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Inflationary Trends in India (1969-2019)

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Abstract

Exploring inflationary fluctuations in India across the past five decades and determining what factors contributed to extremely high and low rates. Indian scenario has experienced vast differences with significant twists given the pre-reform period (also, post-independence period) and the post-reform period. The paper analyzes the measures taken by the government; developing fiscal and monetary tools in the face of such fluctuations within this time frame i.e. 1969-2019. Additionally, the paper observes the impact of inflation across different sectors of people. And finally, the paper aims to provide solutions to remedy these volatile inflationary fluctuations; for a developing country like India.

Keywords: *Inflationary trends, Factors, Government's response, Economy, Five decades, Policies - Impact*

1.0 Introduction

Inflation is merely an increase in the general price level of goods and services over different periods. In short, such an increase pulls upwards the cost of living. Historically, India followed the Wholesale Price Index (WPI) to measure inflation i.e. an index that measures and tracks the changes in the price of goods in the stages before the retail level implying goods that are sold in bulk and traded between entities or businesses instead of consumers. Usually expressed as a ratio or percentage, the WPI shows the included goods' average price change and is often seen as one indicator of a country's level of inflation. But after April 2014 India used the Consumer Price Index (CPI) as a tool for measuring inflation (like the majority of other nations.) The index is then calculated by dividing the price of the basket of goods and services in a given year (t) by the price of the same basket in the base year (b). This ratio is then multiplied by 100, which results in the Consumer Price Index. In the base year, CPI always adds up to 100.

2.0 Literature Review

Inflation is an economic concept and inflationary rates are desired to stay within 2-3 per cent rates. Although, extreme inflation or disinflation (of more than 4-5 per cent) harms the other economic parameters like employment and economic growth.

Studying various papers and books, it is revealed that such extreme fluctuations are not due to a single factor or perhaps due to a pattern of similar factors. It is a resultant of a blanket of factors occurring in the economy that affects the inflation rates in a given period of time. As per the Hindu Business Line newspaper, the fluctuations in inflation in India were due to a combination of poor agricultural productivity and high dependence on monsoon; commodity price shocks (especially, the oil prices), and finally, due to global business cycles and wars.

Further, according to the analysis of the UK essays journal, these trends in the change in inflation were brought about by different factors occurring in different periods. As per the economists who wrote this essay in 2015, one of the highest contributing factors to inflation in the 1990s was the surge in oil prices; which almost doubled the prices. But, at the same time, other factors like specious policies of the government during the preceding years, the mini-oil shock post the outbreak of the Gulf War, the surge in the price of food products, and the slow-pacing industrial growth sector also played a major role in determining the inflation. Following the end of the 21st century, low inflation was enjoyed but it again rose due to an increase in oil prices, prices of agriculture products like oilseeds, edible oils, and government expenditure in the fiscal year 2002-03. In 2008 and 2009, the inflation was up and crossed the 8% point rate because of crude oil prices, reduction of interest rates by the government, increased the money supply by printing of new notes, and increase in prices of food products. Thus, economists analyze several factors causing inflation. Thereby, no single factor can be blamed and even a short period of one year's inflation is experienced due to several factors affecting each other directly or indirectly. Thus, this paper aims to explore these factors in further detail.

