INFLATIONARY MAMMOTH: RUMINATIONS AND RAMIFICATIONS

Dr. Rashi Arora
Assistant Professor, G.S. College of Commerce & Economics, Nagpur

Abstract

Inflationary forces have been unleashed globally and India is no exception. The economic demon is all set to shake up the Indian economy. Worrisome is the negative socio-economic repercussions that it can have, directly or indirectly, on the populace and the macro-economic fundamentals like aggregate consumption levels, employment, income levels, interest rates, growth, etc. The paper explicates the background, reasons, and effects of inflation on the Indian economy and the nature of monetary and fiscal intervention required to contain it.

Keywords: Inflation, GDP, Interest Rates, India

I. INTRODUCTION

India’s CPI (Consumer Price Index) for April 2022 is 7.79%, the highest in 8 years and for the successive 31st month above RBI’s median target of 4%. This may be higher or lower when compared with the other nations. But, such comparisons may be irrelevant since the macro-economic fundamentals like poverty, unemployment, the standard of living, per capita, and inequalities differ from nation to nation. Therefore, reassuring oneself that inflation in India is relatively lower compared to other nations is no comfort or justification.

The USA is witnessing above 8% inflation, the highest price levels in 40 years, as a result of fiscal stimulus doled out by the Federal and Government in large magnitudes, supply chain bottlenecks, food costs, and fuel prices. When other macro-economic fundamentals are compared with USA’s inflation like its per capita, it is a towering $ 63,206.5 (in the year 2020 based on World Bank data). This reflects the state of its citizens being better off than those from the developing nations with low per capita income levels. Developing economies like Sri Lanka and Pakistan are also experiencing inflationary pressures with an emergency-like situation. Though India’s inflation story is not negatively skewed as Sri Lanka or Pakistan nevertheless it calls for timely and effective application of remedial measures in the interest of the nation’s populace and economy.

II. REASONS FOR INDIA’S INFLATION CONFLAGRATION

Inflation is theoretically categorized as demand-pull, cost-push and stagnation. Demand-pull inflation is when the aggregate demand for goods and services exceeds their aggregate supply. This is not the case for India since the aggregate demand was severely affected due to the pandemic lockdowns. The reasons for this decline in demand have been lockdowns followed by reduction in economic activity resulting in high unemployment levels and falling purchasing power of the masses. Though, household consumption that had fallen since the pandemic is improving but the increase is not enough for inflation to be compartmentalized as demand-pull inflation. This is contrary to what the developed nations are experiencing. The initial spurt of inflation in these nations has been due to the heavy stimulus packages provided by the Governments. Governments of these economies rolled out bailout packages in billions and trillions of dollars to prevent liquidity traps and fill empty pockets in their economies to ensure basic demand sustainability. Besides this, the monetary policy stimulus was also provided by reducing the interest rates to encourage borrowings for consumption and production.

Present India’s inflation by origin can be categorized into cost-push inflation. It is a result of an increase in crucial inputs costs like fuel, raw materials, and other inputs for agriculture as well as for industry. Further, the supply bottlenecks due to the pandemic have worsened due to the Russia-Ukraine war creating production lags and disruptions in productive activities. Along with surging inflation, the country is also facing growth challenges thus creating an ideal room for the situation to be called stagnation. The crisis of stagnation (economic growth stagnancy coupled with price rise) makes it difficult for the fiscal and monetary planners to carve out a single-pronged strategy that can control the economic crises since a remedy to control inflation creates conflicting results for growth. For example, increasing interest rates by The Reserve Bank of India (RBI) can help in controlling inflation but the same can negatively impact the nation’s growth prospects. So, what is required is to understand and analyze the reasons for the general price rise and to work towards the corrective measures. The prominent reasons for the same are:

1. Increase in fuel prices
2. Increase in the prices of food items
The prices of petrol and diesel have increased by around 63% from 2nd April 2020 to 25th April 2022. In all probability, if the CPI basket is revised with an increase in fuel weightage, instead of the present share of 7% of fuel and light in the CPI basket, the present CPI number could be higher. A fuel price increase in the economy impacts the prices of almost all goods and services due to their direct or indirect impact. Transportation and supply chain infrastructure controls the nation’s trade and commerce and an increase in fuel prices is bound to impact the prices of all the goods and services produced and marketed irrespective of sector or industry. With an increase in fuel prices of about 63% in both the cases, petrol and diesel, a rise in the price index was inevitable, on CPI as well as on WPI account.

