

## **Q.1 What is PHILLIPS CURVE?**

It is a graphic curve which advocates relationship between inflation and unemployment in an economy. As per the curve there is a 'trade off' between inflation and unemployment, i.e., an inverse relationship between them. The curve suggests that lower the unemployment. During the 1960s, this idea was among the most important theories of the modern economists. This concept is known after the economists who developed it-Alban William Housego Phillips (1914-75). Bill Phillips (popular name) was an electrical engineer from New Zealand and was an economist at the London School of Economics when propounded the idea. In 'The relation between unemployment and the rate of change of money wage rates in the United Kingdom, 1861-1957' (published in *Economica* in 1958), he provided empirical evidence to support his ideas.

By the early 1960s, an economic wisdom emerged around the world that by following a certain kind of monetary policy, unemployment could be checked forever and at the cost of a slightly higher inflation, unemployment could be reduced permanently. The central banks of the developed world started framing the required kind of monetary policies mixing the tradeoff between inflation and unemployment. The idea became popular among the developing economies too by the late 1960s, though they were bit confused, as most of them were fighting the menace of higher inflation (double digit) along with high level of unemployment.

By the early 1970s, two American economists, Milton Friedman (Nobel Laureate, 1976) and Edmund Phelps challenged the idea of the Phillips Curve. According to them the trade-off between inflation and unemployment was only short-term, because once people came to expect higher inflation they started demanding higher wages and thus unemployment will rise back to its 'natural rate' (the unemployment rate that occurs at full employment when economy is producing at potential output, it is usually called the natural rate of unemployment). They advocated that there was no long-term trade-off between inflation and unemployment. In the long run, monetary policy can influence inflation. They suggested that if monetary policy tried to hold unemployment below its natural rate, inflation will be rising to higher level, which is also known as the non-accelerating inflation rate of unemployment (NAIRU). The NAIRU is that rate of unemployment which is consistent with a constant rate of inflation. It means at NAIRU, the upward and downward forces on prices (inflation) and wage (unemployment) neutralize each other and there is no tendency of change in the rate of inflation. We may say that the NAIRU is the lowest unemployment rate that an economy can sustain without any upward pressure on inflation rate.

## **Q.2 How Supply of money is Measured?**

The measures of money supply can be classified into four categories: - M1, M2, M3 & M4.

### **Explanation of M1, M2, M3 & M4: -**

**M1:** - The aggregate of the amount of metallic coin and paper currency with the public (c), current deposit and demand deposit with the banks (DD) and other deposit with central bank (OD) is called M1. It is also called as Narrow Money.

$$M1 = C + DD + OD$$

**M2:** - The sum of M1 along with post office saving bank deposit (POSBD) is termed as M2.

$$M2 = M1 + POSBD$$

$$M2 = C + DD + OD + POSBD$$

**M3:** - Aggregate of M1 and term deposit or fixed deposits of bank is called M3. The M3 is also called as Broad money.

$$M3 = M1 + \text{Term Deposit}$$

$$M3 = C + DD + OD + TD$$

**M4:** - Aggregate of POSBD and term deposits or fixed deposits with M1 is called as M4.

$$M4 = M1 + POSBD + TD$$

$$M4 = C + DD + OD + POSBD + TD$$

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