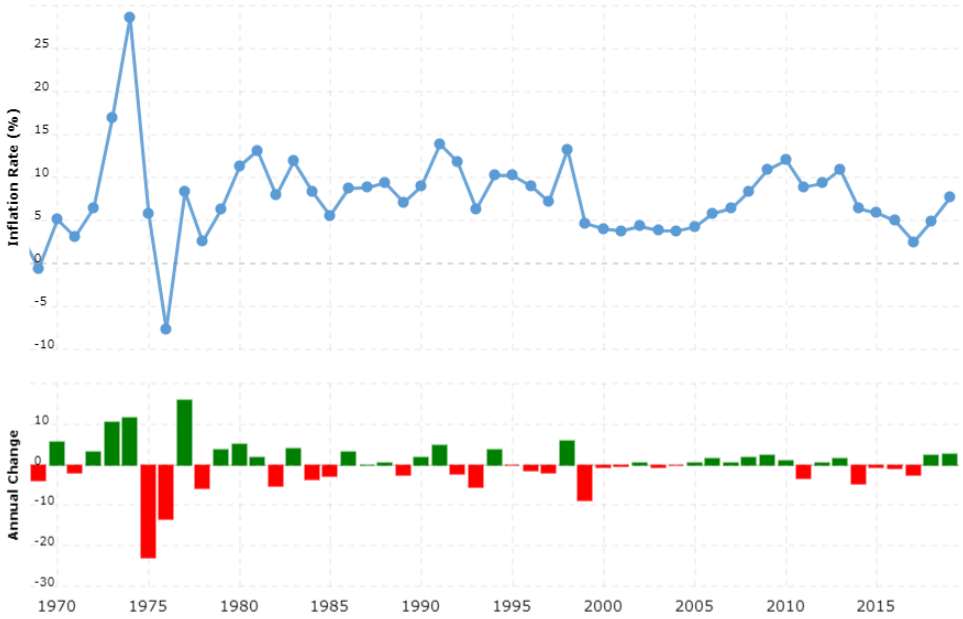
However, as per the financial express journal, the economists argue that "what explains the great Indian inflation decline is buried in a line which states that with domestic control barriers, the dominant determinant of Indian inflation is the procurement price (minimum support prices) for food." This poses a partially erroneous claim as even if the procurement prices of food are controlled; external factors (like the oil crisis or a financial meltdown etc) still have enough power to stretch the inflation to extreme rates.

On the other hand, in the face of such polar fluctuations, the former RBI Governor and RBI economist Raghuram Rajan approved a very recent RBI study (What is responsible for India's sharp disinflation) to combat such a situation. "This study, he stated, had three important conclusions: "first, that the good inflation news follows from a combination of good food management by the government, good luck because of external factors such as lower crude prices, and monetary policy, including the new framework." In line with the same argument, it is agreeable as per The Hindu newspaper's article stating that the improved supply response, improved financial and real economy, better monetary policy, and emphasis on fiscal consolidation are all that help bring down inflation. This paper aims to explore these government defences in a rigorous and analytical form.

3.0 Methodology

The initial perspective was put along the economic lines through making an in-depth study with an analytical and rigorous approach. I was exposed to a deeper insight through newspapers and journals of The Hindu Business Line, Financial Express, UKessays, Livemint and research papers of Bhagwati Paraksh Sharma titled- "Inflation in India" and Khatkhate titled- "The Impact of Inflation on India's Economic Development." Further, my approach was shaped with improved ideals and I was able to better understand the government's response in each period with the help of the book- 'Inflation in India' and through the book - 'An Analysis of Monetary Policy in India'; both published by Shodhgonga. I extracted the quantitative data from RBI's handouts available online and studied the trends collectively from the government's economic surveys, privately available Macro Trends, and Statistia websites enabling a comparative view of inflationary trends.

Trends of inflation in India:



Source: MacroTrends, 2019

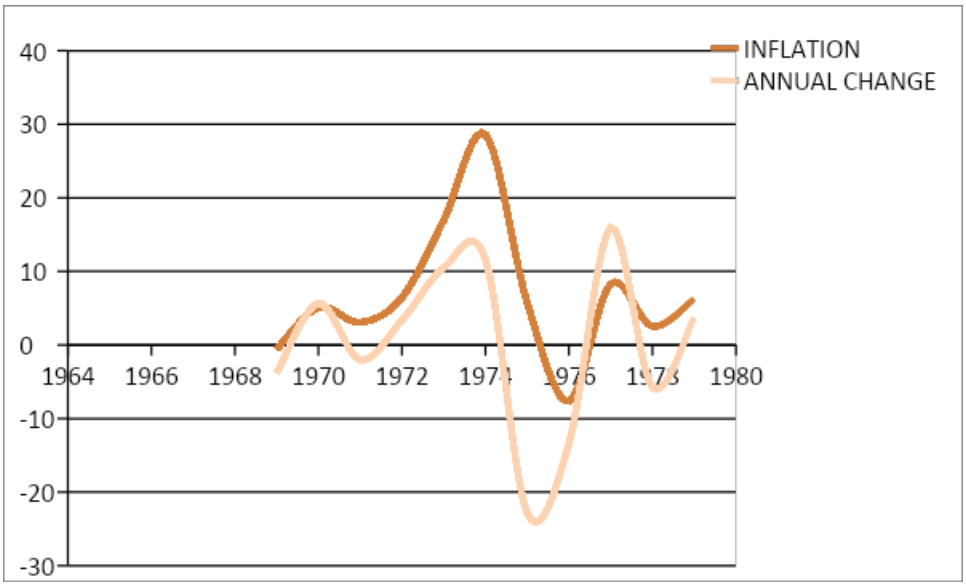
Period	Average Inflation	Range
1966-67 to 1970-71	6.7	-0.91 to 13.95
1971-72 to 1975-76	12.0	-1.1 to 25.2
1976-77 to 1980-81	8.5	0.0 to 18.2
1981-82 to 1985-86	6.5	4.4 to 9.3
1986-87 to 1990-91	7.8	5.8 to 10.3
1991-92 to 1995-96	10.6	8.1 to 13.7
1996-97 to 2000-01	5.0	3.0 to 7.2
2001-02 to 2009-10	5.4	3.8 to 12.3
2010-11 to 2018-19	7.3	4.7 to 10

This graph and the table show the inflation rates, their annual changes, and inflationary range (decade-wise) from 1969 to 2019.

Source: Statistia

4.0 Pre Reform Period :

4.1 1969-1979



Source: Macro Trends, 2020

This graph shows the fluctuations in inflation in India from 1969 to 1979. 1969 embarked with the nationalizing of major banks and a focus by the monetary policymaker on 'credit planning'. This eventually mirrored fiscal dominance in this period.

As the 1970s began, most trembling storms hovered the upcoming period. War of India with Pakistan in 1971, the twin blow of Kharif crop failure due to severe droughts coinciding with the worldwide oil crisis in 1974-75 led to shooting up of inflationary rates to above the 20% level. Moreover, the breakdown of the Bretton-Woods system of global exchange rate arrangements in 1973 further added to these inflationary problems.

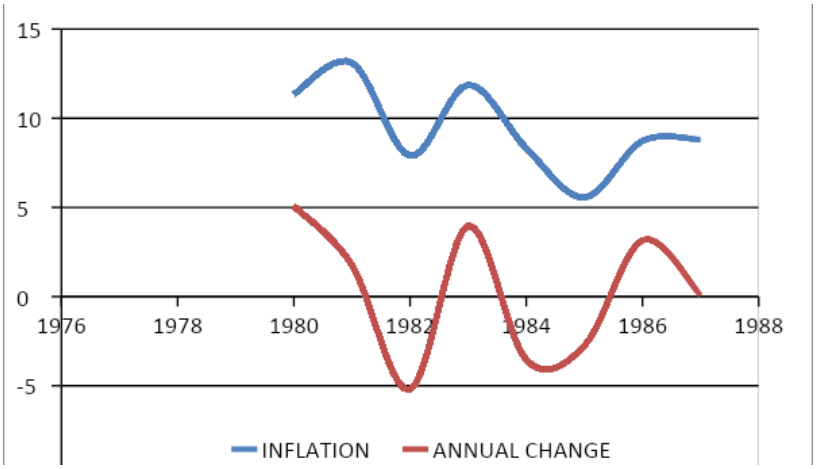
Not only the supply side of the Indian economy was suffering but also an excess domestic demand was witnessed in these periods. During the early half of the seventies, the average growth rate in food grains production was a mere 0.30 per cent, whereas money supply and investment demand grew above 15% and 14% respectively (chapter 5, Inflation in India). These indicated instances of excess demand building up. After this period, the monetary and fiscal constraints kept the rates fairly low until 1979 i.e. an average of 3.04 per cent.

Thus, no single factor had contributed to the pressures created on inflation. This entire period shows that on one hand, the structural system changes (national or global) can pull up the inflationary rates. On the other hand, even factors like warfare and conflicts can significantly contribute to such fluctuations.