Further, prices of fuel are based on external price changes besides the extent of taxes that are levied by the central and state governments. The latter has been responsible on a significant level for increasing the prices of petrol and diesel in India among the other reasons. This being the case, the central government has rightly reduced the taxes imposed by it on fuel to reduce their prices and in turn to exercise a check on India’s CPI and WPI.

Table 1: Percentage increase in fuel prices

<table>
<thead>
<tr>
<th>Date /Price (Mumbai)</th>
<th>Petrol (In Rs)</th>
<th>Diesel (In Rs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2nd April 2020</td>
<td>76.31 per litre</td>
<td>66.21 per litre</td>
</tr>
<tr>
<td>25th April 2022</td>
<td>120.51 per litre</td>
<td>104.77 per litre</td>
</tr>
<tr>
<td>% Increase</td>
<td>63.32</td>
<td>63.19</td>
</tr>
</tbody>
</table>

Source: Constructed by the researcher based on data obtained from news articles as shown in references.

The other prominent reason for the high inflation in India is an increase in food prices. Food items account for 46% of the index (CPI) and India is not isolated in experiencing an increase in food prices. The phenomenon is globally widespread as a result of:

1. Russia-Ukraine political conflict since the two nations exports 30% of the globe’s wheat and 1/5th of the globe’s maize. Shortages of these two staple commodities due to supply chain disruptions caused by the war world over have caused disequilibrium in their demand and supply with supply falling short of the current demand.
2. Protectionist practices that started even before COVID-19 have resulted in countries behaving defensively to prioritise their own needs before the needs of other nations. During COVID-19, the most popular economic integrations saw the closing of boundaries in the literate and economic sense. The same is being seen more so in the present. A recent example is the restrictions on wheat exports that India has imposed post-Russia-Ukraine war. The move has been to put a check on the escalating food prices within the nation and safeguard its own needs. Wheat is a staple food in India as is across the world and exporting wheat to cover its deficit for other nations is in all likelihood bound to import inflation in India with India’s wheat production projected to be less by 3.8 million tonnes in 2021-22 due to strong heat waves.

### III. INFLATION AND FISCAL & MONETARY POLICY STANCE

As a remedy to control inflation various fiscal and monetary measures are adopted.

**Among the fiscal measures are:**

#### Reduction in taxes

The recent reduction in excise duty on petrol and diesel by the Government, though delayed, is bound to have a cascading effect and help in gradually containing the general price level. The impact so far has been marginal but in the long run, a positive impact is certain of cooling down the general price levels, with all other factors remaining the same.

#### Reduction in public expenditure

This helps in controlling the demand side disequilibrium i.e in the case of demand-pull inflation it is effective. Since the situation due to the pandemic has resulted in unemployment and the resultant reduction in purchasing power in the hands of the masses, this is not required. On the contrary, the challenge has been to increase aggregate consumption in the Indian economy. Also, Government has been prudent in many of its allocations in the budgets which may have delayed corrections in recessionary waves brought in due to lockdowns. Public expenditure at this juncture needs to deliberate on the corrections of supply-side disequilibrium and in ensuring a normal aggregate consumption level for sustaining economic growth.

#### Increase in public debts

This again is not feasible due to the decrease in aggregate consumption in the economy due to the pandemic. On the contrary, the need has been to leave purchasing power in the hands of the citizenry to increase aggregate demand for economic recovery. Debts in the form of inflation bonds can be issued to divert the excess money supply from the haves to the have-nots.

**Among the monetary measures are:**

#### Increase in interest rates

The Reserve Bank of India has increased interest rates to tame inflation with the repo rate increasing to 4.9% on 8th June 2022 and the bank rate adjusted to 5.15%.(as of 9th June 2022). This has been to flush out the excess money supply from the economy by reducing its demand.

#### Floating /selling of securities under open market operations

This is a normal operation of the RBI which at this juncture will have to be adopted carefully since it may lead to the collateral damage of flushing out that money that could have been diverted towards productive activities and in turn damage the nation’s economic growth prospects.
IV. INCREASE IN INTEREST RATES AND IMPACT ON GROWTH

An increase in interest rates is a conventional measure to control inflationary pressures. In India’s case, the move to increase interest rates was delayed due to the need to support the bouncing back of the economy after the nation’s GDP saw a trough during lockdowns due to a cessation of productive activities. GDP even before the pandemic had slowed down, the pandemic only worsened it.

