

*University of Mujahid Abdelhafid Boussouf – Mila*

*Faculty of Economics, Commercial & Management Sciences*

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*Lectures On : English economic terminology*

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# ***Inflation and deflation***

Inflation and deflation are key concepts in macroeconomics that describe changes in the general price level of goods and services in an economy over time. Understanding these phenomena is crucial because they affect purchasing power, economic growth, and monetary policy.

## **1. Inflation**

Inflation is a central concept in macroeconomics. It refers to a sustained increase in the general price level of goods and services in an economy over time. Inflation affects purchasing power, savings, investments, and economic growth.

### **1.1. Definition**

Inflation is the rate at which the general level of prices for goods and services rises, leading to a decrease in the purchasing power of money.

**Key Point:** Inflation does not mean all prices rise, but the average level of prices increases.

### **1.2. Causes of Inflation:**

- ✓ **Excess Demand:** When demand grows faster than supply.
- ✓ **Rising Production Costs:** Higher costs for labor, materials, or energy.
- ✓ **Increase in Money Supply:** Printing more money than the economy needs.
- ✓ **Expectations:** People anticipate higher prices and spend more, fueling inflation.

### **1.3. Types of Inflation**

There are several types of inflation, including:

#### **1. Demand-Pull Inflation:**

Occurs when aggregate demand exceeds aggregate supply.

Example: Strong consumer spending, government expenditure, or exports.

#### **2. Cost-Push Inflation:**

Occurs when production costs increase, causing firms to raise prices.

Example: Rising wages, raw material prices, or energy costs.

#### **3. Built-In Inflation (Wage-Price Spiral):**

Happens when workers demand higher wages, leading firms to raise prices, creating a feedback loop.

### **1.4. Effects of Inflation**

✓ **Negative Effects:** Reduces purchasing power, creates uncertainty, may discourage investment.

✓ **Positive Effects:** Moderate inflation can stimulate spending and investment by encouraging consumption today rather than tomorrow.

## 1.5. Measurement of Inflation

- ✓ **Consumer Price Index (CPI):** Measures the price change of a basket of consumer goods.
- ✓ **Producer Price Index (PPI):** Measures changes in prices received by producers.
- ✓ **GDP Deflator:** Measures price changes for all domestically produced goods and services.

### **Inflation Rate Formula:**

Inflation Rate (%) =  $(\text{Price Level in Current Year} - \text{Price Level in Previous Year}) / \text{Price Level in Previous Year} \times 100$

## 1.6. Controlling Inflation

There are several monetary and fiscal policies to reduce inflation, including:

- **Monetary Policy:**
  - Increase interest rates.
  - Reduce money supply.
- **Fiscal Policy:**
  - Reduce government spending.
  - Increase taxes.
- **Other Measures:**
  - Wage and price controls (used rarely).
  - Supply-side policies to increase productivity.

Finally, Inflation is a normal part of a growing economy, but excessive inflation (hyperinflation) or very low inflation (deflation) can disrupt economic stability. Governments and central banks aim for moderate, predictable inflation to encourage growth while maintaining price stability.

## 2. Deflation

Deflation is one of the important topics in macroeconomics because it affects economic stability, production, employment, and purchasing power. While many economies are concerned about rising prices (inflation), a persistent fall in prices can also create serious economic problems. Therefore, understanding deflation is essential for analyzing economic cycles and government policies.

### 2.1. Definition of Deflation

Deflation is the decrease in the general price level of goods and services, often associated with falling demand and economic slowdown.

Economist Irving Fisher explained that deflation may lead to serious economic problems when falling prices increase the real burden of debts and reduce economic activity.

### 2.2. Causes of Deflation

Deflation may occur due to several economic factors, including:

- ✓ **Demand Deficiency:** Weak consumer spending and low investment.
- ✓ **Technological Progress:** Reduces production costs and prices.
- ✓ **Excess Supply:** When supply exceeds demand for an extended period.

✓ **Reduction in Money Supply:** When central banks implement restrictive monetary policies, the amount of money circulating in the economy decreases, which may lead to falling prices.

✓ **Economic Recession:** During economic downturns, income and employment decline, which reduces consumption and investment.

### 2.3. Effects of Deflation

Deflation can have important consequences for the economy:

✓ **Negative Effects:** Can lead to lower profits, layoffs, and recession, as consumers delay purchases expecting lower future prices.

✓ **Positive Effects:** Increases the real value of money and savings.

### 2.4. Government Policies to Combat Deflation

Governments and central banks may adopt several measures to fight deflation:

✓ **Expansionary Monetary Policy:** Lowering interest rates and increasing the money supply.

✓ **Government Spending:** Increasing public investment to stimulate demand.

✓ **Tax Reductions:** Encouraging households and firms to spend more.

✓ **Quantitative Easing:** Central banks purchase financial assets to inject liquidity into the economy.

in summary, Deflation is a macroeconomic phenomenon characterized by a persistent decline in the general price level. Although falling prices may seem beneficial for consumers in the short term, prolonged deflation can negatively affect economic growth by reducing production, increasing unemployment, and discouraging spending and investment. Therefore, governments and central banks usually intervene through monetary and fiscal policies to maintain price stability.

## 3. Comparison between Inflation and Deflation

Inflation and deflation are two opposite economic phenomena related to changes in the **general price level** of goods and services in an economy. While inflation refers to rising prices, deflation refers to falling prices. Both have important effects on economic stability, purchasing power, and production.

**Table 1: Comparison between inflation and deflation**

Feature	Inflation	Deflation
Price Trend	Rising prices	Falling prices
Purchasing Power	Decreases	Increases
Economic Impact	Can stimulate short-term growth if moderate	Can slow economic activity, risk of recession
Monetary Policy Response	Raise interest rates to control inflation	Lower interest rates to encourage spending

Finally, Inflation and deflation reflect the balance between supply, demand, and money circulation in an economy.

- **Moderate inflation** is generally healthy for economic growth.
  - **Deflation or hyperinflation** can have serious negative consequences.
- Economists and policymakers closely monitor price indices to ensure economic stability.
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