UNIT – IV

Inflation and unemployment

Types · Causes · Phillips · Stagflation

Explanatory Lecture Slides

Macro Economics · Major-6 · Semester IV

MACRO ECONOMICS

LEARNING OBJECTIVES

Topics covered in this unit

01 **Define inflation and its types**

02 **Explain demand-pull and cost-push**

03 **State effects of inflation**

04 **Place unemployment types in a macro frame**

05 **State the Phillips curve and its breakdown**

06 **Place India’s inflation-targeting regime**

UNIT IV · SYLLABUS MAP

How this unit is organised

01	02	03	04	05	06
What is inflation	Demand-pull / cost-push	Effects	Unemployment	Phillips	India’s MPC

What is inflation

A sustained rise in the general price level. Not a one-good spike. Measure: CPI (what MPC uses), WPI, GDP deflator.

- Types: creeping, walking, galloping, hyper; anticipated v unanticipated; core v headline.
- Deflation and disinflation are different — a 6-mark of vocabulary.

What is inflation

CPI

- Household basket — the MPC’s target.

HYPER

- Money dies as a store — see Unit on money in Major-2.

Demand-pull and cost-push

Pull: AD beyond Y* (too much money, a fiscal impulse, a boom). Push: wages, oil, exchange-rate pass-through, tax, supply shock (monsoon).

- Quantity theory is a pull story (MV=PY). Keynesian gap is a pull story. 1970s oil is a push story.
- Policy: pull → tighten AD; push → tightening AD costs jobs — the stagflation bind.

Demand-pull and cost-push

PULL

- Too much AD.
- Tighten M or G.

PUSH

- A cost curve of the whole economy.
- Do not only smash demand.

Effects

Redistributes: debtors gain, creditors lose, fixed-income lose, the State as debtor may gain. Menu costs, shoe-leather, uncertainty, BOP, fiscal drag, social unrest.

- Unanticipated inflation is the cruel one. Indexation (DA, inflation-indexed bonds) is the legal/contractual reply.
- s.73 damages in a long contract without an escalation clause is a private inflation problem.

Effects

WHO LOSES

- Cash holders.
- Fixed wage.
- Creditors.

WHO GAINS

- Debtors.
- Owners of real assets.

Unemployment in a macro frame

Cyclical (AD short — Keynes), structural, frictional, classical (real-wage too high), natural rate / NAIRU.

- Okun’s law (optional): Y-gap and unemployment move together.
- India: PLFS; disguised more than dole-queue. Do not import a US U-3 number.

Unemployment in a macro frame

CYCLICAL	STRUCTURAL
• Fix with AD.	• Fix with skilling, moving, industrial mix.

Phillips and stagflation

Original Phillips: inverse w-inflation and unemployment. Friedman–Phelps: in the long run vertical at the natural rate; only unanticipated inflation buys jobs, and only for a while. 1970s: inflation and unemployment together — stagflation.

- A 16-mark of this unit. Draw (in words) SRPC shifting up when expected inflation rises.
- Policy: no permanent inflation-for-jobs bargain.

Phillips and stagflation

SR

- A trade-off if expectations are slow.

LR

- Vertical at NAIRU.
- Stagflation possible.

India’s inflation-targeting regime

RBI Act amended 2016: MPC, 4% CPI ±2%. A monetary-policy reaction to this unit’s theory.

- Name the band. Do not invent the current repo. Food has a large CPI weight — a monsoon is a cost-push the MPC has to look through or not.

India’s inflation-targeting regime

TARGET

- 4% CPI, band 2–6%.

TOOL

- Repo, corridor, communication.

Unemployment in a macro frame

Cyclical (AD short — Keynes), structural, frictional, classical (real-wage too high), natural rate / NAIRU.

- Okun’s law (optional): Y-gap and unemployment move together.
- India: PLFS; disguised more than dole-queue. Do not import a US U-3 number.

LANDMARK AUTHORITIES

Cases a KSLU answer should name

CASE

RBI v Jayantilal N. Mistry

(2016) 3 SCC 525

The inflation actor owes the public a record.

CASE

S.R. Bommai

(1994) 3 SCC 1

Political shocks and fiscal slippage — pull inflation’s political cousin.

CASE

Olga Tellis

(1985) 3 SCC 545

Inflation of house-rents and livelihood — the CPI that a pavement dweller actually faces.

STATUTE / SECTION MAP

Provisions & materials to quote

RBI Act — MPC, s.45ZA	4% CPI target.
FRBM Act 2003	Fiscal contribution to pull inflation.
Essential Commodities	A supply-side statute against push inflation in food.
Industrial relations /	Wage-price indexation in contracts and awards.
Contract Act s.73	Unindexed long contracts in an inflation.

WRITE IT IN THE HALL

10 / 16-mark frames from this unit

Q1 Define inflation. Explain demand-pull and cost-push inflation.

Q2 What are the effects of inflation? Who gains and who loses?

Q3 Explain the Phillips curve. What is stagflation?

Q4 Write a note on inflation targeting in India / types of unemployment.

BEFORE YOU CLOSE THE FILE

Unit recap

1. Inflation = sustained general rise; CPI is the MPC’s number.
2. Pull: too much AD. Push: costs. Policy differs.
3. Unanticipated inflation redistributes cruelly.
4. Phillips: SR trade-off, LR vertical; stagflation is the warning.
5. Quote the 4% ±2% band.