4.2 1980-90

Years	Inflation	Annual change
1980	11.3461	5.07
1981	13.1125	1.77
1982	7.8907	-5.22
1983	11.8681	3.98
1984	8.3189	-3.55
1985	5.5564	-2.76
1986	8.7297	3.17
1987	8.8011	0.07
1988	9.3835	0.58
1989	7.0743	-2.31

Source: Macro Trends, 2020



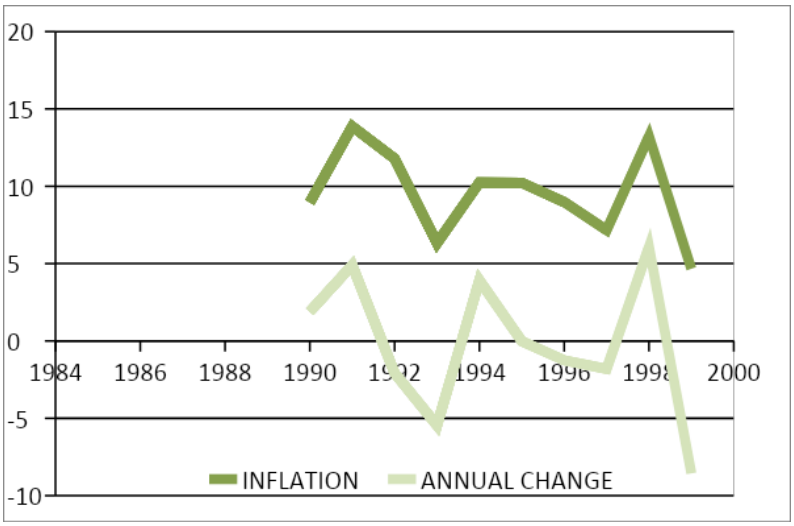
This graph and table show the fluctuations in inflation in India for the 1980s.

The dominance of fiscal policy over monetary policy was again witnessed with the advent of the 1980s. This was due to the borrowing of loans from the International Monetary Fund (IMF) to fight the BOP crisis and the already high inflation. The system of ad hoc treasury bills which began in 1956, for temporary financial accommodation to the government from the RBI, became the dominant instrument of automatic monetization of budgetary deficit (Mohanty, 2017). To accumulate more funds, the Statutory Liquidity Ratio (SLR) and Cash Reserve Ratio (CLR) rates were raised to 37% and 10% of NDTL respectively by 1985. Additionally from 1985, the focus of monetary triggering was shifted to inflation management through control of money supply via a framework where reserve money (M0) was used as an operating target and broad money (M3) as an intermediate target (Mohanty, 2017). As a consequence, many money market instruments like CDs, CPs, etc., were introduced.

At the beginning of the 1980s, India was attacked by the ongoing external supply shocks i.e. the global hikes in oil prices which caused power shortages and transport facilities. It led to an overall industrial recession squashing the necks further of infrastructure building. On the other hand, however, the 1980s enjoyed the maturing of the Green Revolution in agriculture leading to improvements in crop output and yields. Hence where shocks and fluctuations can easily dictate the volatile rates of inflation, the system checks it using several monetary instruments and thrives to keep the rates within ideal limits. Also as the input availability decreases, it is reflected in its prices and eventually all retail prices (if the input is a common one.)

4.3 Post Reform Period

4.4 1991-1999



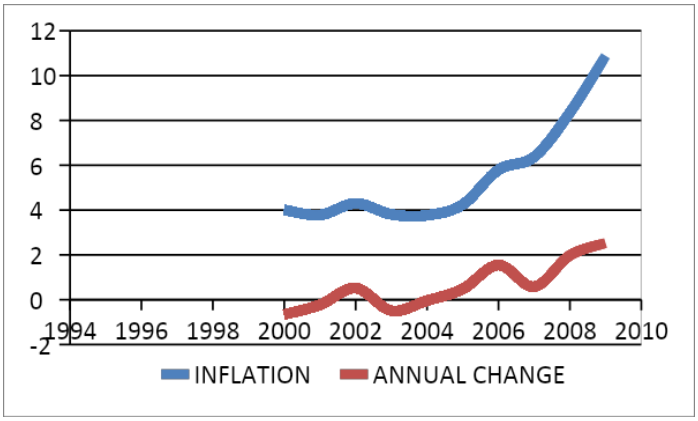
Source: Macro Trends, 2020.

