International Journal of Innovative Research in Management Studies (IJIRMS)
ISSN (Online): 2455-7188
Volume 1 | Issue 2 | March 2016

CURRENT INFLATION IN INDIA

M.Unnikrishnan* **G.Arul Jones****

**I MBA - Gnanamani College of Technology, Namakkal*

***I MBA - Gnanamani College of Technology, Namakkal*

ABSTRACT

This article is about Current Inflation In India, it describes about cause, effect ,the best way to overcome, advantages, disadvantages of inflation .The International Monetary Fund notes that inflation is calculated using a country's consumer price index (CPI) which measures the average amount of consumers' cost of living expense for the year. Inflation is measured as the percent change in CPI over time, usually one year. Price stability can alternately be measured using gross domestic product (GDP) and core consumer inflation. GDP takes into account all of the goods produced in an economy, not just the consumer goods. Core consumer inflation is measured by excluding prices that are set by the government and those of volatile products, including food and energy that may change frequently.

Key Words: Consumer Price Index, Gross Domestic Product, Inflation, Retail Price Index, Wages

INTRODUCTION

Current Inflation India – the inflation is based upon the Indian Consumer Price Index. The index is a measure of the average price which consumers spend on a market-based "basket" of goods and services. Inflation based upon the consumer price index (CPI) is the main inflation indicator in most countries. Consumer Price Index (CPI) - A measure of price changes in consumer goods and services such as gasoline, food, clothing and automobiles. The CPI measures price change from the perspective of the purchaser.

DEFINITION

Inflation is defined as a sustained increase in the general level of prices for goods and services. It is measured as an annual percentage increase. As inflation rises, every dollar you own buys a smaller percentage of a good or service.

Inflation is the percentage change in the value of the Consumer Price Index (CPI) on a year - on year basis. It effectively measures the change in the prices of a basket of goods and services in a year.

In India, inflation is calculated by taking the CPI as base.

FORMULA

$$\textit{Inflation} = \frac{\textit{(CPI in month of current year-CPI in same month of previous year)}}{\textit{CPI in same month of previous year}} \times 100$$

NEED AND IMPORTANCE OF INFLATION

The data from the Consumer Price Index (CPI) and Retail Price Index (RPI) rates are used in many ways by the government and businesses, and play an important role in setting economic policy. That's because the Bank of England uses inflation to set interest rates. If the Bank's Monetary Policy Committee thinks CPI inflation will be above 2% in the next two years or so, it may increase interest rates to try to subdue it.

Conversely if it thinks inflation is likely to be below 2%, it may cut interest rates.
That's why inflation is a crucial factor in determining the rates banks charge for mortgages and the rates they offer on savings accounts. It also has a direct impact on some people's incomes. Anything that is described as index-linked rises in line with inflation, usually as measured by the CPI or the RPI. State benefits and many occupational pensions rise in line with CPI. Government index-linked savings products and some train ticket prices rise in line with RPI.

The basic state pension is currently governed by the so-called triple-lock, rising by the highest of CPI, average earnings or 2.5%. Some companies use the level of inflation to set annual pay rises. In recent years however, due to the effects of the recession, many pay settlements have fallen behind price rises.

Economics Help notes that high rates of inflation increase costs and make a country's exports less competitive in the global marketplace. Fluctuations in inflation, such as a large increase in prices followed by a decrease, can cause decreases in economic growth, reduce spending, decrease investments and increase interest rates. Any inflation over 10 percent per year is potentially problematic for the country's economy.

TYPES OF INFLATION

1. Creeping Inflation: When prices are gently rising, it is referred as Creeping Inflation. It is the mildest form of inflation and also known as a Mild Inflation or Low Inflation. According to R.P. Kent, when prices rise by not more than (i.e. Up to) 3% per annum (year), it is called Creeping Inflation.

2. Chronic Inflation: If creeping inflation persists (continues to increase) for a longer period, then it is often called as Chronic or Secular Inflation. Chronic-Creeping Inflation can be either Continuous (which remains consistent without any downward movement) or Intermittent (which occurs at regular intervals). It is named chronic because if an inflation rate continues to grow for a longer period without any downturn, then it possibly leads to Hyperinflation.

3. Walking Inflation: When the rate of rising prices is more than the Creeping Inflation, it is known as Walking Inflation. Trotting Inflation is it's another name. When prices rise by more than 3%, but less than 10% per annum (i.e., between 3%, and 10% per annum), it is called as Walking Inflation. According to some economists, we must take Walking Inflation seriously as it gives a cautionary signal for the occurrence of running inflation. Furthermore, if, not checked in due time, it can eventually result in Galloping Inflation.

