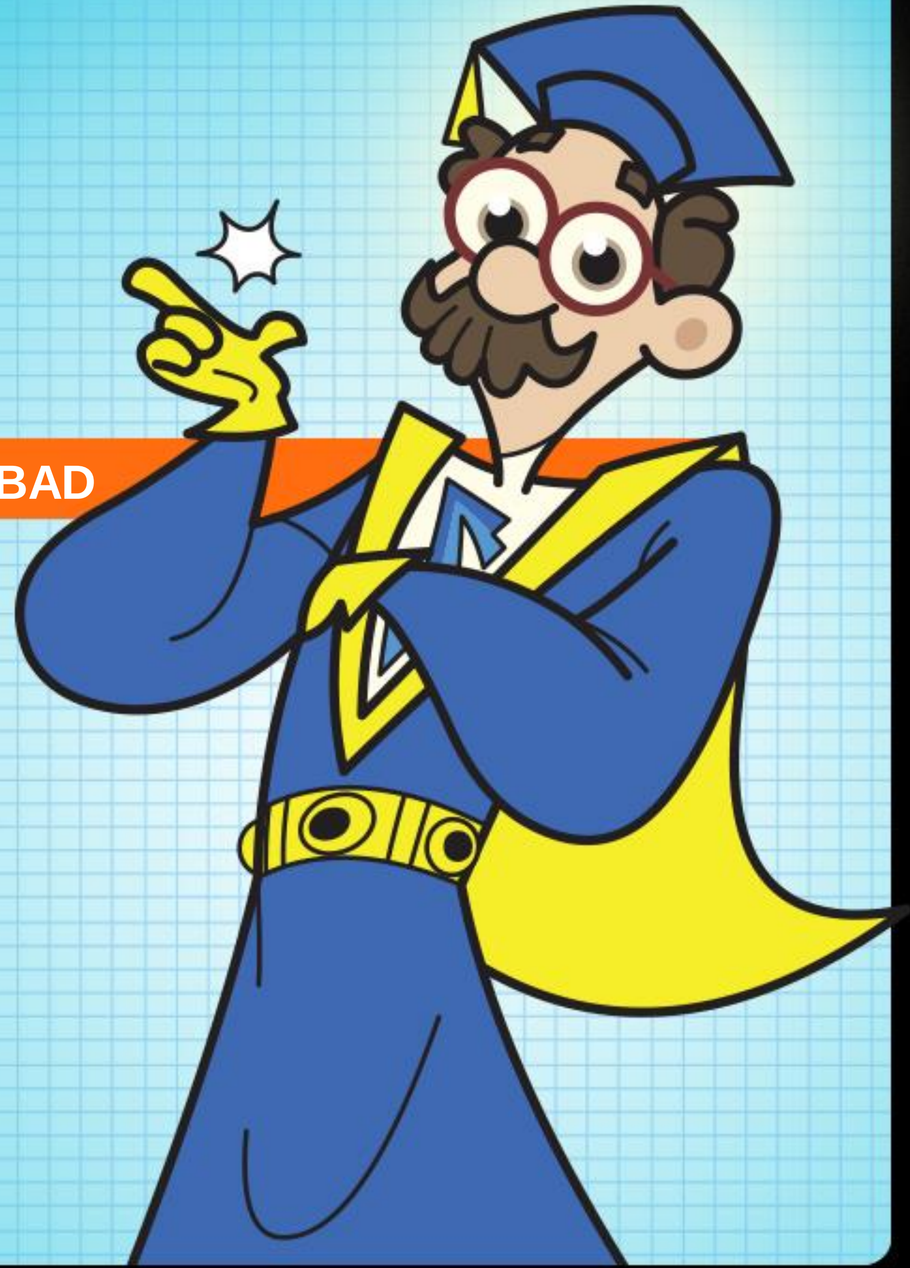
WHY INFLATION IS NOT ALWAYS BAD



Understanding

why Inflation is not always bad

Simply Simple.in

WHY INFLATION IS NOT ALWAYS BAD

Why would somebody want inflation?

Ask an Indian and he will want to stare you into ashes.

But ask a Japanese and he is all likely to smile back at you and seek suggestions.

WHY INFLATION IS NOT ALWAYS BAD

Thus inflation may be a bad word for us in India where everybody seems to be fighting inflation.

We call it all sorts of names like ghost or monster.

But elsewhere inflation is not necessarily a bad omen.

