Measures of inflation and its impact on Indian Economy

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Abstract:
Inflation is one of the economic parameter to be associated with the hike of price, it has its long and far reaching effects on the society and social concerns. Inflation is a sustained increase in the general price level of goods and services in an economy over a period of time. When the price level rises, each unit of currency buys fewer goods and services. Consequently, Inflation reflects a reaction in one purchasing power per unit of money. Fluctuations in prices create an atmosphere of uncertainty which is not conducive to development activity. So inflations mean paying more for goods than paying earlier. Not only essential goods see a hike, non-essential items like cigarettes etc. would also cost more. The price of everything goes up over time. The present article made an attempt to study the impact of inflation on the economy, and measures of inflation in India. So in respect of obtaining a better view of the effects and influence of inflation on the society we need to take mainly the experience of poor and developing nations. This paper analyses the effects of inflation on our country's economy that emerged in the recent past.

Keywords: *Inflation, Causes, Trends, Measures, Purchasing Power.*

Introduction:

Inflation refers to the rise in the prices of most goods and services of daily or common use, such as food, clothing, housing, recreation, transport, consumer staples, etc. Inflation measures the average price change in a basket of commodities and services over time. The opposite and rare fall in the price index of this basket of items is called 'deflation'. Inflation is indicative of the decrease in the purchasing power of a unit of a country's currency. This is measured in percentage. In India, inflation is due to both cost-push and demand-pull factors. For example, the high increase in vegetable prices is an instance of demand-pull inflation, when the storage of vegetables in the markets takes the prices to new heights. Also, prices go up whenever there is a hike in petroleum products is due to the cost-push factor. This is so because petroleum is an important component in many manufactured items, and as essential fuel for road transport, it adds to the transportation costs, so prices, in general, tend to rise. The main demand-pull factors are; mounting government expenditure, deficit financing and increase in money supply, the role of black money, and rapid growth in population. Whereas the main cost-push factors are; fluctuations in output and supply, taxation, administered price, and hike in oil price. The Inflation effects onthe purchasing power of a currency unit decreases as the commodities and services get dearer. This also impacts the cost of living in a country. When inflation is high, the cost of living gets higher as well, which ultimately leads to a deceleration in economic growth. A certain level of inflation is required in the economy to ensure that expenditure is promoted and hoarding money through savings is demotivated. As money generally loses its value over time, it is important for people to invest the money. Investing ensures the economic growth of a country.

Review of Literature

A number of studies have presented useful discussions and research on relationship between economic growth and inflation, interest rates, industrial development, employment generation etc.

AravindVeeramani(2019) summarized that GDP growth in India has followed an inverted U-shaped curve, accelerating from a low of 5.5% in 2012-13 to a peak of 8.2% in 2016-17 and then decelerated to 6.8% in 2018-19.The GDP growth decline is due to rise in real interest rates, enforcement of tighter norms on Bank NPAs and implementation of the Indian Bankruptcy Code, decline in GFCF and other factors

Draghi(2016) through his conducted study revealed that inflation projections have continued to be downgraded, complicating further deleveraging efforts. He also found that 1 percentage decline of inflation from target over five-year period will raise private debt by around 6 percentages, George Karloff, William Dickens and George Perry argue that moderate inflation yields significant efficiency gains by "greasing" the wheels of the labour market. Firms use inflation to "to cover" adjustments in real wages and at zero inflation nominal wage cuts, never popular among workers, would necessarily be more common, Congress, Federal Reserve Board Chairmen Alan Greenspan observed that firm's productivity may rise quickly with price stability, as the "inability to pass cost increase through to higher prices provides a powerful incentive to firms to increase profit margins through innovation

Studies by Loto, (2012) and Papola T.S. (2013) highlighted the role of high growth sectors like manufacturing which have high employment elasticity, high income and consumption impetus and high export growth with the capability to earn huge foreign exchange.

Studies by Friedman (1973), Mallik& Chowdhury (2001) and Behera (2014) have done the research in the area of economic growth and its relation with inflation. Two studies by Mallik& Chowdhury (2001) and Behera (2014) have showcased the inflation and economic growth dynamics in South Asian countries. They have statistically proved the long run positive correlation between the study variables inflation and economic growth.

Hasan, et al (2003) &Goldar (2011) study opined that states that have made industry friendly changes in laws and rules have experienced higher growth of employment in the organized manufacturing sector.

