Growth and Inflation in the Indian Economy

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Introduction: In India Inflation is a persistent rise in the price level in an economy. The price level refers to the average price of goods and services in the economy. Inflation arises when the demand for goods and services in an economy exceeds the supply of same. Inflation is a determinant in functioning of any economy. India is a country with a mixed economy model that comprises both capitalism and socialism; hence the challenges faced are vital for its growth model. The recent rise in inflation has been found to consist of several political and economic crises under the prime ministry of Dr Manmohan Singh. == contesting on the challenges faced; several economists have questioned the method of measuring inflation to be faulty. The present day process being used in India has been The Wholesale Price Index while several other developed countries adopt the Consumer price index to calculate inflation.

Issues: The challenges faced by a 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 mobilization 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.

The Optimal Inflation Rate Money Supply and Inflation: The Quantitative Easing by the central banks with the effect of an increased money supply in an economy often helps to increase or moderate inflationary targets. There is a puzzle formation between low-rate of inflation and a high growth of money supply. When the current rate of inflation is low, a high worth of money supply warrants the tightening of liquidity and an increased interest rate for a moderate aggregate demand and the avoidance of any potential problems. Further, in case of a low output a tightened policy would affect the production in a much more severe manner. The supply shocks have known to play a dominant role in the regard of monetary policy. The bumper harvest in 1998-99 with a buffer yield in wheat, sugarcane, and pulses had led to an early supply condition further driving their prices from what were they in the last year. The increased import competition since 1991 with the liberalization in place have widely contributed to the reduced manufacturing competition with a cheaper agricultural raw materials and the fabric industry. These cost-saving driven technologies have often helped to drive a low-inflation rate. The normal growth cycles accompanied with the international price pressures has several times being characterized by domestic uncertainties.

Global Trade: Inflation in India generally occurs as a consequence of global traded commodities and the several efforts made by The Reserve Bank of India to weaken rupee against dollar. This has been regarded as the root cause of inflation crisis rather than the domestic inflation. When the US dollar has shrieked by a margin of 30%, RBI had made a massive injection of dollar in the economy makes it highly liquid and this further triggered off inflation in non-traded goods. The RBI picture clearly portrays for subsidizing exports with a weak dollar-exchange rate. All these account for a dangerous inflationary policies being followed by the central bank of the country. Further, on account of cheap products being imported in the country which are made on a high technological and capital intensive techniques happen to either increase the price of domestic raw materials in the global market or they are forced to sell at a cheaper price, hence fetching heavy losses.

Factors: 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 550 units of a commodity but the actual demand in the country is 700 units. Hence, as a result of which due to scarcity in demand 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. These supply driven factors have basically have a fiscal tool for regulation and moderation. Further, the global level impacts of price rise often impacts inflation from the supply side of the economy.

Domestic Factors: The underdeveloped 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. Similarly Hoarding has been a problem of major concern in India where onions prices have shot high in the sky. There are several other stances for the gold and silver commodities and their price hike.

External Factors: The exchange rate determination is an important component for the inflationary pressures that arises in the India. The liberal economic perspective in India affects the domestic markets. As the prices in United States Of America 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 measures that depict the competitiveness and challenges for the economy.

Value: The inflation rate in India was recorded at 4.70 percent in May of 2013. Inflation Rate in India is reported by the Ministry of Commerce and Industry. Historically, from 1969 until 2013, India Inflation Rate averaged 7.73 Percent reaching an all time high of 34.68 Percent in September of 1974 and a record low of -11.31 Percent in May of 1976. In India, the wholesale price index (WPI) is the main measure of inflation. The WPI measures the price of a representative basket of wholesale goods. In India, wholesale price index is divided into three groups: Primary Articles (20.1 percent of total weight), Fuel and Power (14.9 percent) and Manufactured Products (65 percent). Food Articles from the Primary Articles Group account for 14.3 percent of the total weight. The most important components of the Manufactured Products Group are Chemicals and Chemical products (12 percent of the total weight); Basic Metals, Alloys and Metal Products (10.8 percent); Machinery and Machine Tools (8.9 percent); Textiles (7.3 percent) and Transport, Equipment and Parts (5.2 percent).