This graph shows the fluctuations in inflation in India from 1991 to 1999. Source: Macro Trends, 2020.

The Economic Reform policy's (also, 'New Economic policy') execution by the former Prime minister involved obtaining borrowings from the IMF and the World Bank which imposed certain conditions. The conditions so forth led to the devaluation of the rupee and thus increases in general pricing. This impacted four to five years in the 1990s of inflationary rates around 10-15%. There was a further shift in the financial paradigm of the economic structure, now the monetary and fiscal policies had a dual focus on the market-determined interest as well as the exchange rates.

In the second half of the 1990s, there had been a constant deceleration of inflation alongside the monetization of government budget deficit which was given away in 1997. RBI was able to shift from direct instruments to indirect market-based instruments in its liquidity management operations (Mohanty, 2017). This deceleration was due to the reduction in the money supply by the government from 18 per cent to 16.3 per cent (chapter 5, Inflation in India), reduced external oil price pressures, and also due to improved monetary and fiscal management.

4.5 2000-2009



Source: Macro Trends, 2020

Years	WPI Inflation
2000-01	7.16
2001-02	3.6
2002-03	3.41
2003-04	5.46
2004-05	6.48
2005-06	4.5
2006-07	6.6
2007-08	4.67
2008-09	3.81
2009-10	8.06

This graph and table show the fluctuations in inflation in India from the beginning of 2000 till 2010. Following 2000, despite the growing difficulties on domestic and international developmental fronts accruing to the Kargil conflict and surge in oil prices, there was high real GDP in the economy.

However, it came to RBI's notice that global integration in the aspect of financing with nations for development had made domestic monetary planning a tough and multidimensional task. Inflation was now also affected by capital flows and the movements in international commodity prices.

In the face of this challenge, RBI adopted a LAF (liquidity adjustment facility) with repo auctions in 2000, as an operating aid to manage liquidity and influence the rate variables. To manage liquidity pressures emanating from large and persistent capital flows, sterilization operations were undertaken through the LAF and open market operations, supported by the Market Stabilisation Scheme. (Mohanty, 2017)

Where large amounts of net capital flows (mainly from the US) out-stripped the Current Account Deficit (CAD), the pressure was built on the monetary policy arrangements. Consequently, the net foreign exchange reserves with RBI peaked at 157% in 2007-08. To curb the mounting inflationary pressure and adjust demand in the economy to contain the inflation expectations, RBI marched upon continued tightening monetary measures. One of the measures involved raising CRR by 300 base points!

Considering that inflationary pressures were rising due to faster growth and occasional supply shocks emanating from food and crude oil prices, RBI initiated an imposition of a target medium-term ceiling to condition policy and expectations for inflation in the range of 4.0-4.5 per cent.

4.6 2010-2019

Years	WPI Inflation
2000-01	7.16
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2003-04	5.46
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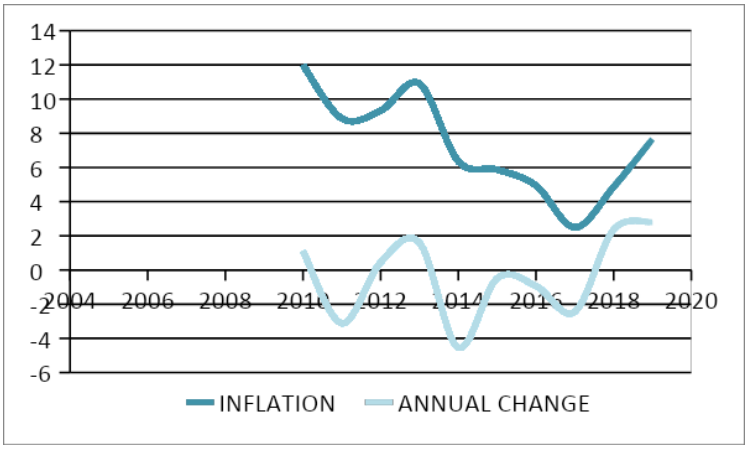

