Economics Class 42

TYPES OF INFLATION (09:02 AM)

- **DEPENDING ON THE RATE OF GROWTH:**
- **1) Creeping Inflation:** It is the mildest form of inflation also known as mild or low inflation.
- The general price rise is low and varies between **2%-3%.**
- If this rate or rise in prices continues it is considered good for the economy as the producers make **reasonable profits** which encourages them to **invest more**.
- **2) Walking Inflation:** it is also known as **Trotting Inflation**.
- In this, the price rise is more than **Creeping inflation (3%-10%).**
- This inflation must be taken seriously as this is a warning for the occurrence of **running or galloping inflation.**
- **3) Galloping Inflation:** Inflation from more than **10% and up to 50%** refers to galloping inflation.
- Even foreign investors **avoid such unstable economies** for investment.
- It is also termed **Running Inflation**.
- **4) Hyper-Inflation:** it is an extreme form of inflation where the prices rise at an **alarmingly high rate** i.e. more than **50%** every month.
- It occurs when there is a **large increase in the money suppl**y,
- In extreme situations, the value of **national currency reduces to zero** & the **paper money becomes worthless.**
- For example **Zimbabwe in mid 2000s, Venezuela (2019), Iran in 2020 etc.**

Turkey in 2022

- **CAUSEWISE TYPES OF INFLATION:**
- **1) Demand-Pull:** It is caused by the **increase in aggregate consumption** & **demand due to increased private & government spending, reduction in taxes, increase in money supply and bank credit**.
- When there is an increase in the **income of households, it** results in a **change in demand** with **no change in aggregate supply leading to demand-pull inflation**.
- **2) Cost-Push Inflation**: Also called **Supply Shock** Inflation.
- General prices rise due to the **growing cost of factors of production** of goods & services such as Land, Labor, Raw Materials, etc.
- **For example,** in the year **1973 in the oil shock,** there was a **massive rise in general levels** of prices across the globe.
- The cost-push inflation is also caused by an **increase in indirect taxes, an increase in import prices, and a higher cost of capital & interest rates**.
- **3) Structural Inflation**: If Inflation persists for a longer period due to deficiencies existing in the economy such as low agricultural productivity, and inefficient distribution & storage facilities etc.
- It is also termed **Bottleneck Inflation** and has to be tackled through structural reforms.

METHODS TO MEASURE INFLATION (09:45 AM):

- **1) Wholesale Price Index (WPI)**
- **WPI** measures the changes happening in wholesale prices of a **basket of commodities** every month.
- **Department of Industrial Policy** & **Promotion** under the Ministry of **Commerce & Industries**, compiles & publishes the WPI.
- WPI takes into account **697 commodities** of various types to measure inflation but it does not take into account services.
- WPI uses the **ex-factory prices** of these commodities to measure inflation.
- In other words, it **takes into account** the prices of commodities before they reach consumers.

- **What is Base Year or Base Effect:**
- **Base Year:** It is the year on the basis of which we **compute** the inflation in an economy.
- **The base Effect** shows the impact of the price levels of the previous year or the reference year on the calculation of the inflation rate.
- **Criteria for deciding a particular year as base year:**
- **1)** Year with **no major natural calamity**, drought, famine, etc.
- 2) The year should not have **inflation at an alarming rate.**
- **3)** Unstable years in **terms of economic activities** are **not considered Base Years**.
- There should not be much gap between the **Base Year selected and the Current Year**.
- The base year should be a recent year.
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Serial No:	COMPONENTS	WEIGHTAGE
01	Primary Articles	22.6%
02	Fuel & Power	13.2%
03	Manufactured Products	64.2%
	Total	100%
	Food	24.4%

NOTE:-

- The weight of the **Primary articles** increased under the new base year 2011-12 whereas the **weights of fuel and power and manufactured products decreased**.

Department of Industrial Policy and Promotion

- **WPI Food Index:**
- To monitor food inflation more effectively, DIPP started publishing the **WPI Food Index in 2017.**
- It measures the rate of **inflation of food items** at the level of producers.
- **Aggregate all food items** within the list of 697 commodities under the WPI is considered to compute the WPI food index.
- ***Reasons for the increase in WPI inflation in the recent past***
- Supply chain disruption, leading to an increase in prices of raw materials, essential commodities, food, crude oil, fertilizers, etc.
- Excessive heat and uneven rainfall affected the farm sector
- The government has taken adequate measures to reduce WPI inflation
- Along with government measures rise in interest rates (monetary tightening), good monsoons were effective in reducing WPI inflation
- WPI inflation is also seen as imported inflation
- Every 1% rise in inflation globally would lead to a 1.63% increase in inflation in India (RBI)
- Reduction in import duties, reduction of excise duty on fuels, and also reduction of customs duty were instrumental in taming inflation

CPI (10:17 AM)

- **Consumer Price Index (CPI)**
- CPI measures the change in retail prices on a monthly basis.
- It includes both goods and services.
- Presently CPI takes into consideration two homogenous groups i.e. rural households and urban households.
- CPI reflects the cost of living of the two concerned categories of consumers.
- **Various types of CPI**

