ECONOMICS OF INFLATION TREND IN INDIA

Dr.S.Murugan & Dr.V.Kannan[1]

Abstract

In the early years of the 90s, India experienced double digit inflation. A major trigger of inflation around this period was a sharp rise in the value of oil imports due to rise in world oil prices in the wake of the gulf crisis. This was the period when agriculture performed poorly for several years adding to the supply shocks. Many observers opine that the persistent inflationary tendency in the Indian economy over the last two decade is a long-term phenomenon, a result of rapid economic growth, rising incomes of a youthful population, stagnating agricultural production and supply capacity falling short of demand. Hence, it is imperative to take long-term visionary initiatives to moderate inflationary pressures and absorb the price shocks before they hit the real economy. Monetary management and fiscal policies such as price controls and quantitative restrictions can only prove to be effective as short-term solutions. An innovative policy regime must necessarily include items such as strengthening of institutions which absorb and prevent price shocks from impacting the real sector:

Key words: Tendency, Policy Regime, Supply Shocks and Price Shocks

[1] Assistant Professor, PG & Research Department of Economics, Thiagarajar College, Madurai-626009.
Assistant Professor, PG & Research Department of Economics, Thiagarajar College, Madurai-626009.

ECONOMICS OF INFLATION TREND IN INDIA

INTRODUCTION

In the early years of the 90s, India experienced double digit inflation. A major trigger of inflation around this period was a sharp rise in the value of oil imports due to rise in world oil prices in the wake of the gulf crisis. This was the period when agriculture performed poorly for several years adding to the supply shocks. The problem was exacerbated by high fiscal deficit and increase in the money supply. A steep devaluation in the wake of economic reforms also made import costlier. The policy response to the crisis took the shape of tightening of the monetary policy, capping the issue of ad-hoc treasury bills by the government restraining thereby government borrowing and liberalizing imports to ease shortages.

Traditionally, inflation in India has primarily been caused by supply shocks; drought and consequent increase in food prices, or (and) increase in oil prices reflecting hikes in the international prices of crude oil. Once in a while demand pressure also manifests in inflation. The most common example cited is that of the increase in the pay of civil servants in the wake of awards by the Pay Commission; that of the Fifth Pay Commission is stated to have been felt in the escalation of prices in 1998-99; and the impact of the Sixth Pay Commission was manifest in 2008 and 2009.

Inflationary situation may worsen if the domestic and external factors that contribute to escalation of price level overlap in the same period. To recall, inflation in 1979-81 was caused by supply shocks created mainly by a combination of the hike in global oil prices and the drought, affecting adversely the domestic agricultural sector. The high rate of inflation is destabilizing for the individual households, businesses and the economy as a whole. Double digit inflation brings down the purchasing power of households at least in the short- run as income levels do not rise so quickly for most people. After a relatively

long period of moderate price inflation, we have experienced now two episodes of high inflation. We had double digit annual rate of inflation based on consumer price index (CPI).

OBJECTIVES

1. To study the fluctuation of inflation rate in India.
2. To offer policy suggestion sustain inflation rate in India.

METHODOLOGY

The data have been collected from the secondary sources such as Handbook of Statistics on the Indian Economy and RBI Bulletin.

REVIEW OF LITERATURE

Raghuram Rajan (2015), highlighted that growth has to be obtained in the right way. It is possible to grow too fast with substantial stimulus as we did in 2010 and 2011, only to pay the price in higher inflation, higher deficit and lower growth in 2013 and 2014. He said that a key task is to keep inflation low show that we get moderate nominal interest rates that satisfy not just the vocal borrowers but also the salient savers

Pulapare Balakrishnan (2015), revealed that the Reserve Bank of India should focus on output at least as much as it does on inflation, but this sits uncomfortably with the mandata of inflation targeting proposed in the draft Indian Financial Code. An argument for inflation targeting is that in the long run there is no trade-off between inflation and unemployment. This is an ambiguous assertion. “The long run is misleading guide to current affairs. Economists set themselves too easy, too useless task, if in tempestuous seasons they can only tell us that when the storm is long past the ocean is flat again.

Kanagasabai, S., (2014), highlighted that the vast changes in the global economic system as well as political alignment have explored certain problems. The process of

spiraling price level affects everybody from plebian to patrician. In a way inflation can be considered as a hidden tax levied on the people without their acceptance. The famous statement of Milton Friedman, a celebrated monetarist of Chicago school bring to the fore a cup-let regarding inflation. That is we have inflation because we expect Inflation and we expect inflation because we have had inflation. Traditionally Inflation in India has primarily been caused by supply shocks and drought but now, demand driven factors also found.

