INFLATION.

- Inflation is a trend of rapid increase in price levels accompanied by a loss of purchasing power.
- It can also be defined as an increase in money supply.
- It is a situation where the volume of purchasing power is running ahead of the output of goods & services such that there is a tendancy of prices to rise

Types of Inflation.

1. Hyper inflation. ✓
2. Creeping inflation ✓
3. Rapid inflation. ✓
4. Moderate inflation.
5. Suppressed inflation.

June 2013 5c.

i) Change in equilibrium level of income.

$MPC = 0.75$ $MPS = 1 - 0.75$

$\Delta I = 50m.$ $MPS = 0.25$

$\Delta Y =$

$$\text{Multiplier} = \frac{1}{MPS} \quad \frac{1}{0.25} = 4.$$

$$\text{Multiplier} = \frac{\Delta Y}{\Delta I} \quad 4 = \frac{\Delta Y}{50m.}$$

$50M \times 4 = 200M.$

$\Delta Y = 200M.$

ii) Change in autonomous spending

$C = a + by$

change in autonomous spending is 0 since it is a constant / fixed consumption ∴ it does not change with change in income.

iii) Induced change in consumption.

$0.75(200,000,000)$

$= 150,000,000.$

Nov 2010 5b.

03/10/2016.

1. Hyper Inflation.

This is where prices rise at a phenomenal rate where the inflation rate surpasses 3 digit levels.

2. Surpressed Inflation:

This is where demand exceeds supply but the effects on price are minimized through price controls.

3. Creeping Inflation.

It occurs when prices & wages push one another upwards causing continous increase in supply of money.

4. Rapid Inflation.

In this case, the prices are at a rate of 6% and above & it is definitely harmful & thus must be seriously controlled.

5. Moderate Inflation.

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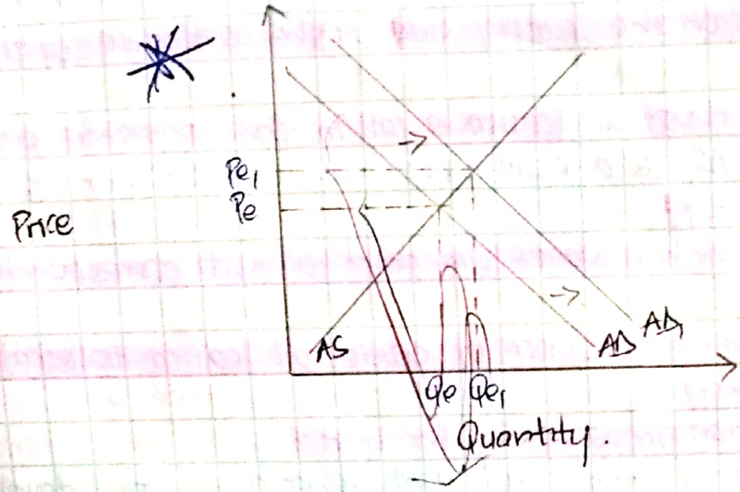
CAUSES OF INFLATION.

1. Demand-pull Inflation.



- This occurs when aggregate demand persistently exceeds aggregate supply at the current prices.
- Since the excess demand cannot be met at the current prices, new equilibrium prices are established.
- An increase in aggregate demand will cause a shift from AD to AD_1, as a result, prices will increase from P_e to P_{e_1}
- If firms cannot respond to demand quickly by expanding output then a situation of excess demand exists & inflation will result
- Demand pull inflation is caused by;

a) An increase in the level of demand for goods & services in a situation of near full employment.

