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Inflation in India

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ABSTRACT *Milton Friedman famously said, " Inflation is always and everywhere a monetary phenomenon". It is like a tax and hits the poor the hardest . Inflation is considered as a severe macro-economic problem since the Third Five Year Plan. We had many high inflation episodes before 2015. The rate of inflation in our country has been higher than in most of other countries .From the perspective of the poor ,the most worrisome aspect of recent overall price rise is the high food inflation. Such a trend has serious adverse welfare effects when in the same period, food inflation at global level has been low /negative .The government and RBI have adopted a set of regulatory ,administrative and economic measures to combat inflation. But it has not yielded the desired results . Still India grapples with the dreaded monster called high inflation. Stagflation-type environment is emerging in the country .*

Meaning and Impact of inflation

Johnson defines ,'Inflation as a sustained rise in prices '.Coulborn defines inflation as 'too much money chasing too few goods'. The Quantity Theory of Money believes that the only cause for rising prices in a growing economy is an increase of the total quantity of money in existence. Keynes defined inflation as a phenomenon of full employment .According to Neo-Keynesian economic theory ; Demand pull inflation -- inflation due to high demand for GDP and low unemployment, also known as Phillips Curve inflation. Cost push inflation -- nowadays termed supply shock inflation, due to an event such as a sudden increase in the price of oil.

The monetarists theory states that when the money supply is increased in order to grow or increase production and employment, creating an inflationary situation within an economy. Structuralism states that the main reason for inflation is the inelasticity in the structures of the economy.

Rising inflation is really a cause of concern for every economy due to its adverse impacts . It impacts rich and the poor differently ; it widens the gap between haves and haves –not ; It redistributes income from those on fixed incomes, such as pensioners, and shift it to those who draw a more flexible income; it promotes speculation ;Volatility in prices affects the financial transactions negatively ; inflation results in fall in overall investment in the economy thus affecting its potential growth ;Uncertainty would force people to withdraw money from the bank and convert it into product with long lasting value like gold, artifacts ;If inflation crosses the threshold , it adversely impact the overall growth .

Review of literature ,Objectives and Methodology

The studies by Bhattacharya & Lodh (1990), Balakrishnan (1991), Sengupta (1993), Nag &Samanta (1994), Joshi & Little (1997), Parikh et. al. (1998), Mallick (2008), Bhattacharya et. al. (2008), Agrawal (2011), Basu (2011) found that inflation in India (measured from 'wholesale price index') is mainly caused by a rise in central government expenditure with a resulting expansion in money supply .Samant (1999) conducted a study on core inflation in India and concluded that the measure of the core inflation excluding primary food and non-food articles was less volatile during the periods 1993-94 to 1998-99. Bagliano and Morana (2001) carried out a study to examine the long run trend in CPI inflation for the US over the 1996-2000 periods ,using a common trend model Şen (2003) has analyzed the relationship between tax revenue and inflation. The report by Rajan (2009) on financial sector reforms recommended that the RBI should focus on the single objective of inflation control. Gordon (2011) says that the contribution of post-Keynesian theory in the Phillips curve model is that inflation and output gap is no longer positively correlated.

Kaushik (2011) argues that food inflation has been managed poorly through misguided government intervention in the food grains market. J.Raj and Misra (2011) tested six measures of core inflation .The study found that the core inflation (CPI inflation) is not an end in itself but rather a mean to achieve low and stable inflation . Against this background , the main objective of this paper is to describe inflationary trends in recent years in our country .

Present study is based on the secondary data on different inflation indicators , mainly collected from Reserve Bank of India publications . Inflation is measured using several price indices in India. Changes in the prices of goods at the wholesale price level are gauged by the Wholesale Price Index (WPI) whereas changes in prices of goods and services at the retail level are measured by the Consumer Price Index (CPI). Another methodology to measure changes in prices, is to use the Gross National Product (GNP) deflator which is the ratio of GNP at current prices to GNP at constant prices.

The headline inflation number refers to the WPI inflation number that's reported every month. The WPI based on 2004-05 is available for all tradable goods (676 in all) . Consumer Price Index (CPI) reflects the cost of living for a homogeneous group of consumers. There are four consumer price indices in India: the CPI for industrial workers (CPI-IW), CPI for agricultural labour (CPI-AL), CPI for rural labour (CPI-RL) and CPI for urban non- manual employees (CPI-UNME).

Trends in Inflation in India

Inflation is a permanent characteristic of Indian economy .After the second world war ,there has been a strong inflationary pressure on the economy which has remained repressed. During 1949-67 our country inherited a strong inflationary pressure because of the world wars and the devaluation of Indian rupee. The situation was stabilized in the coming years because of the bumper agriculture production in the country . Because of the various measures taken during 1991, in the initial years the inflation rate was high. However, the inflation varied through several highs and lows over these time periods. The average WPI inflation between 1952–53 and 2012–13 was 6.3 per cent. Retail inflation averaged 8.1 per cent between 1970–71 and 2012–13. A number of factors have caused high inflation: food inflation and core inflation; entrenched inflation expectations; cost-push shocks; a weaker rupee; and ongoing energy price increases.