Monetary Policy and Growth: A noteworthy feature of Indian growth process over the last one and a half decades has been its stability. This is evident from the substantially lower coefficient of variation of real GDP growth during the post-reform period as compared to that during the pre-reform period, that is, before the nineties. It is also important to note that India's growth is driven by domestic consumption, contributing on an average to almost two-thirds of the overall demand, while investment and export demand are also accelerating. As consumption is less volatile component of demand, this has also contributed to reducing the volatility of GDP.The inflation rate accelerated steadily from an annual average of 1.7% dur f 1.7% during the 1950s to6.4 % during the 1960s and further to 9.0 % in the 1970s before easing marginally to 8.0 % in the1980s. India had generally not experienced runaway inflation. On the other hand, the volatility in the inflation rate, as measured by the coefficient of variation, which was fairly high in the 1950s at 4.4, moved in a narrow band of 0.4–1.0 in the subsequent decades, thus reducing the inflation-risk premium. The pickup in inflation rate from 1970s onwards reflected the impact of a sharp rise in money supply growth and also partly supply shocks from crude oil prices and crop failures. Demand pressures, emanating partly from the widening fiscal imbalances, also contributed to inflationary pressures in the 1980s. The second half of the 1990s was marked by a significant turnaround in the inflation outcome reflecting the improved monetary-fiscal interface. The "Great Moderation": One of the defining characteristics of global economic developments over the last three decades has been termed the ―Great Moderation― –the sustained decline in the volatility of output and inflation. This development has been due to the structural changes that many economies have undergone. Some have attributed these changes to the implementation of better policy options and others to simply good luck. Professor Kenneth Rogoff of Harvard University has argued on many 7occasions that improved competitiveness as a result of increased globalization coupled with better policies has had a major positive impact on inflationary trends in many countries. The declining. The declining trend in inflation since 1990 is clearly evident in India and South Africa. Inflation in India has declined steadily from an

average of 10.3 % between 1990–1994, to 8.9 % during 1995–1999 and to4.3 % in this decade. Similarly in South Africa, inflation has declined from an average of 12.5 %, to7.3 % and to 5.1 % over the same time periods. The economic growth performance of both countries has also been quite impressive. Since 1990, India has experienced average growth rates of around 6% per annum. Inflation could hamper economic growth mainly due to the following reasons Economies that are not fully adjusted to a given rate of inflation usually suffer from relative price distortions caused by inflation. Nominal interest rates are often controlled, and hence real interest rates become negative and volatile, discouraging savings. Depreciation of exchange rates lags behind.

How Rising Inflation Affects The Economic Growth Of India?

As the inflation is raising so the people would not be able to spend their money on other goods other than food. So in this way the demand for other goods other than food would fall and ultimately the profit as well as revenue of all the sectors would fall due to which all private companies would start cutting their work force and thus unemployment would rise and it ultimately affects our country GDP which is used to measure Economic growth of a country.
Inflation could hamper economic growth mainly due to the following reasons: Economies that are not fully adjusted to a given rate of inflation usually suffer from relative price distortions caused by inflation. Nominal interest rates are often controlled, and hence real interest rates become negative and volatile, discouraging savings. Depreciation of exchange rates lag behind inflation, resulting in variability in real appreciations and exchange rates.Real tax collections do not keep up with inflation, because collections are based on nominalincomes of an earlier year (the Tanzi effect) and public utility prices are not raised in line withinflation. For both reasons, the fiscal problem is intensified by inflation, and public savings may bereduced. This may adversely affect public investment. High inflation is unstable. There is uncertainty about future rates of inflation, which reduces the efficiency of investment and discourages potential.