Objectives

1. Study the measures of inflation in India.

2.To analyse the impact of inflation in Indian economy

Methodology

The present study has undertaken to examine the impact of inflation on Indian economy, and measurement of inflation. An account ofmeasuring inflationthe Laspeyres formula is generally used. The study used secondary data from various published reports from Economic survey of India -2019 & 2020, NITI Aayog reports, Ministry of Statistics and Program implementation, Government of India, Reserve Bank of India -Handbook of Statistics, World Bank and IMF reports and Experts opinion published in leading newspapers, published articles in journals.

Measurement of Inflation

The inflation can be defined as a calculated surge in the average prices of goods and services for a longer duration in the economy. It is a macro concept, wherein the effect of inflation is seen over a large basket of goods. The ultimate effect of inflation is that the value of money is reduced i.e., the purchasing power of money is reduced.

India has experienced persistently high inflation in recent years, despite a period of below-trend economic growth. As a result, controlling inflation has become a key objective for policymakers. Inflation is measured by a central government authority, which is in charge of adopting measures to ensure the smooth running of the economy. In India, the Ministry of Statistics and Programme Implementation measures inflation.

The two main indicators of inflation in India are the wholesale price index (WPI) and the consumer price index (CPI). Although the WPI has traditionally been the most widely used measure for assessing inflationary pressures, the Reserve Bank of India (RBI) recently conducted a review of its monetary policy framework, which recommended adopting a flexible inflation targeting regime, based on headline CPI inflation.

Wholesale Price Index (WPI)

The WPI is produced by the Indian Ministry of Commerce and Industry. The data are collected at the first point of bulk sale in the domestic market. The prices used are ‘wholesale prices for primary articles, administered prices for fuel items and ex-factory prices for manufactured products’. That is, the WPI measures the prices of products at the factory or farm gate, prior to their sale to consumers in retail markets. One advantage of the WPI is that it has a long history, dating back to January 1942, which makes it useful for assessing long-term trends in inflation. The WPI also covers a broad range of goods, from raw materials to finished manufactures, but notably excludes services. The WPI is calculated using the Lapsers formula, which measures the change in the cost of purchasing the same basket of items in the current period as was purchased in a specified earlier period. This technique is simpler than other methods, since the weights are computed in the base period and, until this is updated, each subsequent calculation requires only an update of prices. A disadvantage of this type of index is that it will be biased if the composition of sales in the wholesale market is changing and the weights are not regularly updated. This is more likely to be an issue for a fast-changing, emerging economy such as India. As the Indian economy develops and household incomes increase, we would expect non-food items and services to account for a larger share of expenditure and the composition of production to evolve reflecting changes in demand. The weights for components of the WPI are derived from their share of gross output in current price terms. The WPI has only been rebased four times in its history, this was shown in the below table.

Table 1: Wholesale Price Index Group Weights (Per cent of total)

Items	1970/71	1981-82	1993-94	2018-2019
Primary articles	42	32	22	28
Food	30	17	15	17
Non-food	11	10	6	4
Minerals	1	5	1	2
Fuel and power	9	11	14	15
Manufactured products	50	57	64	68
Food	13	10	12	8
Chemicals	6	7	12	12
Basic metals, alloys and metal products	6	8	8	14
Machinery and machine tools	5	6	8	9
Other	20	26	24	27

Sources: Ministry of Commerce and Industry; RBA

The weights for selected groups in the WPI changed significantly with each of the first two rebasing's. Changes were relatively smaller at the latest rebasing in 2018/19. Over the past 50 years or so, a number of broad trends are apparent: the weight of primary articles (especially food) has fallen and the weight of manufactured items has increased.

Consumer Price Index (CPI)

An alternative gauge of price movements in India is provided by the CPI. As discussed below, a recent report to the RBI Governor by the Expert Committee to Revise and Strengthen the Monetary Policy Framework (the Patel Committee) recommended that the RBI adopt a flexible inflation-targeting regime with headline consumer price inflation as the target. Two different government agencies, namely the Ministry of Statistics and Programme Implementation (MOSPI) and the Ministry of Labour and Employment, publish a number of consumer price indices, shown in the below table.

