with their relationship with each other

Review Of Literature:

• Dmitrieva, O., & Ushakov, D. (2011) , states the relationship between the inflation and excessive government spending. It states how the increased government spending on development activities led to the extensive money supply in the market causing the real value money to decrease and more demand for the products and services at inflated price rates

- Totonchi, J. (2011), describes that a continues inflation may led to further inflationary situation in the economy which can bring monetary shock in the system that cannot be control through different fiscal and monetarist measures.
- Machlup, F. (1960) provided highlight on the severity of inflation in the form of characteristics of galloping inflation which causes the consumer price index to rise in double and triple digits. This results in the prices of the commodities to creep up way above the adequate level.
- Hetzel, R. L. (2007), said that the central banks are responsible for inflation, and they should be engaged in effective utilization of resources and its allocation to control the inflationary condition in the given economy
- Nelson, E., & Schwartz, A. J. (2008) stated the impact of monetary policy as the non-conclusive factor of determining the economic health of the society as it is not only the determinant of inflationary condition in the market

Objective:

The objective of this research is to understand demand pull inflation & cost push inflation, factors causing demand pull inflation and establish relationship between the cost push inflation and demand-pull inflation.

Demand Pull Inflation:

The demand-pull inflation is the situation that occurs in the economy when consumer aggregate demand breaks away from the many types of consumer goods and services forcing the overall cost of living to increase. This phenomenon is generally cause due to imbalance between total aggregate supply and aggregate demand where the extensive pressure imposed by the consumer demand on the output capacity of the supply forces the price to rise irrationally causing the inflationary situation. This type of inflation in quite common in monetarist economy since in order to increase the profit margins the supplier will reduce the overall production rate causing prices to rise since consumer would be willing to spend any money to satisfy his or her wants. This situation is called inelastic demand.

Causes of Demand-Pull Inflation:

1. An Expansionary Economic Growth:

When due to positive belief in government's fiscal and monetary policy the consumer shares the significant involvement in the investment and purchasing activities in the economy. This confidence cause increase expectation for better standard of living, increased job opportunities and adequate rate of return on investment in near future. Hence, the families are willing to borrow more without gaining correct knowledge about the markets causing prices to rise. It creates steady and gradual rise in inflationary situation

2. Augmented Money Supply Model:

It is the phenomenon that occurs due to the extensive printing to of money which cause inflation to increase at increasing rate resulting in hyperinflation. This kind of credit extension led to the decrease in the overall money value. Extensive money supply reduces the creditability of the money which may led to too much money chasing very few goods.

3. Government's Permissive Fiscal Policy:

According to the Keynesian theory increased government expenditure and reduction in taxes results in the demand the market to improve significantly as more and more people would be given employment opportunity along with the increased level of disposable income which led to higher marginal propensity to consume. The consumer is provided with more discretionary income they would be willing spend more driving the overall price to inflate for specific set of commodities and services.

4. Technological Research and Innovation:

Breakthrough in the technology which ease the way human lives though innovation in technology always creates buzz in the market. The people demand products with technology that improve overall ease of living. This kind of mod mentality cause increase in demand for the product and shortage of supply which results in inflated prices in the specific segment in the economy.

5. Strong Brand Sales Promotion and Marketing Measure:

Marketing plays a catalyst role in creating brand awareness and builing brand image in the mind of the customer. Strong sales promotion and marketing measure help the company to closely places its product & services in front of the customer which they can correlated with themselves and helping the company to capitalize on this brand recognition and loyalty. When customer associate itself with any brand they would be willing buy the product at inflated price as well since its create the status symbol in the society.

Cost Push Inflation:

Cost push inflation is the circumstance that occurs due to the increase in the supply cost caused by increase in cost of factor of production like labour cost, cost of raw material and cost of capital goods creating cost push inflation. When an organization running at full employment capacity its become inviable for them to maintain same profit margin when the overall cost of production increases forcing them to increase the price of the product to maintain the sustainable profitability.

Causes of Cost-Push Inflation:

1. Wage Push Inflation:

It is the event that has an inflationary spiral effects that occurs when due to increase in real wages of the labour as the factor of production the businesses are forced to pay at higher wage rate and charge more from their product & services to maintain the adequate proportion of profit margins. This will result in the increase in cost of producing goods.

2. Exchanges Rates:

Currency devaluation is the circumstance where the value of currency in terms its exchange rate in respect with other currencies declines. Currency depreciation or devaluation can occurs due to various factors like interest rate differentials, political instability, risk aversion among investors and economic fundamentals which led to the demand to be inelastic causing the prices to rise.

3. Monopoly:

In an economy when an organization is able to achieve the state of monopoly can infiltrate the current prices of goods and services but creating the shortage of supply. This will result in the prices of the respective commodity to rise and give rise to the cost push inflation created by the money through speculative events.

4. Natural Calamity / Disasters:

Certain unexpected natural calamities causing cost push inflation that includes events like fires, earthquakes, floods, cyclone, droughts, etc. if a large disaster causes unprecedented damages to the production facilities and hampers the availability of factor of production can led to higher production cost.

Relationship Between Cost-Push Inflation and Demand-Pull Inflation

There is an inverse relationship between cost-push inflation and demand-pull inflation that is shown in table 1 through various key indicators:

Key Indicators	Cost-Push Inflation	Demand Pull Inflation
Definition	A situation arising as the result of increased in cost of factor of production causing the decline in aggregate supply	A situation arising as the result of increased in aggregate demand
Caused By	Increase in aggregate demand	Increase in cost of factor of production
Impact on Aggregate Demand	Increased aggregate demand	Aggregate demand remains constant
Contributive Factors	Real factors and money factors	Caused by business groups of society who respond to rise in costs of the product
Ubiquity	Demand pull inflation is common in most of the world economy	Cost push inflation is not that relevant in current times

Conclusion:

As we understand the dynamics of two different variants of inflation where demand pull inflation is caused by excessive demand over the supply in the economy on the other hand when the factors contributing in production becomes scared in nature it will give rise to the cost push inflation. There are different ways through with both cost-push inflation and demand pull-inflation could be rectified using various fiscal as well as monetary measure by the government and monetary authority of respective country. The contractionary fiscal and monetary policies measure will going to impact the ill effects and triggers less motivation for increased willing for product demand, decrease government spending and increased taxes which would result in reduction in demand and help in controlling the prevailing inflationary condition in the given market.

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