Period	Casual factors
April 1956-Feb 1957	Drought and decline in Agricultural output
Aug 1964-Feb1965	Indo-Pak war ,Drought
March 1966 –Nov. 1967	Drought , Indo-Pak War, First Oil Price Shock,Large Monetary Expansion
June 1979- Aug 1981	Global inflation , Second oil Price shock, Drought
Nov. 1990 –July 1992	Large fiscal deficit , Drought ,Increase in the prices of administered items and excise duties
March 1994 – May1995	Substantial hike in administered prices
June 2008 – Oct 2008	High global commodity prices ,Large credit expansion
March 2010-July 2010	Drought ,Administered prices increased
Jan 2011- Jan 2015	Rising prices of primary articles and fuel

India had not faced double digit inflation in food during the last several years despite serious drought and decline in food output in some years. The scene of food inflation has turned quite different after 2008. Factors driving food inflation are ; shift in dietary habits towards protein foods, pressure stemming from inclusive growth policies ,large increase in minimum support prices of food grains ,supply side constraints ,and rising cost of production . Food inflation is spreading to other areas resulting in overall inflation .On an average ,from December 2009 to August 2013 , the egg ,meat ,and fish group has recorded the highest inflation rate of 17.16 % ,followed by milk (11.78%),fruits and vegetables (10.84%) ,foodgrains (9.11%) ,condiments and spices (7.08%) ,and tea and coffee (6.14%).The average inflation rate of food products (in the manufactured products group) also ruled high at 7.14 % . Such a trend has serious adverse welfare effects when in the same period, food inflation at global level has been low /negative . There is serious concern regarding stickiness of food prices.

In the past four decades, WPI and CPI inflation have risen steadily in India. CPI inflation in 2012 was 10.9 % compared to 3.2% in 1971-72. Similarly, WPI inflation rose to 7.4% from 5.6% over the same period. Another change has been the divergence between WPI and CPI inflation from 1994 onwards. WPI inflation registered a sharp decline while CPI inflation rose sharply during 2009-10. Specifically, CPI increased from 10.83 % in 2008 to 12.11% in 2009 and in contrast WPI fell from 8% to 3.8% during the same period. The sharp surge in consumer prices was due to adverse global and domestic factors with high food and fuel prices dominating overall CPI . This rise in wholesale food prices was not captured by WPI as the weightage for food articles was just 14.3% in this index . On the other hand, the weightage for food was 57% in CPI items which captured the impact of food prices better. Crude oil prices certainly helped inflation move down in 2014 .

Central Bank had adopted the new CPI as the key measure of inflation as it reflects cost of living on the recommendations of Urjit Patel panel . The CSO has revised the base year from 2010 to 2012 .CPI inflation in terms of the revised series stood at 5.1 percent in January, 2015. Table 1 shows the annual and average inflation rate on CPI bases .The consumer inflation rose to 5.32 % in urban areas and 4.71 percent in rural areas during Dec 2014 . While growth continues to weaken, WPI and CPI inflation persists at a significantly higher level. Stagflation-type environment is emerging.

FIG 1 Inflation Rate Based on WPI Series

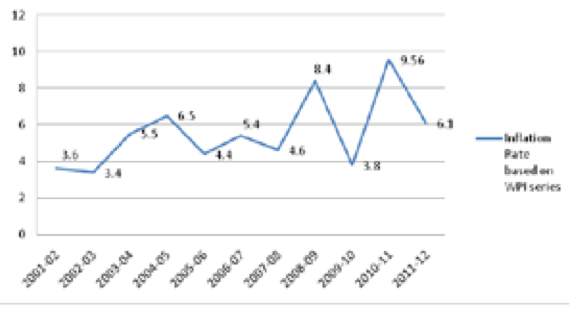

Table 1

Year	Annual(CPI)	Average Rate	Year	Annual	Average Rate
2015	-	6.276	2005	5.57	5.79
2014	5.86	6.58	2004	3.78	4.25
2013	9.13	6.37	2003	3.72	3.77
2012	11.17	10.92	2002	3.20	3.81
2011	6.49	9.30	2001	5.16	4.31
2010	9.47	8.87	1999	0.47	3.77
2009	14.97	12.11	1998	15.32	4.02
2008	9.70	10.83	1997	6.29	4.84
2007	5.51	8.32	1996	10.41	13.17
2006	6.53	6.39	1995	9.69	7.25

Source:www.rbi.org.in/scripts/publicationsview.aspx?id=13840

Control of Inflation in India

The handling of India's inflation challenge consisted of a careful combination of effort on the part of the RBI and government, including the Ministry of Finance and several other ministries. There was action on several fronts— monetary, fiscal, and supply chain management.

The Bank Rate stands at 8.50 per cent. The cash reserve ratio (CRR) of scheduled banks has been retained at 4.00 per cent of their net demand and time liabilities (NDTL). It has been decided to reduce the statutory liquidity ratio (SLR) of scheduled commercial banks to 21.50 per cent . Government continued to curb fiscal and revenue deficits. Govt has imposed export restrictions on certain farm commodities .

However monetary policy has very limited role to counter inflation in food commodities which is essentially caused by supply side constraints and the underlying deficiencies.

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Overhauling the PDS is another corrective measure which can be undertaken in the medium term. It is also logical to widen the scope of PDS by including more essential commodities to provide some protection to the poor against food inflation. The short –term policy measures have focused on managing liquidity and reducing the scope for speculation and hoarding .But we also need long term measures. For keeping food inflation low in a sustainable manner, more radical measures will have to be taken to revamp agriculture- and food sector production, storage, marketing, and distribution.

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