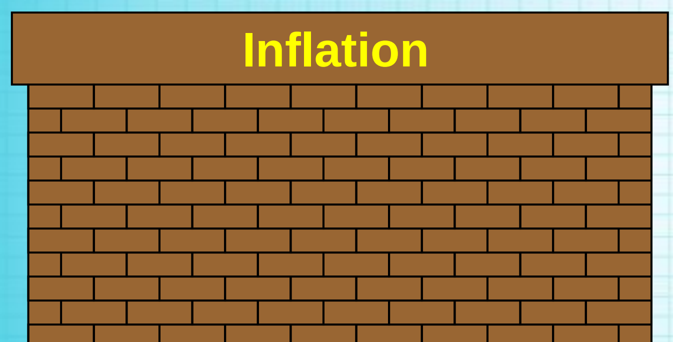
WHY INFLATION IS NOT ALWAYS BAD

In fact “inflation” is the rally cry in Japan to reverse the economy from the brink of coming to a standstill and going nowhere.

WHY INFLATION IS NOT ALWAYS BAD

To understand this it is imperative to see "inflation" as a dividing wall between consumers on one side and manufacturer on the other side.

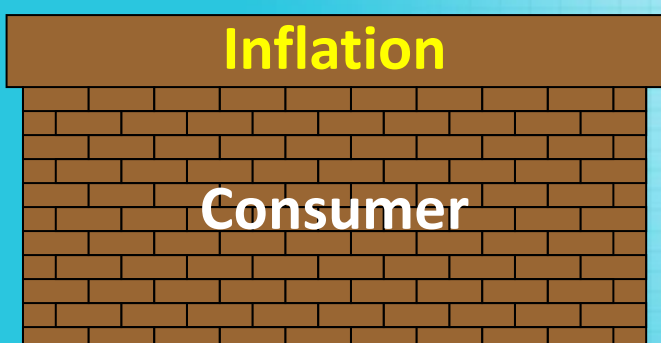
Consumer

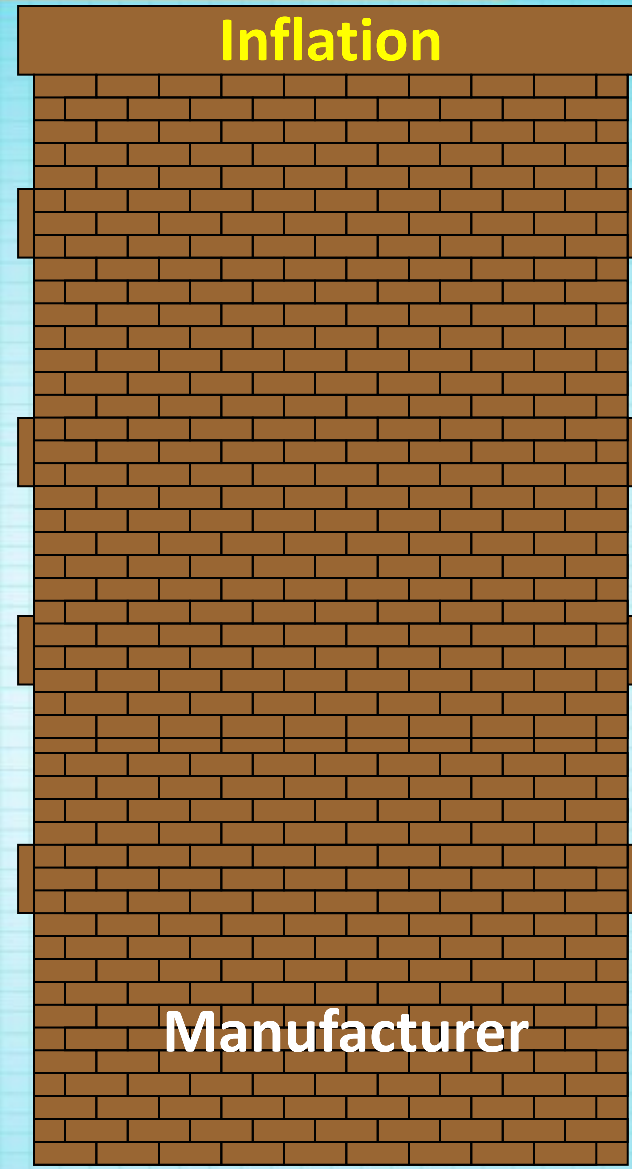


Manufacturer

WHY INFLATION IS NOT ALWAYS BAD

The consumers always want the wall to be short so that they can easily climb up and enter the manufacturing side and use the goods and services without much effort.