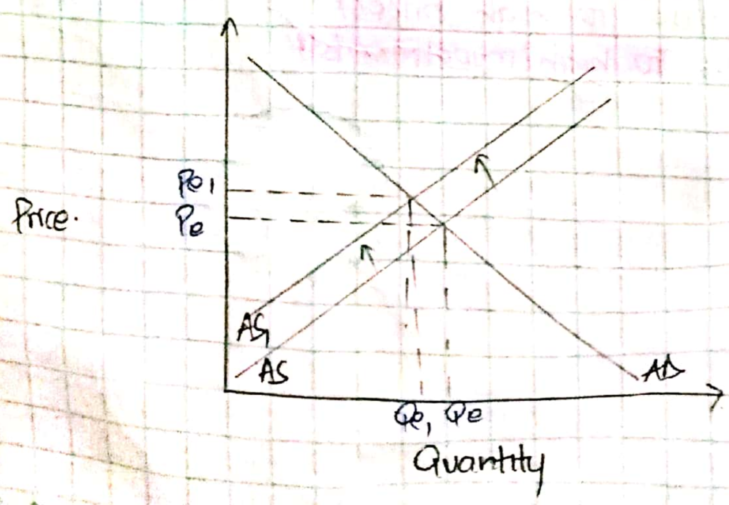
b) A general shortage of goods & services in times of disasters such as floods & earthquakes etc.

c) The expansion of govt spending by borrowing from the banking sys esp when it is not matched by an increase in output.

d) A country trying to achieve an export surplus because exports generate income at home. Foreign exchange currency inflows causes increase in money. This inflows become a source of inflationary pressure.

e) Social evils eg holding & smuggling etc can cause artificial shortages which cause prices to go up.

2. Cost-push Inflation.



- This is when the increase in the cost of production pushes the general prices up.
- This type of inflation arises on the supply side or the cost side of the market.
- An increase in the cost of production will cause a fall in the aggregate supply which will shift from AS to AS_1 as a result prices will increase from P_0 to P_1
- Cost push inflation is caused by;

a) Increase in wage cost when higher wages are paid without corresponding increase in production.

b) A rise in import prices such as the price of crude oil leading to escalating prices throughout the economy.

c) An increase in indirect taxation imposed by the govt.

d) Changes in exchange rates. It is established that when a country devalues its currency by 4% it causes a 1% increase in domestic inflation.

e) Structural rigidity whenever the factors of production or resources fail to move quickly from one place to another or from one use to another. This may lead to shortages & eventually an increase in prices.

Effects of Inflation.

1. In case of hyper inflation, the public may lose confidence in the domestic currency & may prefer to hold its assets in other currencies.
2. Inflation may deter economic growth because of increased uncertainty.
3. Discourages savings through low real interest rates.
4. Inflation may deter investments esp with long gestation periods.
5. May lead to political unrest as the population is unable to afford basic necessities.
6. Loss of purchasing power of money.
7. Creditors may make losses when they give out loans since they will be paid back less than they loaned out.
8. Inflation may cause a disequilibrium in the balance of payments whereby inflation may mean goods produced domestically are not affordable in the foreign markets meaning exports will fall while imports will rise

NB/ Inflation may also be beneficial;

1. Increased production esp. because of increased demand.
2. Increased investments due to high prices.
3. Increased employment due to high investments.

Dec 2013 5b

May 2011 6c

Measures to Combat Inflation.

Demand pull inflation.

Fiscal policies.

- Raising taxes in order to cut consumer's income & hence their level of spending.
- i) The govt. can lower its expenditure & as a result the money supply in circulation decreases & prices fall.
- i) Public borrowing: During inflation, the govt borrows money from individuals & starts production projects. In this case, production of commodities may increase & prices will automatically fall.

2) Monetary policies.