India must reduce inflation or it risks stunting its growth: Recently the Indian Central Statistical Organisation (CSO) forecast that the Indian economy is projected to expand by 8.6 per cent in the current fiscal year to a record US$1.73 trillion (Dh6.35tn). At this level of nominal GDP, India's per capita income inches up to above $1,200, putting it on the path to becoming a middle-income country. These numbers have been gleefully trotted out by every policy expert in New Delhi as proof of India's impressive growth trajectory. India's growth spurt is driven by high domestic savings rates, growing domestic demand and consumption and a globalised economy that is rewarding the Indian companies' newfound competitiveness. "While all these may make it harder to get soft loans for social sector projects, these are welcome growing pains," says Professor Ravi Bapna, who divides his time between the University of Minnesota's Carlson School of Management and the Indian School of Business in Hyderabad. Critics in the social sector say India's growth numbers are something of a double-whammy: not only are they mere window-dressing that masks India's underlying problems; they also make it harder for India to become eligible for multilateral soft loans for social sector projects. For a country that runs large deficits, and where large sections remain outside the mainstream, all these pose new challenges. While India's international prestige has been steadily rising, its eligibility for aid has been heading in the other direction. India's economic indicators have been steadily improving since 1991, but it is only recently they have started galloping. Some economists predict India's growth rate is likely to overtake China's this decade. The primary evidence for this argument is that

demographic trends are quite favourable to a rapidly increasing workforce in India, while China's demographics are slowly turning the other way. Even as China slows to absorb overbuilt capacity, India is struggling to invest enough to keep pace with the demand for infrastructure - power, roads and ports. This suggests India's growth may exceed that of China. While persistent high growth over the past few years has attracted international attention, it papers over many worrying issues. The most important of these is inflation. India is caught in the classic negative spiral that hits many an emerging economy: high inflation, which reduces demand, leading to capital exodus and a decline in investment. But whether the current government has the political will to curb inflation is questionable. "Taming inflation would require the government to reduce its fiscal deficit. However, rising oil prices and a slew of populist social infrastructure projects on employment, food security and education are going to make this a challenge," says Professor Chetan Subramanian, who specialises in international macroeconomics at the Indian Institute of Management, Bangalore. The forthcoming state assembly elections will further reduce the probability of curbing government spending. The impact of inflation has been driven home over the past few months in particular because onion prices quadrupled during the previous quarter. Onions have a special place in Indian homes - as they do for Indian politics. A rise in onion prices has been blamed for the defeat of at least two previous governments. The incumbent Congress Party-led United Progressive Alliance (UPA) government is fervently hoping that past is not prologue in this case. Much talk has taken place over inflation but nothing much has been accomplished. The weather, which thankfully has improved for crops, will probably bring down food inflation over coming months. In the medium term, the government has to increase its focus on the agricultural sector and free up its bottlenecks, with a view to reducing food price inflation. India runs a persistently high single to low double-digit combined fiscal deficit (at the state and central government level) and a reasonably high current account deficit of 4 per cent of GDP. This implies that the government's ability to simply add more social programmes is limited. Already the Mahatma Gandhi National Rural Employment Guarantee Scheme is considered to be the world's largest social programme with an annual budget of about $10 billion. India's collapsing markets demonstrated last week what has been obvious for some time: financing a large and growing current account deficit requires continued capital flow from the developed world. India may well become a resource poor country that is considered too "rich" to deserve support for large-scale social programmes. An embarrassment of riches at the overall level hides several underlying problems. Hopefully, the government will realise sooner rather than later the flip side of robust growth numbers is better utilisation of existing financial resources, particularly those targeted towards social initiatives. With increasing prestige comes increasing responsibility. With Pranab Mukherjee, the finance minister, preparing to present the Union Budget 2011 on February 28, the Indian media is abuzz with news and views on how to cure the country's ills and carve a path to a brighter future.

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