WHY INFLATION IS NOT ALWAYS BAD

For the sake of analogy consider "effort" equal to "money" & "wall" to "inflation", let us use it interchangeably.

Therefore for consumers a shorter wall means lower prices.

WHY INFLATION IS NOT ALWAYS BAD

But the manufacturers on the other side think exactly the opposite. They would like the consumer to spend more money in climbing the wall before they can enter the manufacturing side and consume goods and services.

Thus a taller wall for the manufacturer means more money and profits.

WHY INFLATION IS NOT ALWAYS BAD

Thus high inflation or a tall wall is more acceptable to the manufacturer as compared to the consumer while low inflation or negative inflation might be acceptable to the consumer but is a worrying sign for the manufacturer.

However the story does not end there.

WHY INFLATION IS NOT ALWAYS BAD

One needs to also understand that every consumer is also a producer or connected with a producer somewhere or the other.

So while cheap goods makes him happy when he goes for shopping with his family, the same low cost of products that his company produces has become a pain for him at work.

WHY INFLATION IS NOT ALWAYS BAD

Because of less demand for the products that his company makes, the prices are low and so are the profits.

WHY INFLATION IS NOT ALWAYS BAD

As a result the company makes less money, gives a small salary and defers increments and bonus. In the absence of less money even low prices in the market does not entice him to spend much.

This further impact the market and prices keep falling because of weak demand.

WHY INFLATION IS NOT ALWAYS BAD

This is how the situation in Japan has been for some time.

However, now the government wants to change the mood of the people by providing easy money in their hands.

WHY INFLATION IS NOT ALWAYS BAD

This is called Quantitative Easing

which is similar to say printing money.

What is the effect of this move?

WHY INFLATION IS NOT ALWAYS BAD

1. It brings the value of the Yen down. This immediately makes Japanese exports more lucrative and creates demands for Japanese goods in the international market.

2. As consumers have more money and willingness to spend on goods and services, inflation rises resulting into depreciated purchasing power of money. This will also lead the consumers to prepone their purchases.

WHY INFLATION IS NOT ALWAYS BAD

3. More demand for the goods will mean that factories will invest more in capacity building which itself is a demand engine for raw material and labor.

4. Companies will hire more people to meet the increased demand.

5. The companies would pay higher wages to ensure that people work hard and keep pace with demand.

6. Money in the hands of the people through better increments and bonus etc means more domestic demand.

WHY INFLATION IS NOT ALWAYS BAD

This is what the Japanese PM Shinzo Abe would like to believe and is hence formulating policies accordingly.

WHY INFLATION IS NOT ALWAYS BAD

He believes that if parents were to increase the pocket money of children, then surely the children will start consuming more of all the goodies like ice cream, candies, toys, books etc.

And the manufacturers of these goods would make more of these products, buy raw material and hire more people to make them. The raw material maker too would hire more people to supply more raw material and so on and so forth.

WHY INFLATION IS NOT ALWAYS BAD

The increased domestic and international demand would increase the share prices of the manufacturing companies and we are seeing this play out in Japan.

More international money would move into Japan to take advantage of this growth opportunity. We are seeing this as well today.

WHY INFLATION IS NOT ALWAYS BAD

Investors would sell out other asset classes in favor of Japanese equity. The drop in gold and commodity prices is a symptomatic of these policy changes.

All this activity is expected to re-invigorate the Japanese economy and propel it to a growth trajectory.

WHY INFLATION IS NOT ALWAYS BAD

However the downside of this initiative is to ensure that inflation does not spiral out of control and begin the dampening the demand cycle.

Shinzo Abe believes he can ensure a smooth take off for the Japanese economy through his actions and policy decisions.

WHY INFLATION IS NOT ALWAYS BAD

This mechanism is known as Abenomics, a term coined after the name of the Prime Minister Mr. Shinzo Abe.

In economics such an activity whereby the government tries to re-energize the economy by inducing inflation is known as "Reflation".

WHY INFLATION IS NOT ALWAYS BAD

Hope you have understood

why inflation is not always bad.

Simply Simple.in

Thinking of Investment

Contact

vEcoſys

Simply Simple.in

DISCLAIMER