Principles of Economics and Management

INFLATION IN INDIAN ECONOMY AND ITS IMPACTS

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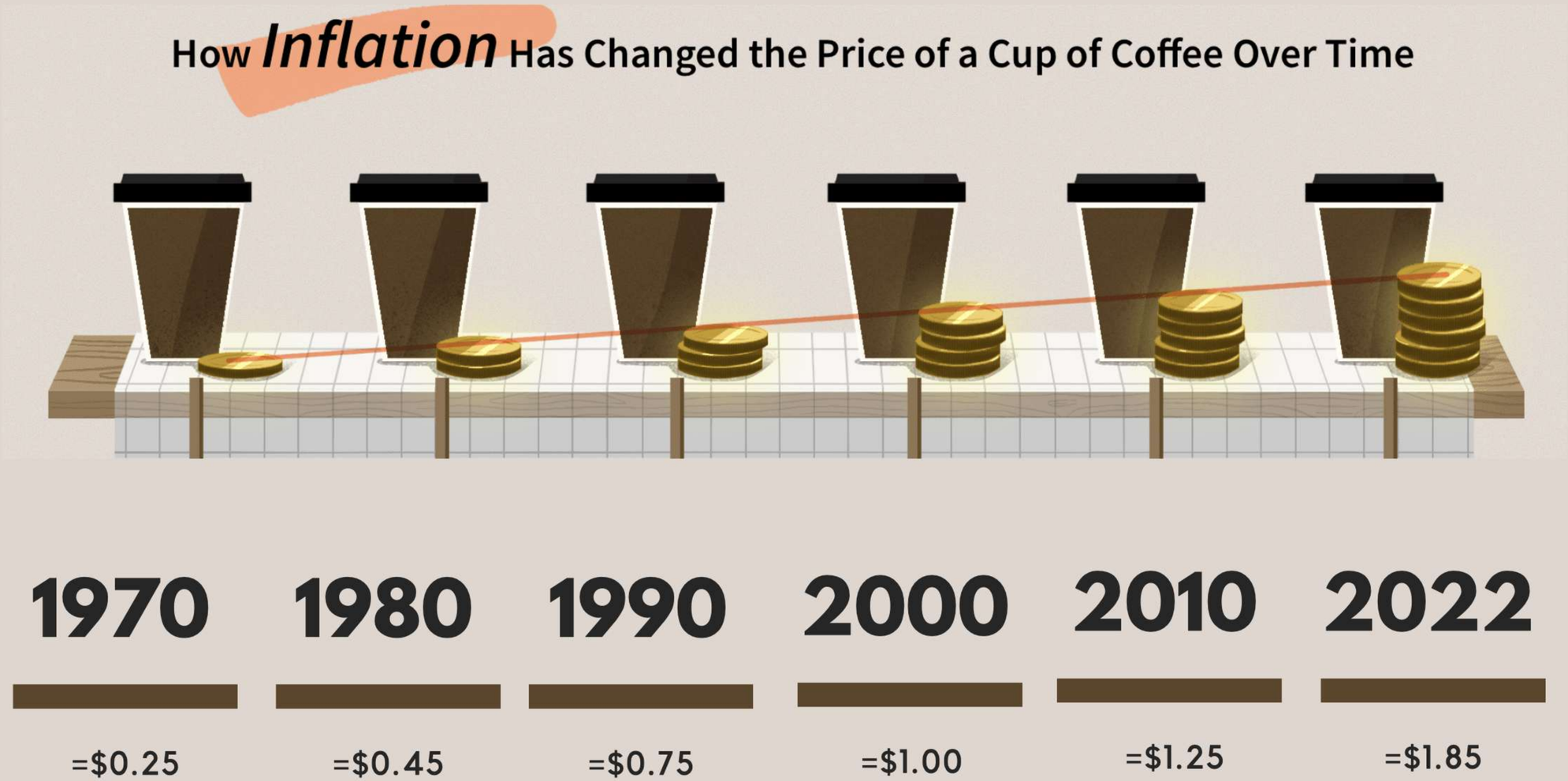
What is Inflation?

Inflation is the rate of price increase over a specific time period. Typically, inflation is a broad metric, such as the general increase in prices or the rise in a country's cost of living.