An increase in interest rates to control inflation is a measure that brings with it collateral damage of impeding economic growth. Economic growth requires a ‘cheap money policy’ stance whereas managing inflation requires a ‘dear money policy’ stance. The two are contradictory objectives and towards fulfilling one objective the rather has to be sacrificed. This situation will spell trouble for the fragile Indian economy that was recovering from the damage that was caused by the lockdowns.

In the present situation, a further increase in repo rates is inevitable since the impact of decreased taxes on fuel by the center and states so far has shown a weak response in controlling the spiraling of prices. Also, with the prolongation of the Russia-Ukraine war, the food and fuel crisis globally is going to stay along with the impact on other commodities gradually showing up like electronics and automobiles since crucial inputs for semi-conductor production come from the two war-torn nations.

Aggregate demand and aggregate supply are the two pillars of any economy. A high-interest rate can damage the economic health of both these pillars since it makes obtaining credit for consumption and production expensive with the commercial banks and other lending institutions also increasing interest rates with an increase in rates by the RBI. On the consumption side credit contraction eventually reduces the demand for durables like electronics, automobiles, and home loans. This, in turn, damages the supply side of production with a decrease in productive activities due to a decrease in demand for those items like electronics, automobiles, and homes. Further, the vicious cycle may get spurred as follows:

Figure 1: Negative impact of high interest rates

V. GLOBAL INFLATIONARY PHENOMENON

USA’s inflation is the highest in 40 years, the eurozone is seeing record inflation with the situation no different for most of the emerging and developing economies. The exception here is China where prices are low. This can be a help for economies struggling with a price rise as they can import low-priced finished goods and inputs from China instead of other economies with high prices. This may again change the dynamics of protectionism for many economies that had given an orchestrated call against trading with China as also against neo-liberalism to safeguard their economies.

Further, the globe is witnessing more and more central banks increasing interest rates to arrest the inflationary conundrum. This is bound to create volatility of its own with the world’s economic growth suffering on one hand and capital outflows from developing nations like India to safer havens like the US.
VI. CONTAINING INFLATION TSUNAMI WITHOUT HAMPERING GROWTH

Increasing interest rates to control inflation is likely to hamper economic growth. Therefore, the situation requires careful calibration in the use of fiscal and monetary policy tools. For mending a torn seam utmost care is required to prevent a path strewn with un mendable holes. Increasing interest rates can be made selective by distinguishing between essential consumption and production, productive and speculative activities, and setting a list of priorities in credit dissemination and interest charges. This is certainly not going to be easy but may play its part in arresting the intensity of damage to growth.

To prevent the damaging effect of interest rate hikes on the normal aggregate consumption and production, compensatory measures can be adopted where Governments in their spending of financial resources ensure that wastages and leakages are minimized from the productive stream. Public works are an excellent manner to employ the working force along with productively building assets for the community.

The nation has seen growing inequalities in recent years with the widening of income and wealth gaps between the have-nots and have-nots. During this period to compensate for the decrease in purchasing power of the masses, aggressive measures are required along with providing jobs, and the reduction in prices of basic goods like food, fuel, etc. This is also a time to provide relief to them by strengthening the public distribution system.

The revenue generation of the governments during this period calls for levying of inflation tax on corporates, issuing of inflation bonds, etc., with the distribution of the same being used for the welfare schemes of the masses.

One cannot forget that later in the year the nation will be heading for elections in various states of India and it is common knowledge that elections unleash loosening of financial resources from all sides. The following increase in election expenditure may further worsen the inflationary pressures neutralizing the policy measures taken earlier to contain inflation.

VII. CONCLUDING REMARKS

All things come to an end, and India’s inflationary crisis too shall end but till then it calls for judicious and sensible strategic decisions by the RBI and the Government to arrest the inflation tsunami without hampering the nation’s GDP and taking care of the citizenry.

VIII. REFERENCES

- Saini Ayush. 2022. Times of India. CPI Inflation surges to near 8-year high of 7.79% in April, May 15, 2022 (web add: https://timesofindia.indiatimes.com/readersblog/the-startup-news/cpi-inflation-surges-to-near-8-year-high-of-7-79-in-april-42985/) (last accessed on 6th June 2022)