Types of CPI	**Base year**	**Compiled by**
CPI (Industrial Workers, IW) Designed to measure the changes in the pricing of a given basket of products and services used by industrial workers	2016	Labor Bureau under the Ministry of Labor and Employment
CPI (Agricultural Labourers, AL) It is designed to revise minimum wages for agricultural labour in different states	1986-87	Labor Bureau under the Ministry of Labor and Employment
CPI (Rural Labourers, RL)	1986-87	Labor Bureau under the Ministry of Labor and Employment
CPI (Rural, Urban, and Combined)	2012	CSO or currently ~~NSSO~~

NSO

- *CPI (Rural, Urban)*
- It covers 448 in the rural basket and 460 items in the urban baskets
- The base year used to compute CPI is 2012
- For inflation targeting RBI and the central government use CPI (Combined) instead of WPI for policy-making based on the recommendations of the Urjit Patel Committee
- Our headline inflation is based on CPI (Combined)
- *CPI weights*

Groups	Weightage
(1) Food and beverages	45.9
(2) Pan, tobacco, and intoxicants	2.4
(3) Clothing and footwear	6.5
(4) Housing	10.1
(5) Fuel and light	6.8
(6) Miscellaneous	28.3

- CPI headline = 1 + 2 + 3 + 4 + 5 + 6
- CPI core = 2 + 3 + 4 + 6
- CPI (Refined Core) will also remove transport-related aspects from the core inflation as it is dependent on fuel prices
- Inflationary expectations will be lower when households and business houses have trust in institutions like RBI i.e. they believe that RBI and the government will be successful in handling inflation in the long-term.
- Monetary tightening policies of RBI like increasing repo rates and CRR though affected the money supply, investment, and credit expansion were positive indicating that India's policies related to inflation will lead to soft-landing i.e. no recession in spite of monetary tightening.
- This situation is quite different from inflationary situations in the 1970s or 1990s, as there was the challenge of hard-landing due to tightening policies in different countries (hard-landing due to tightening policies leading to recession)

- ***Headline inflation***
- It is a raw inflation figure reported through CPI (Combined).
- It includes both volatile and non-volatile categories.
- ***Core inflation***
- This measure is computed by policy-makers to analyze the inflation data which excludes the more volatile categories like food items and energy (fuel and power products).
- Core inflation is calculated to remove the impact of temporary and short-term shocks.

EFFECTS OF INFLATION (11:30 AM)

- 1. On lenders and borrowers
- Inflation benefits the debtor whereas it can lead to loss to lenders/creditors
- Inflation goes against bondholders or creditors
- 2. On fixed-income groups
- Inflation affects the salaried and pensioned classes, as their purchasing power reduces drastically without any increase in income
- 3. On exchange rate and exports
- Currency value may depreciate due to inflation and there is a benefit to exporters.
- However, exports may not increase as domestic sales may look more attractive due to higher prices
- 4. On savings
- Marginal propensity to save decreases, as most of the savings in India are done by households.
- it shifts the savings pattern in favour of unproductive assets like gold.
- 5. On bond yields
- Inflation increases the bond yields
- 6. Fiscal deficit may rise due to a rise in inflation as the government needs to give more subsidies, in order to make goods affordable to poor people
- 7. On inequalities and distribution of income
- Inequalities may rise in the economy due to inflation as inflation affects the poor more
- 8. On Employment
- In the short run, employment may increase with the rise in inflation (Philips Curve), however, it may not be true in the long run.
- **Philips Curve**
- It reflects the relationship between the rate of inflation and the rate of unemployment.
- It describes the inverse relationship between the rate of inflation and the rate of unemployment in an economy.

MEASURES TO CHECK INFLATION (11:50 AM)

- 1. *Fiscal measures*
- The government may come up with fiscal measures like avoiding deficit financing, reducing private expenditure (increasing taxes on private households), and also by decreasing non-developmental government expenditure
- 2. *Monetary measures*
- Quantitative and qualitative tools of RBI.
- 3. *Administrative measures*
- Prevention of black-marketing and hoarding.
- Banning the export of constrained items.
- Stock limits on commodities.

TERMS (11:55 AM)

- **Stagflation**
- It emerges when both stagnation and inflation occur simultaneously.
- It is an economic period of no growth, relatively high unemployment and rise in prices of goods and a decline in GDP.
- It is a rare phenomenon and is bad for the economy.
- Example- The USA in the 1970s due to an increase in oil prices.
- **Reflation-** It is a phenomenon when inflation returns after a spell of deflation thereby indicating that the economy is recovering.
- **Disinflation-** It shows the rate of change of inflation over time. In this inflation is declining over time but it remains positive. E.g. If the inflation rate in India was 7% in March but decreased to 4% in May, it is said to be experiencing Disinflation.
- **Deflation-**
- Deflationary cycles are more dangerous than inflation. It is a fall in general price levels of goods and services.
- Deflation is mainly caused by a shift in supply and demand.
- It is usually associated with significant unemployment.
- To handle deflation, Govt may increase its spending (Fiscal stimulus), reduce taxes to boost demand, RBI may reduce Repo rates or print more currency.

TOPIC OF THE NEXT CLASS- AGRICULTURE