Coffee Cup example of Inflation



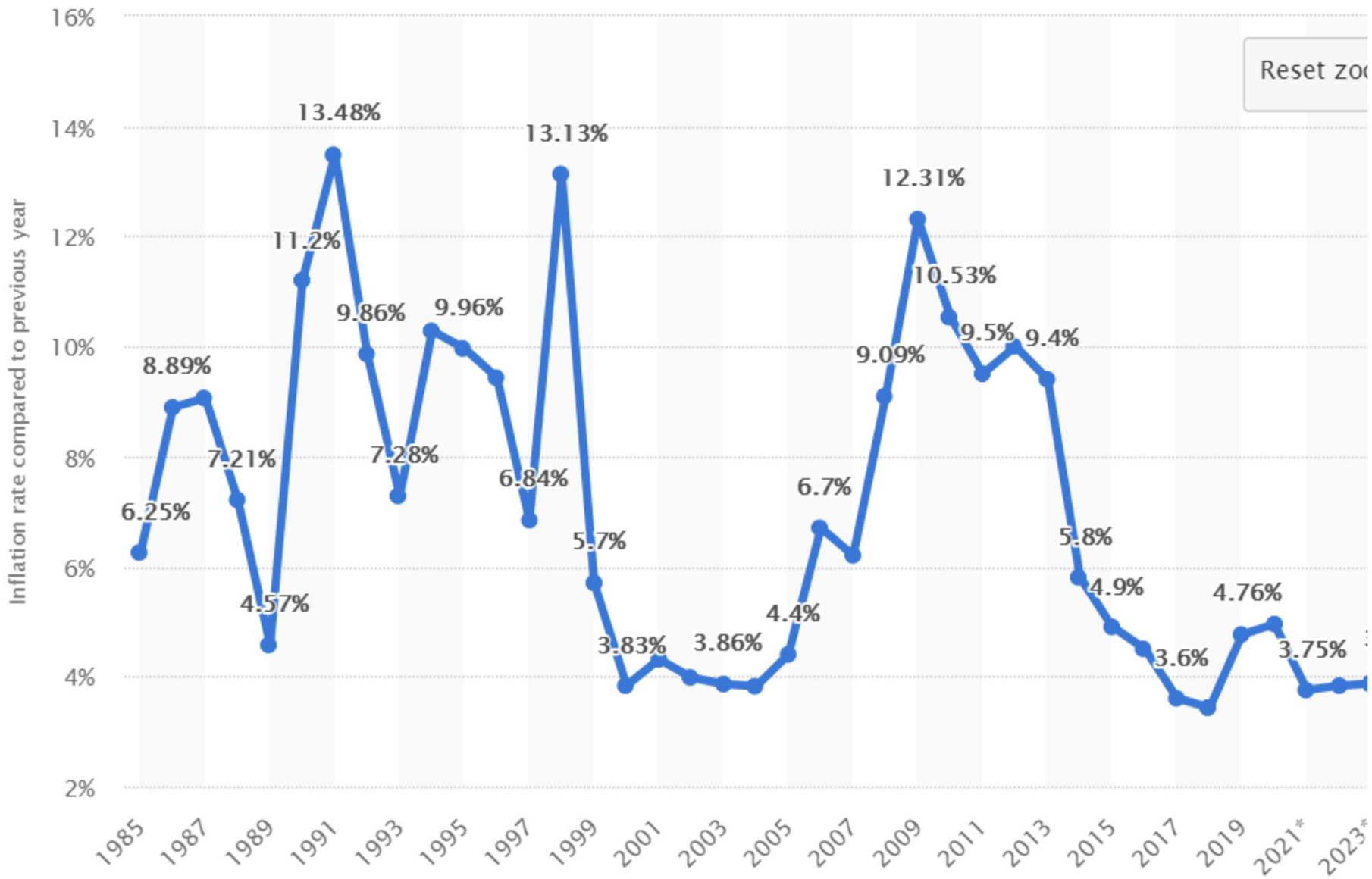
How inflation in calculated ?

The inflation formula rate helps us understand how much the price of goods and services in an economy has increased in a year. For example, if the price of goods and services in an economy is now $103 and in the previous year the same was $100, then the inflation is $3.