4. Moderate Inflation: Prof. Samuelson clubbed together concept of Creeping and Walking inflation into Moderate Inflation. It happens when prices rise by less than 10% per annum (single digit inflation rate). According to him, it is a stable inflation and not a serious economic problem.

5. Running Inflation: A rapid acceleration in the rate of rising prices is called Running Inflation. It occurs when prices rise by more than 10% in a year. Though economists have not suggested a fixed range for measuring running inflation, we may consider a price increase between 10% to 20% per annum (double-digit inflation rate) as a Running Inflation.

6. Galloping Inflation: According to Prof. Samuelson, if prices rise by dual or triple digit inflation rates like 30% or 400% or 999% yearly, then the situation can be termed as Galloping Inflation. When prices rise by more than 20%, but less than 1000% per annum (i.e. between 20% to 1000% per annum), Galloping Inflation occurs. Jumping Inflation is its another name. India has been witnessing it from second five-year plan period.

7. Hyper Inflation refers to a situation where the prices rise at an alarming high rate. The prices rise so fast that it becomes very difficult to measure its magnitude. However, in quantitative terms, when prices rise above 1000% per annum (quadruple or four-digit inflation rate), it is termed as Hyperinflation. During a worst-case scenario of hyperinflation, the value of the national currency (money) of an affected country reduces almost to zero. Paper money becomes worthless, and people start trading either in gold and silver or sometimes even use the old barter system of commerce. Two worst examples of hyperinflation recorded in the world history are of those experienced by Hungary in the year 1946 and Zimbabwe during 2004-2009 under Robert Mugabe's regime.

CAUSES OF INFLATION IN INDIA

1. Increase in Money Supply: Over the last few years the rate of increase in money supply has varied between 15 and 18 per cent, whereas the national output has increased at an annual average rate of only 4 per cent. Hence the rate of increase in output has not been sufficient to absorb the rising quantity of money in the economy. Inflation is the obvious result.

2. Deficit Financing: When the government is unable to raise adequate revenue for its expenditure, it resorts to deficit financing. During the sixth and seventh Plans, massive doses of deficit financing had been resorted to. It was Rs. 15,684crores in the sixth Plan and Rs. 36,000crores in the seventh Plan.

3. Increase in Government Expenditure: Government expenditure in India during the recent years has been rising very fast. What is more disturbing, proportion of non-development expenditure increased rapidly, being about 40 per cent of total government expenditure. Non-development expenditure does not create real goods; it only creates purchasing power and hence leads to inflation. Not only the above mentioned factors on the Demand side cause inflation, factors on the Supply side also add fuel to the flame of inflation.

4. Inadequate Agricultural and Industrial Growth: Agricultural and industrial growth in our country has been much below what we had targeted for. Over the four decades period, food grains output has increased and-.i.e., of 3.2 per cent per annum. But there are years of crop failure due to droughts. In the years of scarcity of food grains not only the prices of food articles increased, the general price level also rose. Failure of crops always encouraged big wholesale dealers to indulge in hoarding which accentuated scarcity conditions and pushed up the price level. Performance of the industrial sector, particularly in the period 1965 to 1985, has not been satisfactory. Over the 15 years period from 1970 to 1985, industrial production increased at a modest rate of 4.7 per cent per annum. Our industrial structure, developed on the basis of heavy industry-led growth, is not suitable to meet the current demand for consumer goods.

5. Rise in Administered Prices: In our economy a large part of the market is regulated by government action. There are a number of important commodities, both agricultural and industrial, for which the price level is administered by the government. The government keeps on raising prices from time to time in order to cover up losses in the public sector. This policy leads to cost-push inflation. The upward revision of administered prices of coal, iron and steel, electricity and fertilizers were made at regular intervals. Once the administered prices are raised, it is a signal for other price to go up.

6. Rising Import Prices: Inflation has been a global phenomenon. International inflation gets imported into the country through major imports like fertilizers, edible oil, steel, cement, chemicals, and machinery. Increase in the import price of petroleum has been most spectacular and its contribution to domestic price rise is very high.

7. Rising Taxes: To raise additional financial resources, government is depending more and more on indirect taxes such as excise duties and sales tax. These taxes invariably raise the price level.