MEASURING INFLATION IN INDIA

The measurement of inflation has got a lot of attention in India. Presently, there are different primary measures of inflation - the Wholesale Price Index (WPI) and four measures of the Consumer Price Index (CPI) - the CPI for Industrial workers (CPI-IW); CPI for agricultural labourers (CPI-AL); CPI for rural labourers (CPI- RL) and CPI for urban non-manual employees (CPI- UNME). In addition to this, Gross Domestic Product (GDP) deflator provides implicit economy-wide inflation. Inflation based on WPI is considered as representative figure for the whole economy.

$$\text{Inflation Rate} = [(P_t - P_{t-1}) / P_{t-1}] * 100$$

Where P_t =price indices of current year

P_{t-1} = price indices of previous year

Wholesale Price Index (WPI) as its name suggests Wholesale Price Index (WPI) tracks wholesale prices in India. WPI is the weighted price index of a basket of goods consisting of 435 commodities, which are categorised under three major groups: i) Primary Articles; (98 commodities) ii) Fuel power, light and lubricants; (19 commodities) iii) Manufactured products; (318 commodities). These three are again divided into smaller sub-groups. WPI is compiled on a weekly basis. The Indian government has taken WPI as an indicator of the rate of inflation in the economy. More

volatility is found in fuel group based inflation followed by primary article group as compared to manufacture products group.

Consumer Price Index (CPI)

Consumer Price Index is measured on the basis of the change in retail prices of a specified set of goods and services on which a particular group of consumers spend their money. It reflects the cost of living index condition for a homogenous group based on retail price. It actually measures the increase in price that a consumer will ultimately have to pay for. India is the only major country that uses a wholesale index to measure inflation. Most countries use the CPI as a measure of inflation.

CPI = (Price of basket in current CPI inflation rate = $[(CPI_t - CPI_{t-1}) / CPI_{t-1}] * 100$

Where CPI_t = consumer price index of current year

CPI_{t-1} = consumer price index of previous year

As mentioned earlier there are four measures of CPI. Set of goods and services for each CPI measure is different based on the consumption pattern. For example, for CPI for industrial worker (CPI-IW), a basket of 260 commodities is tracked; for urban non manual employees (CPI- UNME), 180 commodities, for agricultural labours (CPI-AL), just 60 commodities. Here again, each commodity is given a different weight age. For example, the CPI- AL would give a greater weight age to food grain than the CPI-UNME, since a greater proportion of the income of this group would go towards the purchase of food grain. CPI-IW has got a broader coverage of set of goods and services than others measures of CPI.

INFLATION RATE IN INDIA

The trend in inflation rate in India from 1990-91 to 2017-18 is presented in table 1.1.

Table 1.1

Inflation Rate in India

Year	*Inflation Rate*	*Percentage Change*
1990-91	10.3	
1991-92	13.7	33.0
1992-93	10.1	-26.3
1993-94	8.4	-16.8
1994-95	12.6	50.0
1995-96	8.0	-36.5
1996-97	4.6	-42.5
1997-98	4.4	-4.3
1998-99	5.9	34.1
1999-00	3.3	-44.1
2000-01	7.2	118.2
2001-02	3.6	-50.0
2002-03	3.4	-5.6
2003-04	5.5	61.8
2004-05	6.5	18.2
2005-06	4.5	-30.8
2006-07	6.6	46.7
2007-08	4.7	-28.8
2008-09	8.1	72.3
2009-10	3.8	-53.1
2010-11	9.6	152.6
2011-12	8.9	-7.3
2012-13	6.9	-22.4
2013-14	5.2	-24.6
2014-15	1.2	-76.9
2015-16	-3.7	-408.3
2016-17	1.7	-145.9
2017-18	2.9	70.6
Average Total	**6.2**	**-14.1**

Source: Handbook of Statistics on the Indian Economy, RBI Bulletin.

The above table highlights the inflation rate in India from 1990-91 to 2017-18. The overall data indicate the fluctuation in inflation during the study period. The highest rate of inflation is 13.7 per cent during 1991-92 whereas the lowest is 1.2 per cent during 2014-15. In addition to that inflation is reached negatively a -3.7 per cent during 2015-16 which is considered as deflation. Hence the average annual percentage change in inflation has been declined to 14.1 per cent per annum during the study period.