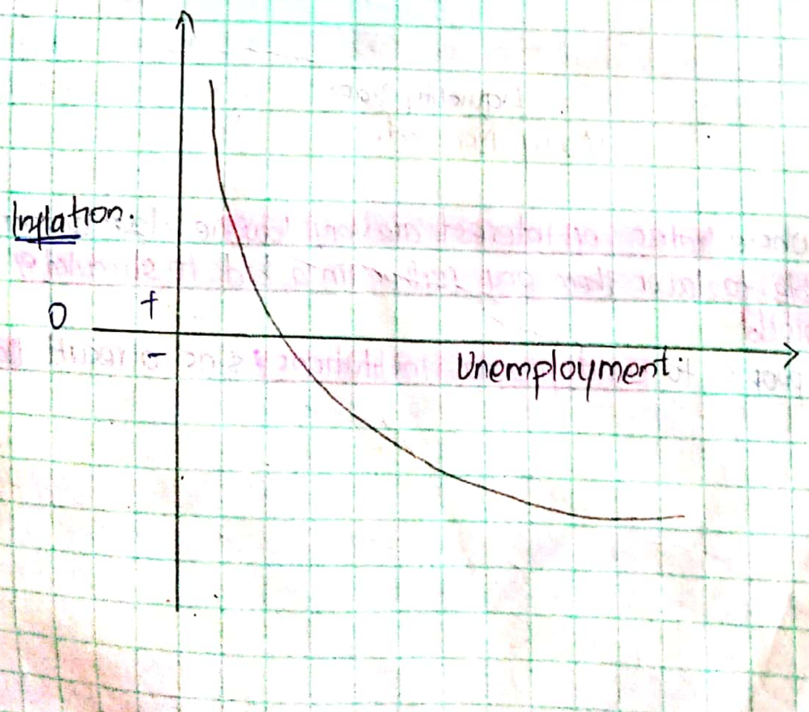
- This takes the form of contractionary monetary policy aimed at regulating or controlling money supply & excess credit expansion.
- Monetary polices are implemented by the CBK & its instruments include;

i) Raising interest rates or the cost of borrowing through sale of treasury deals in open market operations (OMO)
ii) Increase of cash liquidity ratio requirements on commercial banks.
iii) Restricting direct lending to the govt.

2. Cost-push Inflation.

a) The govt. can enforce price controls esp. for essential commodities.
b) Wage controls can be put in place or encouraging greater productivity in the industry.
c). Reducing the quantity of imports by looking for alternative sources of supply.
d) Output adjustments. Steps must be taken by the govt to increase the production of goods such that the price levels will remain checked.

Phillip's Curve



- This is a statistical relationship btwn unemployment & the rate of money wage inflation.
- This relationship implies that in general the rate of inflation falls as unemployment rises & vice versa.
- It implies that zero inflation is associated with some employment. It is not possible to achieve zero inflation & zero unemployment at the same time.

Consumer Price Index.

- This is an index no. of the prices of commodities.
- It measures relative changes in the prices of a specified set of consumer goods which would be bought by the average household on a regular basis.

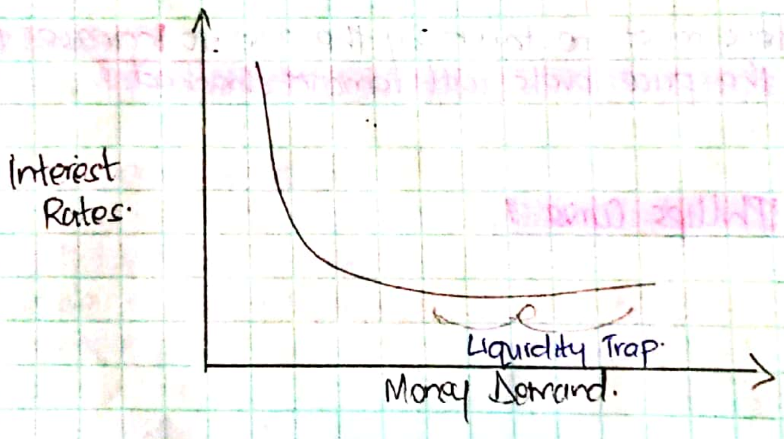
$$\frac{P_1}{P_0} \times 100\% = CPI$$

P_0 = Base year's price
P_1 = Current Year's price.