Inflation in India

7%

Inflation Rate in India



Inflation is nothing but when money loses its value

Causes of Inflation

1. Demand-Pull
2. Cost-Push
3. Money Supply
4. Inflation Expectation

Demand Pull

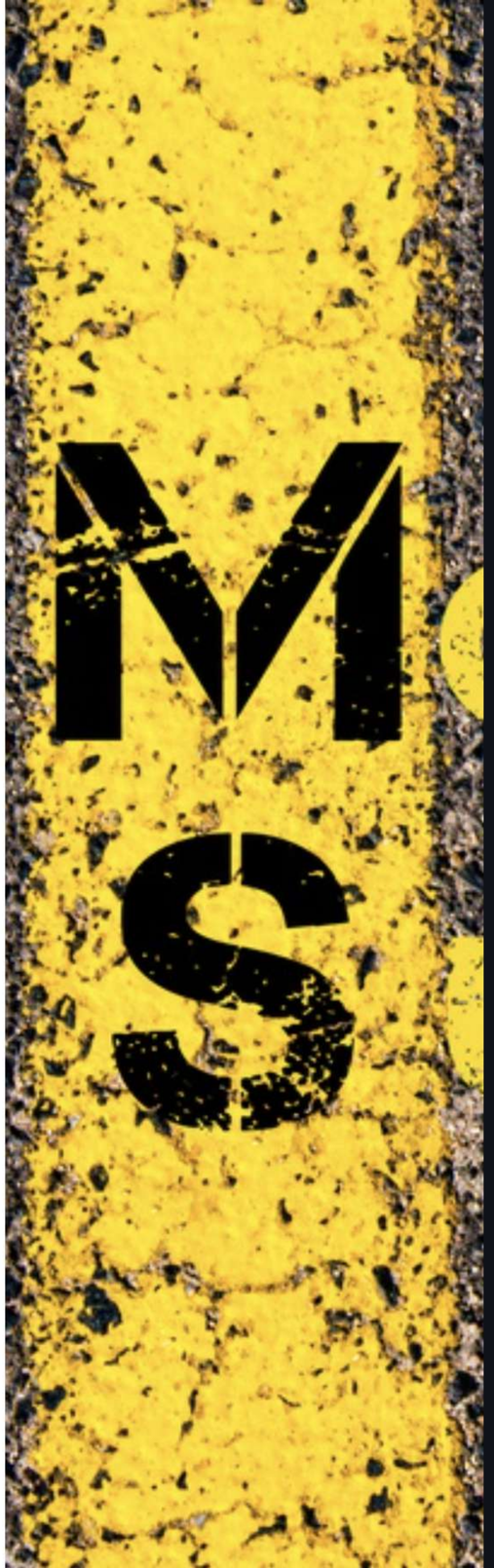
Demand-pull inflation is a tenet of Keynesian economics that describes the effects of an imbalance in aggregate supply and demand. When the aggregate demand in an economy strongly outweighs the aggregate supply, prices go up. This is the most common cause of inflation.

Cost Push

Cost-push inflation is the decline in the aggregate supply of goods and services caused by a rise in production costs. Cost-push inflation is a type of inflation driven by the rise in labour and material costs throughout a supply chain. When this inflation occurs, prices for products and services increase, leading to a decline in supply.

Money Supply

Inflation occurs when the money supply of a country grows more rapidly than the economic output of a country. The Federal Reserve changes the money supply by buying short-term securities from banks, injecting capital into the economy.



Inflation Expectation

Inflation expectations are simply the rate at which people—consumers, businesses, and investors—expect prices to rise in the future. They matter because actual inflation depends, in part, on what we expect it to be.

Impacts of Inflation on Indian Economy

Balance of Payments

INDIA'S CURRENT ACCOUNT DEFICIT IS AROUND 17 BILLION DOLLARS FOR THE LAST QUARTER OF 2018. THIS IS ROUGHLY 2.5% OF OUR GDP. THIS IS BECAUSE FOR YEARS NOW INDIA'S IMPORTS ARE MISMATCHED WITH THEIR EXPORTS. WITH INCREASING PRICES OF GOODS IN INDIA, EXPORTS HAVE SEEN A FURTHER DECLINE. AND THE IMPORTS HAVE ACTUALLY BECOME CHEAPER. SO THE CURRENT ACCOUNT DEFICIT WILL CONTINUE TO BE A PROBLEM FOR OUR ECONOMY.

Industrial Sector

INDIA HAS SEEN A STAGNATION IN THE INDUSTRIAL GROWTH IN THE LAST FEW YEARS. THE INDUSTRIAL GROWTH FOR THE MONTH OF FEBRUARY 2019 YEAR-ON-YEAR WAS MERELY 0.1%. THIS IS BECAUSE INFLATION HAS ADVERSELY AFFECTED THE INDUSTRIAL SECTOR AS WELL.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.

