What Is Inflation?

Inflation is a quantitative measure of the rate at which the average [price level](https://www.investopedia.com/terms/p/price_level.asp) of a [basket of selected goods](https://www.investopedia.com/terms/b/basket_of_goods.asp) and services in an economy increases over some period of time. It is the rise in the general level of prices where a unit of currency effectively buys less than it did in prior periods. Often expressed as a percentage, inflation thus indicates a decrease in the [purchasing power](https://www.investopedia.com/terms/p/purchasingpower.asp) of a nation’s currency.

**Types of Inflation**

[Inflation](https://www.thebalance.com/what-is-inflation-how-it-s-measured-and-managed-3306170) is when the prices of goods and services increase. There are four main types of inflation, categorized by their speed. They are creeping, walking, galloping, and hyperinflation. There are specific types of asset inflation and also wage inflation. Some experts say demand-pull and cost-push inflation are two more types, but they are causes of inflation. So is the expansion of the money supply.

Creeping Inflation

Creeping or mild inflation is when prices rise 3% a year or less. According to the Federal Reserve, when prices increase 2% or less, it benefits economic growth. This kind of mild inflation makes consumers expect that prices will keep going up. That boosts demand. Consumers buy now to beat higher future prices. That's how mild inflation drives economic expansion. For that reason, the Fed sets 2% as its target inflation rate.

Walking Inflation

This strong, or destructive, inflation is between 3-10% a year. It is harmful to the economy because it heats-up economic growth too fast. People start to buy more than they need to avoid tomorrow's much higher prices. This increased buying drives demand even further so that suppliers can't keep up. More important, neither can wages. As a result, [common goods and services](https://www.thebalance.com/market-economy-characteristics-examples-pros-cons-3305586) are priced out of the reach of most people.

Galloping Inflation

When inflation rises to 10% or more, it wreaks absolute havoc on the economy. Money loses value so fast that business and employee income can't keep up with costs and prices. Foreign investors avoid the country, depriving it of needed capital. The economy becomes unstable, and government leaders lose credibility. Galloping inflation must be prevented at all costs.

Hyperinflation

Hyperinflation is when prices skyrocket more than 50% a month. It is very rare. In fact, mostexamples of hyperinflation occur when governments print money to pay for wars. Examples of hyperinflation include Germany in the 1920s, Zimbabwe in the 2000s, and Venezuela in the 2010s. The last time America experienced hyperinflation was during its civil war.

Cost Push and Demand pull Inlfation

Cost-Push Inflation

Aggregate supply is the total volume of goods and services produced by an economy at a given price level. When the aggregate supply of goods and services decreases because of an increase in production costs, it results in cost-push inflation.

Cost-push inflation means prices have been "pushed up" by increases in the costs of any of the four [factors of production](https://www.investopedia.com/terms/f/factors-production.asp)—labor, capital, land, or entrepreneurship—when companies are already running at full production capacity. Companies cannot maintain profit margins by producing the same amounts of goods and services when their costs are higher and their productivity is maximized.

The price for raw materials may also cause an increase in costs. This may occur because of a [scarcity](https://www.investopedia.com/terms/s/scarcity.asp) of raw materials, an increase in the cost of labor to produce the raw materials, or an increase in the cost of importing raw materials. The government may also increase taxes to cover higher fuel and energy costs, forcing companies to allocate more resources to paying taxes.

In order to compensate, the increase in costs is passed on to consumers, causing a rise in the general price level or inflation.

For cost-push inflation to occur, demand for goods must be static or inelastic. That means demand must remain constant while the supply of goods and services decreases. One example of cost-push inflation is the oil crisis of the 1970s. The price of oil was increased by OPEC countries, while demand for the commodity remained the same. As the price continued to rise, the costs of finished goods also increased, resulting in inflation.1﻿

Let's take a look at how cost-push inflation works using this simple price-quantity graph. The graph below shows the level of output that can be achieved at each price level. As production costs increase, aggregate supply decreases from AS1 to AS2 (given production is at full capacity), causing an increase in the price level from P1 to P2. The rationale behind this increase is, for companies to maintain or increase profit margins, they will need to raise the retail price paid by consumers, thereby causing inflation.

Demand-Pull Inflation

[Demand-pull inflation](https://www.investopedia.com/terms/d/demandpullinflation.asp) occurs when there is an increase in aggregate demand, categorized by the four sections of the [macroeconomy](https://www.investopedia.com/terms/m/macroeconomics.asp): households, businesses, governments, and foreign buyers.2﻿ 3﻿

When concurrent demand for output exceeds what the economy can produce, the four sectors compete to purchase a limited amount of goods and services. That means the buyers "bid prices up" again and cause inflation. This excessive demand, also referred to as "too much money chasing too few goods," usually occurs in an expanding economy.3﻿

In Keynesian economics, an increase in aggregate demand is caused by a rise in employment, as companies need to hire more people to increase their output.4﻿

The increase in aggregate demand that causes demand-pull inflation can be the result of various economic dynamics. For example, an increase in government spending can increase aggregate demand, thus raising prices.4﻿ Another factor can be the depreciation of local exchange rates, which raises the price of imports and, for foreigners, reduces the price of exports. As a result, the purchasing of imports decreases while the buying of exports by foreigners increases. This raises the overall level of aggregate demand—assuming aggregate supply cannot keep up with aggregate demand as a result of full employment in the economy.5﻿

Rapid overseas growth can also ignite an increase in demand as more exports are consumed by foreigners. Finally, if a government reduces taxes, households are left with more disposable income in their pockets. This, in turn, leads to an increase in consumer confidence which spurs consumer spending.