Producer Price Index.

- This is an index of prices charged by the b/s ~~of~~ ~~to~~ for raw, intermediate & finished goods.

Liquidity Trap.



- This is a situation where rates of interest are very low ie close to zero & the monetary authority is unable to lower them any further in a bid to stimulate borrowing & economic growth.
- Low interest rates cause people to avoid financial institutions & as a result liquidity is trapped.

UNEMPLOYMENT

04/10/2016.

This is a situation where factors of production are willing & capable of being employed at the ruling market wage rate but are unutilized or underutilized.

$$\text{Unemployment Rate} = \frac{\text{Unemployed}}{\text{Total Labour Force}} \times 100\%.$$

Types of Unemployment:

1. Seasonal Unemployment:
- This is caused by annual variation of seasons which affects economic activities eg agriculture & tourism.
- During the booming time in this sectors, demand for labor is very high but during the ~~eo~~ off peak seasons there will be a standard drop in demand for labour.

2. Structural unemployment:
This results from an imbalance btwn supply of a particular group of workers & the demand for their services eg technological changes may make the product on which a particular industry is based absolete.

3. Cyclical unemployment: [redacted]
- It is associated with trade cycles. During the recovery & boom phases of the trade cycle, the demand for output & labour is very high & unemployment is low.

4. Disguised unemployment:
- This occurs when work available to a given work force is insufficient to keep it fully employment so that some members of the work force could be withdrawn without loss of output.

5. Frictional unemployment:
It arises from immobility of labour force rather than lack of demand for labour eg when people are changing jobs, they may become ~~uno~~ unemployed for a short time.

6. Voluntary unemployment:
- Caused by people who choose not to work. It is common in developed economies where some people inherit a lot of wealth from their families.

7. Involuntary unemployment:
This is where people who are willing to work are unable to find work.

8. Technological unemployment:
- Caused by technological advances or highly advanced tech. Some people's skills become irrelevant hence they are laid off or retrenched.

9. Casual unemployment:
Affects casual labourers hired on part-time services ~~not~~: not entitled to the benefits of a full-time employee.

10. Demand deficient unemployment

- This is a situation where there is no demand for products produced by a certain type of labour.
- Demand for labour is derived demand. It is derived from the demand for the products that the labour produces.
- It follows that, when the product that labour produces is no longer demanded then there is no need to demand that type of labour.

11. General unemployment.

This is that which is widespread throughout the economy & not confined to a particular region or category of labour.

Social-Economic Effects of Unemployment.

1. High-level of poverty.
2. High rates of drug use, crime rates & social unrest.
3. Low levels of economic growth & development
4. Low living standards.
5. Prostitution & other related social ills.
6. Generation of slums.

Causes of Unemployment in Developing Countries.

1. Rapid population growth.

The population grows faster than the overall rate of growth in the economy.

2. Use of inappropriate technology.

In developing countries where technology is often labour saving on capital intensive production.

3. Nature of education sys.

Education sys. in developing countries were adopted from developed countries & are geared to white collar jobs which don't conform. to the reality of the job market.

4. Seasonality of production.

- This is especially important in developing countries where agricultural sector is predominant.
- Changes in weather lead to seasonality in unemployment.

5. Massive rural-urban migration.

This results to urban unemployment owing to insufficient job creation capacity.

Measures to Combat Unemployment:

1. Diversification of economic activities.
Can be used in reducing seasonal unemployment eg regions that depend on tour for employment can introduce alternative activities eg labour intensive manufacturing during off-peak periods

2. Intensive Rural development by the govt.
3. Encouraging foreign direct investment by making political & economic development conducive for capital inflow.
4. Encouraging use of domestic goods because this tends to create employment domestically.
5. Diversification of products & market to other lines of production.
Increasing employment creation in the private sector by creating an enabling environment by for private sector development through microfinancing.
7. Encouraging the use of appropriate technology.