EFFECTS OF INFLATION IN INDIA

Inflation affects both the economy of a country and its social conditions, as well as the political and moral lives of its inhabitants. However, the economic effects of Inflation are stated and described below:

- Price inflation has immense effect on the Time Value of Money (TVM). This acts as a principal component of the rates of interest, which forms the basis of all TVM calculations. The real or estimated changes occurring in the rates of inflation lead to changes in the rates of interest as well.
- Inflation exerts impact on the treasury of a nation as well. In United States of America, Treasury Inflation-protected Securities (TIPS) ensures safety to the American government, assuring the public that they will get back their money. However, the rates of interest charged by TIPS are less compared to the standard Treasury notes.
- The most immediate effect of inflation is the decrease in the purchasing power of dollar and its depreciation. Inflation influences the investments of a country. The Inflation-protected Securities (IPSs) may act as a guard against the loss in the purchasing power of the fixed-income investments (like fixed allowances and bonds), which may occur during inflation.
- Inflation changes the allocation of income. This exerts maximum effect on the lenders than the borrowers at the time of persisting inflation, because the loans sanctioned previously are paid back later in the form of inflated dollars.
- Inflation leads to a handful of the consumers in making extensive speculation, to derive advantage of the high price levels. Since some of the purchases are high-risk investments, they result in

diversion of the expenditures from regular channels, giving birth to a few structural unemployment.

THE BEST WAY TO OVERCOME INFLATION IN INDIA

India's inflation is largely consumption driven. The central bank has unsuccessfully tried to moderate consumption by keeping key interest rates high. There were more than a dozen consecutive rate hikes. But consumption in India is not just tied with economic growth but also tied with public subsidies. The government runs huge subsidy bills through various 'populist' policies. Now there is a disparity in the activities of the central bank and the government. The central bank wants to moderate consumption while the government, by its subsidies, indirectly encourages consumption and thereby indirectly nullifying the effects of RBI. Now, India had unprecedented levels of growth prior to 2008 and inflation was seen as a good thing. Tweaking interest rates was a rather new concept in the Indian economy. There is no clear idea as to how increase in rates can lower consumption. Keep in mind that higher rates also stifle the economy and Indian economy has already crashed to historical lows. Economists like Swaminathan Aiyar have suggested the opposite- i.e. lowering rates to tame inflation like countries like Brazil and use of targeted subsidies. Now the rates have been lowered but economy is still yet to revive. Now while it is true that increase in fuel prices has an avalanche effect on prices- the motive is to reduce the fiscal deficit and reduce government spending. Other measures like direct cash transfers are also aimed at the same thing. These measures come with a lag and we have to wait and see the long term effects. But it’s true that fuel price increase will add on to inflation in the short run.

ADVANTAGES OF INFLATION

- **Deflation (a fall in prices – negative inflation) is very harmful**. During a prolonged period of deflation and very low inflation, the Japanese economy has suffered lower growth because of deflationary pressures. When prices are falling people are reluctant to spend money because they are concerned that prices will be cheaper in the future, therefore, they keep delaying purchases. Also, deflation increases the real value of debt and reduces the disposable income of individuals who are struggling to pay off their debt. When people take on a debt like a mortgage, they generally expect an inflation rate of 2% to help erode the value of debt over time. If this inflation rate of 2% fails to materialize, their debt burden will be greater than expected.

- **Moderate inflation enables adjustment of wages.** It is argued a moderate rate of inflation makes it easier to adjust relative wages. For example, it may be difficult to cut nominal wages (workers resent and resist nominal wage cut). But, if average wages are rising due to moderate inflation, it is easier to increase the wages of productive workers wages; unproductive workers can have their wages frozen – which is effectively a real wage cut. If we had zero inflation, we could end up with more real wage unemployment, with firms unable to cut wages to attract workers.
- **Inflation enables adjustment of relative prices.** Similar to the last point, moderate inflation makes it easier to adjust relative prices. This is particularly important for a single currency like the Euro zone. Southern European countries like Italy, Spain and Greece became uncompetitive, leading to large current account deficit. Because Spain and Greece cannot devalue in the Single Currency, they are having to cut relative prices to regain competitiveness. With very low inflation in Europe, this means they have to cut prices and cut wages which causes lower growth (due to effects of deflation). If the Euro zone had moderate inflation, it would be easier for southern Europe to adjust and regain competitive without resort to deflation.
- **Inflation can boost growth**. At times of very low inflation the economy may be stuck in a recession. Arguably targeting a higher rate of inflation can enable a boost in economic growth. This view is controversial. Not all economists would support targeting a higher inflation rate. However, some would target higher inflation, if the economy was stuck in a prolonged recession.

DISADVANTAGES OF INFLATION

Inflation is usually considered to be a problem when the inflation rate rises above 2%. The higher the inflation, the more serious the problem it is. In extreme circumstances hyperinflation can wipe away peoples savings and cause great instability, e.g. Germany 1920s, Hungary 1940s, Zimbabwe 200s. However, in a modern economy, this kind of hyperinflation is rare. Usually inflation is accompanied with higher interest rates so savers do not see their savings wiped away. However, inflation can still cause problems.

