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A Study of Inflation and Its Relative Impact on the Indian Economy: Current Scenario.

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Abstract:

In economics, inflation refers to a general progressive increase in prices of goods and services in an economy. When the general price level rises, each unit of currency buys fewer goods and services; consequently, inflation corresponds to a reduction in the purchasing power of money. This paper made an attempt to assess the issues relating to inflation and its impact on Indian economy. The study examines that increasing price level could leads to reduction in purchasing power of the money. The common measure of inflation is inflation rate, the percentage change of a price index over time. India's retail inflation spikes to 6.07% in February, government data revealed. Today, most economists are in favour of low and stable rate of inflation. So, it is important to control inflation in order to minimise its impact on the economy.

Key words: Inflation, Purchasing power, Consumer Price Index, Economy

Introduction:

"Inflation poses a serious threat to growth dynamics. Whatever the cause, the fact remains that inflation is something that needs to be addressed with great urgency. [Dr. Manmohan Singh, Prime Minister of India, 4 February 2011, New Delhi]. Inflation is the rate of price growth over a given period of time. Inflation is usually a broad measure, such as an overall increase in prices or an increase in the cost of living in a country. But it can also be calculated more narrowly – for certain goods, such as food, or for services. In terms of policy objectives such as price stability, sustainable growth and financial stability, authorities need to manage inflation expectations and inflation risks for a variety of reasons. First, an environment of low and stable price inflation is considered a necessary condition for improving the growth and productive potential of the economy. Second, inflation expectations and the inflation risk premium are essential components for risk

assessment of financial products. According to the popular Fisher condition of interest parity, the nominal return on a financial asset should equal the sum of the real return and expected inflation. Expectations of higher inflation and risks would be reflected in higher nominal interest rates (Berument, 1999). Okun (1971) and Friedman (1977) argue that inflation is positively associated with inflation uncertainty, which is supported by a large body of empirical literature (Berument and Yuksel, 2002, Ball et al. 1992). In addition, a certain measure of inflation associated with greater expectations and risk than others may require frequent adjustments to policy instruments. Such a strategy may further exacerbate uncertainties with adverse consequences for investment and production activities. According to Rangarajan (1997), price volatility creates uncertainty in decision making. Rising prices adversely affect savings while making speculative investments more attractive. Second, the relationship of the inflation rate with policy instruments and intermediate target variables such as monetary aggregates become crucial. The authorities would be interested in whether and to what extent the condition of inflation is a monetary phenomenon. In this regard, based on Friedman's view that "inflation is a monetary phenomenon", price stability is understood as monetary stability (Issuing, 2000, Rangarajan, 1997). From the second point of view, there are two important applied problems. First, would alternative indicators of the inflation rate show a different relationship to monetary variables? Second, the choice regarding a particular measure of inflation is two-dimensional with respect to alternative measures of inflation and alternative monetary aggregates. Illustratively, indicators of inflation may show a different correlation with narrow money than broad money aggregates. Tight money, including currency and demand deposits, reflects the transactional demand for money (Gauge, 1992). On the other hand, the broad monetary aggregate includes interest-sensitive term deposits in addition to transaction demand. Some researchers use a broad monetary aggregate to explain the effect of wealth on consumption demand, in addition to the transactional demand for money (Bredin and Cuthbertson, 2001). Third, the structural aspect of the inflation rate indicator, particularly the persistence of inflation, related to the flexibility or rigidity in the pricing behavior of the manufacturing sectors, could also be another key issue for policy purposes. More persistent inflation may require more aggressive policy (Cecchetti and Debelle, 2004). Fuhrer and Moore (1995) show that when inflation is persistent, the output loss associated with disinflation is greater than when persistence does not exist. Bordo and Haubrich (2004) find that a key factor in the yield curve's ability to predict output growth is the persistence of inflation. They provide theoretical and empirical

evidence that the yield curve it has better predictive power in regimes with high inflation persistence. According to Bilke and Stracc (2007), in the medium term, authorities should place more emphasis on more permanent movements and ignore shocks that are likely to return soon. Putting this idea into practice would mean excluding less persistent inflationary processes or giving them less weight. Blinder (1997) stated that it is important for policy to consider "what portion of each monthly inflation observation is permanent and what portion is transitory." The choice between alternative indicators of the inflation rate in terms of dispersion and persistence indicators thus becomes extremely complex (Bilke and Stracca, 2007). A key lesson from the literature is that it is not the dispersion and persistence of inflation per se that is important. Rather, the consequences of the persistence of inflation for economic fundamentals regarding financial markets, aggregate demand and growth are relevant. These considerations may mean that a measure of inflation that is smooth and less volatile is preferred over a more volatile measure.

