B.com-II — Money & Banking(S) | Sujeet Kr. Suman R.N.C.

Q.No→2.→ Explain deflation ? Causes and effect of deflation?

Ans.

Many people accept inflation as a fact of life, Howeever, under certain economic system, the oppositie phenomenon actually takes place and is known as "deflation."

Deflation is the reduction of goods and although deflation may seem like a good thing when you're standing at the chekout counter, it is not. Rather, deflation is usually associated with significant unemployment, which is ~~usually~~ only corrected after wages drop considerably. furthermore, business profits drop significantly during periods of deflation, making it more difficult to raise additional capital to expand and develop new technologies.

According to Prof. Crowther -" Deflation is a state in which the value of money is rising i.e., price are falling.

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* Causes of deflation → Deflation can be caused by a number of factors, all of which stem from a shift in the supply - demand curve. Remember, the price of all goods and services are heavily affected by a change in the supply and demand, which means that if demand drops in a relation to supply, prices will have to drop accordingly. Also, a change in the supply and demand of nation's currency plays an instrumental role in setting the prices of the country's goods and services. There are the main causes of deflation :—

(a.) Change in structure of capital market → Many different companies are selling the same goods or services, they will typically lower their prices as a means to compete. Often, the capital structure of the economy will change the companies will have easier access to debt and equity markets, which can use to fund new business or improve productivity.

(b) Increase productivity → Innovative solutions and new processes help increase efficiency, which ultimately leads to lower prices. Although some innovations only affect the productivity of certain industries, others may have a profound effect on the entire economy.

For, example., after the Soviet union collapsed in 1991, many of the countries that formed as a result struggled to get back on track. In ~~other~~ order to make a living citizens were willing to work for very low prices, and as companies in the united states outsourced work to these countries, there were able to significantly reduce their operating expenses and ~~~~ bolster productivity.

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(C.) Decrease in currency supply → As the currency supply decrease, prices will decrease so that people can afford goods. How can currency supplies decrease? one common reason is through Central banking system.

For instence, when the fedral reserve was first created, it considerably contracted the money supply of the united states. In the process, this leal to a severe case of deflation in 1913.

(d.) Austerity measures :— Deflation can be the result of decreased governmental, business or consumer spending, which means government spending cuts can lead to periods of significant deflation. For, example, when spain initiated austerity measures in 2010, preexisiting deflation began to spiral out of control.

(e.) Deflationary spiral → Deflation has shown its ugly head, it can be very difficult to get the economy under control for a number of reasons. First of all, when consumers stard cutting spending, businesses profits decrease. Unfortunately, this means that businesses have to reduce wages and cut their own purchases.

* Effect of deflation :— Deflation can be compared to a terrible winter. The damage can be intense and be experienced for many seasons afterwards. Unfortunately, some nations never fully recover from the damage caused by deflation. Hong kong, for example, never recovered from the deflationery effects that gripped the Assian economy in 2002. Deflation can be following effects —

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(a.) Reduced business Revenues :— Business must significantelly reduce of the prices of their productions in order to stay competitive. obviously, as they reduce their prices, their revenues start to drop. business revenues frequently fall and recover, but deflationary cycles tends to repeat themselves multiple times.

(b.) Wage cutbacks and Layoffs → when revenues start to drop, companies need to find ways to reduce their expenses to meet their bottom line. They can make their cuts by reducting wages and cutting possitions. understanby, this exacerbates the cycle of inflation, as more would - be- consumers have less to spend.

(c.) Change in customer Spending → The relationship between deflation and consumer spending is complex and often difficult to predict, when the economy undergoes a period of deflation, customer's often take advantage of the substantially lower prices, initially, consumer spending may increase greatly, however, once businesses start looking for ways to bolster their bottom line.

(d.) Reduced stake in investment → when the economy goes through a series ~~bottom~~ of deflation, investors tend to view cash as one of their best possible investment. Investors will watch their money grow simply by holding onto it.

(e.) Reduced credit → when deflation, rears its head, financial lenders quicly start to pull the plugs on many of their lending operations for a variety of reasons. First of all assets such as houses decline in value, customers cannot back their debt with the same collateral.

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