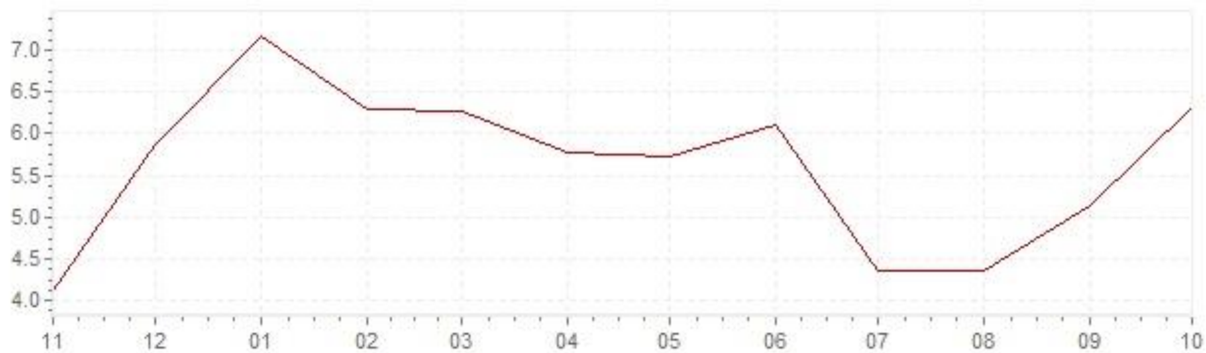
- Inflationary growth tends to be unsustainable leading to a damaging period of boom and bust economic cycles. For example, the UK saw high inflation in the late 1980s, but this economic boom was unsustainable and when the government tried to reduce inflation, it led to the recession of 1990-92.

- Inflation tends to discourage investment and long term economic growth. This is because of the uncertainty and confusion that is more likely to occur during periods of high inflation. Low inflation is said to encourage greater stability and encourage firms to take risks and invest.
- Inflation can make an economy uncompetitive. For example, a relatively higher rate of inflation in Italy can make Italian exports uncompetitive, leading to lower AD, a current account deficit and lower economic growth. This is particularly important for countries in the Euro-zone because they can't devalue to restore competitiveness.
- Reduce value of savings. Inflation leads to a fall in the value of money. This makes savers worse off – If inflation is higher than interest rates. High inflation can lead to a redistribution of income in society. Often it is pensioners who lose out most from inflation. This is particularly a problem if inflation is high and interest rates low.
- Menu costs – costs of changing prices lists which becomes more frequent during high inflation. Not so significant with modern technology.

TABLE NO.1 – CURRENT INFLATION INDIA (CPI) – LAST 12 MONTHS

Inflation(Monthly Basis)	Inflation	Inflation (Yearly Basis)	Inflation
October 2015 - September 2015	1.13 %	October 2015 - October 2014	6.32 %
September 2015 - August 2015	0.76 %	September 2015 -September 201	5.14 %
August 2015 - July 2015	0.38 %	August 2015 - August 2014	4.35 %
July 2015 - June 2015	0.77 %	July 2015 - July 2014	4.37 %
June 2015 - May 2015	1.16 %	June 2015 - June 2014	6.10 %
May 2015 - April 2015	0.78 %	May 2015 - May 2014	5.74 %
April 2015 - March 2015	0.79 %	April 2015 - April 2014	5.79 %
March 2015 - February 2015	0.40 %	March 2015 - March 2014	6.28 %
February 2015 - January 2015	-0.39 %	February 2015 - February 2014	6.30 %
January 2015 - December 2014	0.40 %	January 2015 - January 2014	7.17 %
December 2014 - November 2014	0.00 %	December 2014 - December 201	5.86 %
November 2014 - October 2014	0.00 %	November 2014 - November 201	4.12 %

CHART NO.1 – CURRENT CPI INFLATION INDIA (YEARLY BASIS) – LAST 12 MONTHS



CONCLUSION:

Inflation has remained in check for much of the past three decades. As a result, prices of goods and services have remained relatively steady. However, we must be on the lookout for factors that can lead to periods of high inflation. Prices of goods and services will rise. The rise may be caused by demand exceeding supply, or because the cost of making goods and services rises and that cost gets passed on to the consumer, or because there is too much money in the economy. Whatever the reason, or combination of reasons, we can expect some inflation in our economy. The inflation table and graph present the inflation rates during the last 12 months. The CPI inflation rates in the table are presented both on a monthly basis, compared to the month before, as well as on a yearly basis, compared to the same month last year.

REFERENCES

Book References:

Don Paarlberg "An Analysis and History of Inflation", Praeger, 1993.

Jordi Galí "Monetary Policy, Inflation, and the Business Cycle: An Introduction to the New Keynesian Framework", Princeton University Press, 2008.

Axel Leijonhufvud "Monetary Theory and Policy Experience", Palgrave, 2001.

Website References:

http://www.economicshelp.org

http://www. quora.com

http://www.ehow.com

*****