Growth and stability are two sides of the same coin. Insecurity never leads to the economic development of a country. Price fluctuations are not a good indicator of a country's development. In the time of the COVID-19 pandemic, inflation is slowly taking its toll on the Indian economy. On the one hand, there was a drop in demand due to a drop-in economic activity. On the other hand, supply chain disruptions have caused drastic changes in the rate of food price inflation that persist throughout the life of the economy. Inflation is an unpredictable phenomenon and occurs in every economy. It is necessary to control the level of inflation to balance the growth and development of the economy. A common measure of inflation is the inflation rate, the annualized percentage change in the general price index. Because prices do not all rise at the same rate, the Consumer Price Index (CPI) is often used for this purpose. The Consumer Price Index (CPI), the Personal Consumption Expenditure Price Index (PCEPI), and the GDP deflator are some examples of broad price indices. Today, most economists favour a low and stable rate of inflation. Low (as opposed to zero or negative) inflation reduces the severity of economic recessions by allowing the labour market to adjust more quickly in downturns and reducing the risk that a liquidity trap prevents monetary policy from stabilizing the economy while avoiding associated costs. with high inflation. The task of maintaining a low and stable rate of inflation is usually entrusted to the monetary authorities. Generally, these monetary authorities are central banks that control monetary policy by setting interest rates, conducting open market operations, and changing the reserve requirements of commercial banks. Core inflation is a measure of inflation for the subset of consumer prices that excludes food and energy

prices, which are rising and will fall more than other prices in the short term. The Federal Reserve Board pays particular attention to the core inflation rate to obtain a better estimate of long-term future inflation trends overall.The rate of inflation is most often calculated by determining the movement or change of a price index, typically the consumer price index. The inflation rate is the percentage change in the price index over time. The Retail Price Index is also a measure of inflation commonly used in the UK. It is broader than the CPI and includes a larger basket of goods and services. The level of inflation is defined as a steady increase in the overall price level of goods and services. In India, inflation is measured as the percentage change in the wholesale price index (WPI) of a basket of goods and services in annual terms. According to the Economic Times, the inflation rate is the percentage change in the wholesale price index (CPI) value on an annualized basis. It reflects changes in the prices of a basket of goods and services during the year. The Consumer Price Index (CPI) is used to measure the rate of inflation in India.

Effects of Inflation:

There is no sector in the industry that is immune from the adverse effects of inflation. Inflation can occur in any service or product, including but not limited to real estate, pharmaceuticals, cosmetics, automobiles, and travel.Once inflation becomes a recurring phenomenon, there is no guarantee that it will return to normal. Inflation is a big problem because it reduces the value of money saved today. Moreover, inflation systematically spoils the purchasing power of the customer.Inflation may not be an umbrella term for all things that go wrong in the economy. Inflation is often considered important for maintaining and managing consumption. Inflation keeps businesses profitable without forcing consumers to wait for prices to drop to a certain level before making a purchase. It is no news that governments around the world have increased their fiscal spending in response to the pandemic, and India is no exception. In addition, central banks have pumped in a lot of liquidity to deal with the uncertainties associated with the lockdown and the pandemic.As the world recovers from the pandemic, US inflation rates and economic policy decisions continue to drive global trends. Higher global inflation would directly or indirectly lead to higher domestic prices through dependence on imported goods and services.India's central bank has fresh inflation concerns as the rupee continues to weaken against the US dollar. This sudden depreciation was the result of rising commodity and oil prices. The unexpected second wave of Covid caused a fundamental miscalculation in the

banks' inflation estimates.Moreover, the RBI's support to lower G-Sec yields to increase liquidity erodes the value of the currency and further pushes inflation.The new local lock-ins are expected to cause a long-term rift on the Indian supply side. As cases and deaths from covid mount, local state and city governments are forced to impose curfews, lockdowns and other restrictions. These government actions disrupt the movement of the supply chain, leading to higher prices.