Table 2: Consumer Price Indices

Ministry of Statistics and Programme Implementation	Ministry of Labour and Employment
Urban CPI	CPI – rural labourers
Rural CPI	CPI – agricultural labourers
Combined (urban and rural) CPI	CPI – industrial labourers
CPI – urban non-manual employees (ceased in 2015)	

Sources: Ministry of Labour and Employment; Ministry of Statistics and Programme Implementation

Each index has its own set of weights and the base period used varies across measures. There are also methodological differences between the indices, such as the way in which prices are collected. The urban, rural and combined CPIs produced by MOSPI have been published since 2011. In contrast, the measures of consumer price inflation computed by the Ministry of Labour and Employment have a much longer history; the time series of the CPI for industrial workers began in 1989. Although these indices have been used in wage determination and as a reference for the provision of welfare benefits, they use base period weights that are substantially out of date, and are unlikely to reflect the current Indian household consumption basket.6 Moreover, the RBI has expressed a preference for the MOSPI CPIs. For these reasons, the rest of this article focuses on the recently developed urban, rural and combined CPIs produced by MOSPI.

Core Inflation

India does not publish an official measure of ‘core’ (or ‘underlying’) inflation, although such measures can be useful as an indication of underlying trends in economy-wide price pressures. In a 2011 occasional paper, the RBI assessed a number of alternative measures of core inflation and found that the ‘non-food manufacturing’ component of the WPI was the most suitable series.8 Non-food manufacturing inflation is not published, although it can be estimated using the published WPI 8 See Raj and Misra (2011) for further information. indices and weights. While headline WPI inflation and non-food manufacturing inflation have both trended lower since 2011, non-food manufacturing inflation has fallen to much lower rates. This may indicate a degree of downward pressure on inflation consistent with slow growth in industrial production and economic demand more generally. The RBI estimates that potential growth has slowed from around 8 per cent prior to the global financial crisis, to about 6 per cent at the end of 2013 (Reserve Bank of India 2014b). This implies that GDP (at factor cost) has been growing at about 1–2 percentage points below potential, in year-ended terms, for the past two years.

Inflation as measured by the consumer price index reflects the annual percentage change in the cost to the average consumer of acquiring a basket of goods and services that may be fixed or changed at specified intervals, such as yearly. The Laspeyres formula is generally used.

1.India inflation rate-for 2020-4.95%, a 3.54% decline from 2019.

2.India inflation rate- for 2019 -7.66%, a 2.8% increase from 2018.

3.India inflation rate -for 2018 - 4.86%, a 2.37% increase from 2017.

4.India inflation rate- for 2017 - 2.49%, a 2.45% decline from 2016.

5.India inflation rate- for 2016 - 4.94%, a 0.93% decline from 2015.

Impact of inflation on Indian economy

Inflation seemed to be a chronic problem in many parts of the world. There is a wide spread recognition that inflation results in inefficient resource allocation and hence reduces potential economic growth. Inflation imposes high cost on economies and societies; disproportionately hurts the poor and fixed income groups and creates uncertainty throughout the economy and undermines macroeconomic stability. High inflation has always penalized the poor more than the rich because the poor are less able to protect themselves against the consequences, and less able to hedge against the risks that high inflation poses. Lowering inflation therefore, directly benefits the low and fixed income groups. Rapid inflation can disrupt our entire economy can cause a financial crisis in the country. One of the major results of inflation in an economy is the general slowdown of the economy. When this happens unemployment rates rise, the purchasing power of the consumer decreases, credit becomes expensive. All these cause a strain on the entire financial system of the country.

The rising prices mean that the factors of production like labor and raw materials have also become expensive. The profit margins of the companies are decreasing. And after an extent, the companies pass on the burden of these additional expenses to the final consumer. And the entire economy suffers in this way inflation has adversely affected the industrial sector.

If the prices of goods and services are constantly rising. But the salaries and income of consumer do not rise proportionately, there is a lag. So the goods and services become less affordable to these final consumers. And the population in the lowest income group are the most affected. They cannot even afford basic necessities.

One of the major effect of inflation in an economy is the general slowdown of the economy. When this happens unemployment rates rise, the purchasing power of the consumer decreases, credit becomes expensive. All these cause a strain on the entire financial system of the country. It discourages heavy investment in the economy by both domestic and international players.

Conclusion

Inflation is affected badly the life of middle and poor class. Controlling inflation is needs tremendous, effective and long term policies of the government. Inflation has been properly being curbed or averted the world economy with experience of new face on employment policies and have a new breath on the standard of living around the globe. For inflation People start consuming or buying less of these goods and services as their income is limited. This leads to slowdown not only in consumption but also production. This is because manufactures will produce fewer goods due to high costs and anticipated lower demand. Banks will increase interest rates as inflation increases otherwise real interest rate will be negative. (Real interest = Nominal interest rate – inflation). This makes borrowing costly for both consumers and corporate. Thus people will buy fewer automobiles, houses and other goods. Industries will not borrow money from banks to invest in capacity expansion because borrowing rates are high.

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