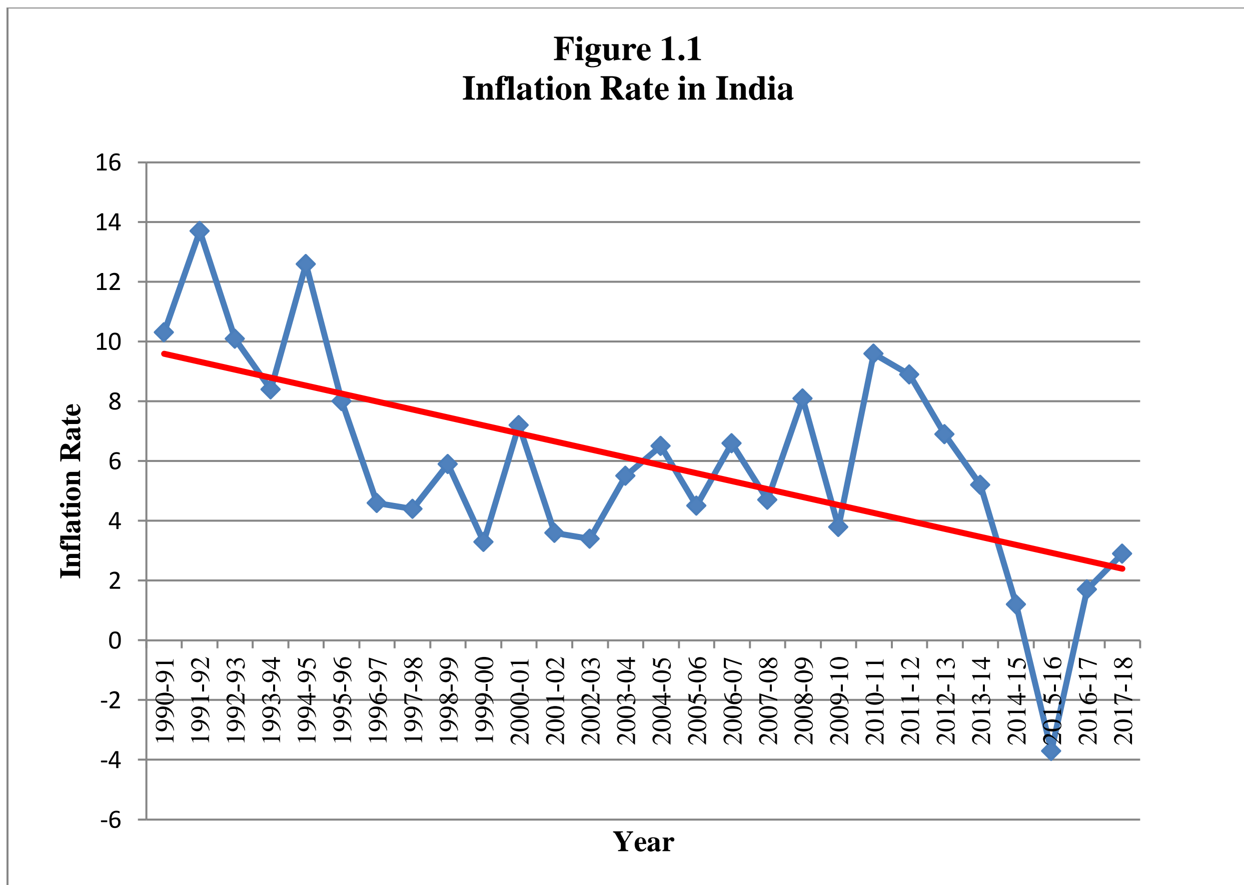

Figure 1.1
Inflation Rate in India

Conclusion

Many observers opine that the persistent inflationary tendency in the Indian economy over the last two decade is a long-term phenomenon, a result of rapid economic growth, rising incomes of a youthful population, stagnating agricultural production and supply capacity falling short of demand. Hence, it is imperative to take long-term visionary initiatives to moderate inflationary pressures and absorb the

price shocks before they hit the real economy. Monetary management and fiscal policies such as price controls and quantitative restrictions can only prove to be effective as short-term solutions. An innovative policy regime must necessarily include items such as strengthening of institutions which absorb and prevent price shocks from impacting the real sector: the institution of exchange-traded commodity derivatives. It is time the opportunities thrown open by globalization are harnessed in designing an innovative policy framework towards this end.

References

1. Ashima Goyal, "The Growth Slowdown and Working of Inflation Targeting in India", *Indira Gandhi Institute of Development Research,* Mumbai, February 2018.
2. Handbook of Monetary Statistics of Indian Economy, RBI, 2018.
3. Ruchi Priyakhilar, "Review of Monetary Policy of India Since Independence" ***Journal of Management***, December 2017.
4. Raghuram Rajan "Indian Economy "***The Hindu Newspaper***, Business Column, Sep18, 2015, p.15.
5. Pulapare Balakrishnan, "Going beyond inflation targeting", ***The Hindu Newspaper***, Madurai, Aug18,2015 p.10.
6. Kanagasabai, S, Inflation and Economic Environment of India: Pitfalls and Opportunities, ***Economics of Inflation Dynamics,*** Sep.2014.
7. Ahmed, S. (2010). An Empirical Study on Inflation and Economic Growth in Bangladesh. *OIDA International Journal of Sustainable Development, Vol. 2, No. 3, pp. 41-48.*
8. Manas Bhattacharya "Inflation Episodes in India" Yojana forthcoming Issues September 2010 p22-24.

9. Shivkumar Birader “Measuring Inflation” Yojana forthcoming Issues September 2010 p41-46.