
Inflation and Its Causes

CAUSES OF INFLATION

Inflation is the state where overall worth level is growing time by time signifying imbalance between claim and providence of things at present prices. Reasons of inflation differ from country to country, so diverse sorts of inflation occur at diverse places relying upon the causes which produce inflation. Nevertheless there are some mutual causes of inflation which are defined in next segment.

- Deficit financing
- Increase in money supply
- Increase in developmental and non-developmental expenditures
- Population explosion
- Devaluation of currency
- Political instability
- Undesirable activities

DEFICIT FINANCING

It is a condition where government spending go beyond its income is said to be the deficit financing. The increased spending in the shortage budget is completed by deficit financing. Because of deficit financing the money providence in country rises but its production does not rise at the similar rate so rates tend to increase and result in inflation.

INCREASE IN MONEY SUPPLY

Increase in money supply is a major cause of inflation. Lower bank rates, decrease in reserve radio and deficit financing etc. are the major reasons for increase in money supply. The increase in money supply causes the amount of cash with banks and people to increase hence causing the commercial banks to give more loans to people at low interest rates. People will then ask for more goods and services due to the availability of cash. The increased demand of goods and services causes the prices to rise, thus causing inflation.

INCREASE IN DEVELOPMENTAL AND NON DEVELOPMENTAL EXPENDITURES:

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Inflation is also caused by developmental and non-developmental expenditures of the government. For instance, the non-developmental expenditures such as expenditures on defense, official tours of governments' employees, rise in the salaries of government employees etc. lead economy to inflation. Usually, in most developmental projects, outputs usually start many years after the money investment. These kinds of developmental projects may also be the reason for inflation.

POPULATION EXPLOSION

Rapid increase in population also causes inflation. The demand for goods and services does not meet with the supply rate because of the increase in population. This imbalance between goods' demand and supply results in prices hike, hence causing inflation.

DEVALUATION OF CURRENCY

Devaluation of currency means the official lowering of external value of the currency by monetary authorities. Prices of imported goods increase whenever local currency is devalued against the foreign currency. Different factors of production use imported goods which in turn increase the production cost. The increase in production cost increase prices and cause inflation. This type of inflation is known as push inflation.

POLITICAL INSTABILITY

The economic development of a country is dependent upon its political stability. Political stability increases investment and decreases hoarding and speculations. Entrepreneurs are reluctant to invest in a country where there is unpredictable political situation. Foreign investors also stop investing and then the businessmen and industrialists are unable to make good plans because of financial insecurity. This leads to shortage of services and goods, resulting in inflation.

UNDESIRABLE ACTIVITIES

Smuggling, hoarding, black marketing and such other illegal activities slow down economic growth and decrease supply for domestic purpose. In case of frequent hording, magnificent profits are charged by creating fake scarcity of costly items. The income obtained from such sources is then spent on jewelry, luxury items, consumer goods and speculation, instead of spending it on productive activities. This increased expense increases the demand for services and goods, and cases inflation.

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