Key sectors affected by inflation –

1. Aviation and Hospitality-

Revenues in the airline industry are falling at an alarming rate due to continued inflation. A rise in the price of base oil causes an increase in the price of fuel and will directly result in higher airfares, route cancellations and a significant reduction in overall demand in the airline industry.As a result of ever-increasing inflation, people's spending capacity or disposable income decreases and people avoid trips or vacations in general to save and spend money on necessities. When people don't use hospitality services like restaurants and hotels, it directly affects the entire industry. Additionally, inflation results in higher prices for land, food and wages, which are key to the functioning of the hospitality ecosystem.Without much government support and policies aimed at the leisure and tourism industry, the entire industry suffers in the most obvious way during the cycle of peak inflation.

2. Automobile and its allied industries-

Rising inflation is one of the most fundamental issues facing car manufacturers and buyers. The rising cost of basic production equipment directly means that the consumer will have to pay more. The industry ecosystem is facing the most resistance with commodity inflation, lower discounts, operating leverage and cost cutting strategies.It is not only production prices that skyrocket during inflation, but also interest rates on loans. Higher interest rates have an impact on vehicle sales. In addition, there may also be a shift in tax policy in the economy as an escape tool to manage inflation by the government, making it even more difficult to close auto loans.With these factors affecting the buy and sell side of the auto industry, inflation is a concern.

3. Industries associated with raw materials such as sugar, oil, grains-

Regardless of whether you are a buyer or a producer, you may have recently witnessed a gradual but noticeable increase in prices for all types of products. The most obvious and

fundamental is the rise in prices in the aisles of your local supermarket.When increased prices of raw materials increase prices for consumers, the situation is called cost inflation. Lockdowns around the world have forced workers and manufacturers to stay at home, resulting in shortages and reduced production capacity.On the other hand, consumers pre-stocked and increased their demand by 4%. This has led to an imbalance in the system and has led to an increase in prices across the ecosystem of raw materials including but not limited to sugar, refined oils, grains, pulses, etc.Even though the government is trying to keep a check on the increased prices in the food space, it is not possible to control and manage every small increase, which makes it difficult to manage inflation.Core inflation, excluding food and fuel and light items, is at 5.64%, the highest in two years. The increase in transport costs is the main reason for higher inflation, which rose by 11.16% in October. The prices of buses, taxis, autorickshaws and rickshaws have increased, mainly because petrol and diesel are now more expensive as the government has increased the excise duty on them. The government's reliance on fuel taxes has increased, reflecting higher inflation. Gasoline and diesel used for vehicles fall under the CPI transport category, not the fuel category. Another major reason for the high core inflation is the rise in inflation in the pan, narcotics and tobacco segments. Interestingly, foreign alcohol and beer cost 22.32% and 25.32% more than last year, respectively. The government raised taxes to increase its revenue. Inflation in the personal segment is 12.07% in October. The prices of gold, silver and other ornaments are increasing significantly by 33.77%, 36.66% and 20.52%. Inflation in the personal segment is 12.07% in October. The prices of gold, silver and other ornaments rose significantly, rising by 33.77%, respectively. 36.66% and 20.52%. Inflation in the health category increased by 5.22%, the highest in 2019. In October, the price of domestic cooking gas increased by 10.16%, while kerosene without PDS increased by 8.28%.

Conclusion:

The inflation rate indicator is not directly monitored; it is derived as a percentage increase of the monitored aggregate price indices between two time periods. In general, the rate of inflation defined as the rate of growth of the aggregate price index between two discrete time periods can be statistically derived for different frequencies such as weekly, monthly, quarterly and annually. In practice, however, central banks measure the rate of inflation as a year-on-year percentage increase in the price index. The reform of the financial sector mainly consists in reducing the legal liquidity indicator and rationalizing subsidized loans

to priority sectors, loosening interest controls and restricting companies' access to capital markets and greater autonomy of public sector banks. The rate of inflation in general and food inflation in particular has been a persistent problem in India in recent years. The pandemic caused both a demand and supply shock. Both wholesale and retail inflation continued to rise as a result of the pandemic. The main reason for the rise in inflation in India is the sharp rise in commodity prices. The government should take safeguards to ensure the country's security of supply to stimulate the economy and keep production costs low. The implementation of monetary policy is the main tool to keep the inflation rate low.

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