Looking again at the price-quantity graph, we can see the relationship between aggregate supply and demand. If aggregate demand increases from AD1 to AD2, in the [short run](https://www.investopedia.com/terms/s/shortrun.asp), this will not change aggregate supply. Instead, it will cause a change in the quantity supplied—represented by a movement along the AS curve. The rationale behind this lack of shift in aggregate supply is aggregate demand tends to react faster to changes in economic conditions than aggregate supply.

As companies respond to higher demand with an increase in production, the cost to produce each additional output increases, as represented by the change from P1 to P2. That's because companies would need to pay workers more money (e.g., overtime) and/or invest in additional equipment to keep up with demand. Just like cost-push inflation, demand-pull inflation can occur as companies pass on the higher cost of production to consumers to maintain their profit levels.

OR

You may see the following notes

# Difference Between Demand-Pull and Cost-Push Inflation.

Inflation refers to the rate at which the overall prices of goods and services rises resulting in the decrease in the purchasing power of the common man, which can be measured through Consumer Price Index. Modern analysis of inflation revealed that it is mainly caused either by demand side or supply side or both the factors. Demand side factors result in **demand-pull inflation** while supply side factors lead to **cost-push inflation**.

The demand-pull inflation is when the aggregate demand is more than the aggregate supply in an economy, whereas cost push inflation is when the aggregate demand is same and the fall in aggregate supply due to external factors will result in increased price level. This article explains clearly the significant difference between demand-pull and cost-push inflation.

## Content: Demand-Pull Inflation Vs Cost-Push Inflation

### Comparison :-

| **BASIS FOR COMPARISON** | **DEMAND-PULL INFLATION** | **COST-PUSH INFLATION** |
| --- | --- | --- |
| Meaning | When the aggregate demand increases at a faster rate than aggregate supply, it is known as demand-pull inflation. | When there is an increase in the price of inputs, resulting in decrease in the supply of outputs, is is known as cost-push inflation. |
| Represents | How price inflation begins? | Why inflation is so difficult to stop, once started? |
| Caused by | Monetary and real factors. | Monopolistic groups of the society. |
| Policy recommendations | Monetary and fiscal measures | Administrative control on price rise and income policy. |

### Definition of Demand-Pull Inflation

Demand Pull Inflation arises when the aggregate demand goes up rapidly than the aggregate supply in an economy. In simple terms, it is a type of inflation which occurs when aggregate demand for products and services outruns aggregate supply due to monetary factors and/or real factors.

* **Demand-Pull Inflation due to monetary factors**: One of the major cause of inflation is; increase in money supply than the increase in the level of output. The German inflation, in the year 1922-23 is the example of Demand-Pull Inflation caused by monetary expansion.
* **Demand-Pull Inflation due to real factors**: When the inflation is due to any one or more of the following reasons, it is said to be caused by real factors:
  + The increase in government spending without the change in tax revenue.
  + Fall in tax rates, with no change in government spending
  + Increase in investments
  + Decrease in savings
  + Increase in exports
  + Decrease in imports

Out of these six factors, the first four factors, will result in the rise in the level of disposable income. The increase in aggregate income result in the increase in aggregate demand for goods and services, causing demand-pull inflation.

### Definition of Cost-Push Inflation

Cost push inflation means the increase in the general price level caused by the rise in prices of the factors of production, due to the shortage of inputs i.e. labour, raw material, capital, etc. It results in the decrease in the supply of outputs which mainly use these inputs. So, the rise in prices of the goods emerges from the supply side.

Moreover, cost-push inflation may also be caused by depletion of natural resources, monopoly and so on. There are three kinds of cost-push inflation:

* **Wage-push inflatio**n: When the monopolistic groups of the society like labour union exercise their monopoly power, to enhance their money wages above the competitive level, which cause an increase in the cost of production.
* **Profit-push inflation**: When the monopoly power is used by the firms operating in the monopolistic and oligopolistic market to increase their profit margin, leading to rise in the price of goods and services.
* **Supply shock inflation**: A type of inflation arising due to unexpected fall in the supply of necessary consumer goods or major industrial inputs.

## Key Differences Between Demand-Pull and Cost-Push Inflation

The differences between dDemand-pull and cost-push inflation can be drawn clearly on the following grounds:

1. Demand-pull inflation arises when the aggregate demand increases at a faster rate than aggregate supply. Cost-Push Inflation is a result of an increase in the price of inputs due to the shortage of cost of production, leading to decrease in the supply of outputs.
2. Demand-pull inflation describes, how price inflation begins? On the other hand, cost-push inflation explains Why inflation is so difficult to stop, once started?
3. The reason for demand-pull inflation is the increase in money supply, government spending and foreign exchange rates. Conversely, cost-push inflation is mainly caused by the monopolistic groups of the society.
4. The policy recommendation on demand-pull inflation is associated with the monetary and fiscal measure which amounts to the high level of unemployment. Unlike, cost push inflation, where policy recommendation is related to administrative control on price rise and income policy, whose objective is to control inflation without increasing unemployment.

### Conclusion

Therefore, you can conclude with the above discussion the main reason for causing inflation in the economy is either by demand-pull or cost-push factors. It is often argued that which is the supreme factor for inflation, which one of the two-factor causes rise in the general price level for the first time. Experts hold that demand-pull factor the leading factor for inflation in any economy.

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