Final Consumer

THE PERSON MOST AFFECTED BY RISING INFLATION IS THE FINAL CONSUMER OF GOODS. 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.

Investments

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. IT DISCOURAGES HEAVY INVESTMENT IN THE ECONOMY BY BOTH DOMESTIC AND INTERNATIONAL PLAYERS.

How Can the Indian Government Control Inflation?

Being an import-oriented country, India has to purchase (import) raw materials and other goods at a higher price due to higher dollar value. Importing at a high cost increases the cost of production, leading to higher costs of the final goods or services, thereby causing Inflation in the Consumer Price Index.

Monetary Policies

ONE SIGNIFICANT MONETARY WAY TO CURB INFLATION IS TO CONTROL THE MONEY SUPPLY IN THE ECONOMY. IF THE MONEY SUPPLY GOES DOWN, THE DEMAND FOR GOODS WILL REDUCE, CAUSING A PRICE FALL. ANOTHER WAY TO CURB THE MONEY SUPPLY IS WHEN THE GOVERNMENT WITHDRAWS SPECIFIC PAPER NOTES OR COINS FROM CIRCULATION. LOWERING THE LENDING RATE FOR COMMERCIAL BANKS ALLOWS MONEY CIRCULATION TO BE CONTROLLED. THE CENTRAL BANK CAN ALSO BLOCK COMMERCIAL BANKS' MONEY BY ISSUING GOVERNMENT SECURITIES.

Fiscal Policies

THE TWO ESSENTIAL COMPONENTS OF A FISCAL POLICY ARE GOVERNMENT REVENUE AND EXPENDITURE. THE GOVERNMENT CAN CHANGE ITS TAX RATES TO INCREASE REVENUE OR EFFICIENTLY MANAGE EXPENDITURE. AN INFLATIONARY GAP IS CREATED WHEN THE DEMAND IS HIGHER THAN THE SUPPLY. THE GOVERNMENT CAN TACKLE THIS IN TWO WAYS. ONE, BY DECREASING THE OVERALL GOVERNMENT EXPENDITURE AND TRANSFER PAYMENTS. TWO, INCREASING THE TAX RATES LEADS TO DECREASED INDIVIDUAL DEMAND AND A DROP IN THE ECONOMY'S MONEY SUPPLY.

Bottom Line

GIVEN THE EXCESSIVE VOLATILITY IN GLOBAL CRUDE OIL PRICES SINCE LATE FEBRUARY, INFLATION IS LIKELY TO REMAIN VOLATILE. THE RATE IS CONTINGENT UPON FUTURE OIL AND COMMODITY PRICE DEVELOPMENTS. CONSIDERING RBI'S PAST MEASURES, WE CAN ALSO SUCCESSFULLY PREDICT INDIA'S CENTRAL BANK TAKING ADDITIONAL RATE HIKE MEASURES TO REDUCE INFLATION WITHIN ACCEPTABLE LIMITS.

Indian Government Has Taken to Curb Inflation

WITH CPI REACHING 7.79%, THE RBI GOVERNOR ANNOUNCED SEVERAL INITIATIVES TO CONTROL PRICE RISE:

IN MAY AND JUNE, THE RBI RAISED REPO RATES. THE 0.90% TWO-MONTH RATE RISE. THE RBI MAY RAISE IT TO MANAGE INFLATION. THE GOVERNMENT DECREASED FUEL EXCISE TAXES. THE EXCISE DUTY DROP ON GASOLINE AND DIESEL WILL COST THE GOVERNMENT 1 TRILLION RUPEES. WITH THE DROP IN CRUDE OIL PER BARREL, INDIA'S FUEL PRICES HAVE FALLEN. THE GOVERNMENT DECREASED IMPORT DUTIES ON KEY RAW MATERIALS FOR THE STEEL AND PLASTIC INDUSTRIES, REDUCING MANUFACTURING COSTS AND STABILISING FINAL PRODUCT PRICES. 20 LAKH TONNES OF CRUDE SUNFLOWER OIL CAN BE IMPORTED DUTY-FREE FOR TWO YEARS. THE GOVERNMENT CAPPED SUGAR AND WHEAT EXPORTS. IT'S TO ENSURE APPROPRIATE STOCK, FOOD SECURITY, AND PRICE STABILITY.

Thank You

NOTHING SO WEAKENS A GOVERNMENT AS INFLATION.

- J.K. GALBRAITH