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A Study on the Impact of Inflation in Indian Economy

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1. Introduction :

Inflation is a rise in the general level of prices of goods and services in an economy over a period of time. When the general price level rises, each unit of currency buys fewer goods and services. Consequently, inflation also reflects and erosion in the purchasing powers of money- a loss of real value in the internal medium of exchange and unit of account in the economy.

Views on which factors determine low to moderate rates of inflation are more varied. Low or moderate inflation may be attributed to fluctuations in real demand for goods and services, or changes in available supplies such as during scarcities, as well as to growth in the money supply.

The adoption of fiat currency (paper money) by many countries, from the 18th century onwards, made much larger variations in the supply of money possible. Since then, huge increases in the supply of paper money have taken place in a number of countries, producing hyper inflations episodes of extreme inflation rates much higher than those observed in earlier periods of commodity money.

2. Issues :

The challenges in developing economy are many, especially when in context of the monetary policy with the Central Bank, the inflation and price stability phenomenon. There has been a universal argument these days when monetary policy is determined to be a key element in depicting and controlling inflation. The Central Bank works on the objective to control and have a stable price for commodities. A good environment of price stability happens to create saving mobilisation and a sustained economic growth. The former Governor of RBI C. Rangarajan points out that there is a long-term trade-off between output and inflation. He adds on that short-term trade-off happens to only introduce uncertainty about the price level in future. There is an agreement that the Central banks have aimed to introduce the target of price stability while an argument supports it for what that means in practice.

3. Measures of Inflation :

Inflation is usually estimated by calculating the inflation rate of a price indeed, usually the Consumer Price Index.

- **Producer Price Indices :**

  Which measures average changes in prices received by domestic producers for their output. This differs from the CPI in that price subsidization, profits, and taxes may cause the amount received by the producer to differ from what the consumer paid.

- **Commodity Price Indices :**

  Which measures the price of a selection of commodities? In the present commodity price indices are weighted by the relative importance of the components to the "all in" cost of an employee.

- **Core Price Indices :**

  Due to frequent fluctuation in food and oil markets. It is difficult to use in long run trend of price levels. Therefore CPI excludes these markets.

4. Comparison of Various Indexes :

Table No. 1
Comparison of Price Index, Cost Index, Gold Index, Silver Index & House Index from 2010 to 2018

Year	Price Index (IMF)	Cost Index (CBDT)	Gold Index (RBI)	Silver Index (RBI)	House Index (RBI)
2010	90.153	71.100	94.687	116.836	53.300
2011	98.718	78.500	126.970	181.068	67.050
2012	108.590	85.200	144.595	177.763	80.400
2013	118.797	93.900	128.696	138.810	90.250
2014	125.687	102.400	122.602	118.703	106.050
2015	131.846	108.100	121.157	106.972	109.550
2016	137.779	112.500	135.582	127.866	121.000
2017	142.742	115.900	133.092	116.539	129.100
2018	149.816	119.280	141.901	115.134	133.350

Source : Secondary Data

5. Factors affecting Inflation in India :

There are several factors which help to determine the inflationary impact in the country and further help in making a comparative analysis of the policies for the same. The major determinant of the inflation in regard to the employment generation and growth is depicted by the Phillips curve :

- **Demand factors :** It basically occurs in a situation when the aggregate demand in the economy has exceeded the aggregate supply. It could further be described as a situation where too much money chases just few goods. A country has a capacity of producing just 5,500 units of a commodity but the actual demand in the country is 7,000 units. Hence, as a result of which due to scarcity in supply the prices of the commodity rises. This has generally been seen in India in context with the agrarian society where due to droughts

and floods or inadequate methods for the storage of grains leads to lesser or deteriorated output hence increasing the prices for the commodities as the demand remains the same.

- **Supply factors :** The supply side inflation is a key ingredient for the rising inflation in India. The agricultural scarcity or the damage in transit creates a scarcity causing high inflationary pressures. Similarly, the high cost of labour eventually increases the production cost and leads to a high price for the commodity. The energies issues regarding the cost of production often increases the value of the final output produced.

- **Domestic factors :** Developing economies like India have generally a lesser developed financial market which creates a weak bonding between the interest rates and the aggregate demand. This accounts for the real money gap that could be determined as the potential determinant for the price rise and inflation in India. There is a gap in India for both the output and the real money gap. The supply of money grows rapidly while the supply of goods takes due time which causes increased inflation.

- **External factors :** The exchange rate determination is an important component for the inflationary pressures that arises in India. The liberal economic perspective in India affects the domestic markets. As the prices in United States rises it impacts India where the commodities are now imported at a higher price impacting the price rise. Hence, the nominal exchange rate and the import inflation are a measures that depict the competitiveness and challenges for the economy.

6. Causes of Inflation :

- **Demand-pull inflation :** Is caused by increases in aggregate demand due to increased private and government spending.

- **Cost-push inflation :** Also called "Supply shock inflation", is caused by a drop in aggregate supply (potential output). This may be due to natural disasters, or increased prices of inputs.

- **Built-in inflation :** Is induced by adaptive expectations, and is often linked to the price/wage spiral.

First, international crude oil prices continue to remain high. Second, in the context of inflation in the 'Fuel and Power' segment, one must also take note of the rising prices of coal.

7. GDP :

The potential output (sometimes called the "natural gross domestic product"), a level of GDP, where the economy is at its optimal level of production given institutional and natural constraints. If GDP exceeds its potential (and unemployment is below the NAIRU), inflation will accelerate as suppliers increase their prices and built in inflation worsens. If GDP falls below its potential level (and unemployment is above the NAIRU), inflation will decelerate as suppliers attempt to fill excess capacity, cutting prices and undermining built in inflation.

8. Monetary Measures :

The most important and commonly used method to control inflation is monetary policy of the Central Bank. Most Central banks use high interest rates as the traditional way to fight or prevent inflation.

- **Monetary measures used to control inflation include :**

    i. Bank Rate Policy

    ii. Cash Reserve Ratio and

    iii. Open Market Operation

i. Bank Rate Policy :

Is used as the main instrument of monetary control during the period of inflation. When the Central bank raises the bank rate, it is said to have adopted a dear money policy.

ii. Cash Reserve Ratio (CRR) :

To control inflation, the Central bank raises the CRR which reduces the lending capacity of the commercial banks.

iii. Open Market Operations :

Open market operations refer to sale and purchase of Government securities and bonds by the Central bank.

9. Fiscal Measures :

Fiscal measures to control inflation include taxation, Government expenditure and public borrowings. The Government can also take some protectionist measures (such as banning the export of essential items such as pulses, cereals and oils to support the domestic consumption, encourage imports by lowering duties on import items, etc.)

Conclusion :

This analysis focuses the effect of inflation and the controlling measures by Government. Inflation is a rise in the General level of prices of goods and services in all economy over a period of time. Economists generally agree that high rates of inflations and hyper inflation are caused by an excessive growth of the money supply. Today most main stream economists favour a low, steady rate of inflation. Low inflation may reduce the severity of economic recessions by enabling the labour market to adjust more quickly in a downtimes and reduce the risk that a liquidity trap prevents monetary policy from stability the economy.

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