Source: Macro Trends, 2020

This graph and table show the fluctuations in inflation in India from the year 2010 to 2019. The global financial crisis that occurred in 2008 pushed the government to lower interest rates which showed repercussions on inflationary rates and growth in 2010. From the second decade of the 20th century, inflation rates climbed double-digit numbers! This was not only due to the remedial effects taken to perturb the chaos from the financial crisis (also called global recession), it also involved the high global commodity prices and the tremendously bad harvests. The pitiful low yields of vegetables were caused due to unseasonal rains destroying them during this period and causing their prices to shoot up. Headline inflation of 9.6% in 2010-11 was rectified by RBI's response of changing the repo rate by seven times by 25 base points each in that year itself. The subsequent shocks from moth demand and supply sides caused costs to rise and eventually the consumer prices and led to a general rise in overall prices. The deceleration of inflationary growth began in April 2012 and reached a single-digit rate of 8.01% (WPI).

The year 2012-13 was marked by slowing growth, lingering inflation, large fiscal and current account gaps, and deteriorating asset quality. Thus, monetary policy was faced with Hobson's choice. With growth decelerating, ordinarily, the policy response would have been accommodative. (Mohanty, 2017) 2014-2015 showed a CPI inflation of 7.35% in December reaching above the threshold limit set by RBI. This inflation rate is accrued to mostly the surging of food prices. These price pressures are shown in both urban and rural areas. From 2015 onwards, the inflation rate kept falling due to cyclic or temporary changes such as weaker domestic demand (also attributed to the cash ban in November 2016), a fairly stronger currency coupled with structural factors like better food management by the government. A bonus benefit was also enjoyed by the Indian industries from subdued inflation globally, especially in oil.

Thus, the WPI inflation in the period 2015-16 went negative! The inflation rate however picked up to 4.3% in 2018-19. Inflationary rates have remained within desired limits also due to the government increasing the MSP not more than 5%.

Table: Wholesale Price Inflation in India (Average)
[1969-70 to 2018-19 (up to March 2019)]

Year (per cent)	All Commodities	Primary Articles	Of which		Fuel, Power, Light and Lubricants	Manufactured Products
			Food Articles	Non-Food Articles		
1	2	3	4	5	6	7
(Base Year: 1952-53=100)						
1953-54	4.6	-	6.7	-	-0.8	-1.0
1954-55	-6.8	-	-11.3	-	-2.1	1.6
1955-56	-5.2	-	-8.5	-	-2.0	-0.9
1956-57	14.0	-	18.1	-	9.5	6.6
1957-58	2.9	-	4.1	-	8.8	1.7

1958-59	4.1	-	8.2	-	1.8	0.3
1959-60	3.8	-	3.3	-	1.0	3.0
1960-61	6.6	-	0.8	-	3.0	10.9
1961-62	0.2	-	0.1	-	1.7	2.2
(Base Year: 1961-62=100)						
1962-63	3.8	-	6.5	-	3.2	3.1
1963-64	6.2	-	8.4	-	14.4	2.5
1964-65	11.0	-	17.3	-	1.9	3.9
1965-66	7.6	-	6.8	-	3.2	7.7
1966-67	13.9	-	18.3	-	8.4	8.0
1967-68	11.6	-	21.4	-	5.6	3.2
1968-69	-1.1	-	-5.2	-	4.6	2.3
1969-70	3.7	-	-0.1	-	4.4	6.0
1970-71	5.5	-	3.6	-	4.3	7.9
(Base Year: 1970-71=100)						
1971-72	5.6	0.9	1.1	-1.4	5.9	9.5
1972-73	10.0	9.7	10.1	9.0	4.0	11.3
1973-74	20.2	28.1	22.7	36.4	18.6	14.4
1974-75	25.2	25.2	26.0	11.7	51.8	21.0
1975-76	-1.1	-6.6	-4.9	-14.6	1.05	1.4
1976-77	2.1	0.8	-5.1	19.7	5.3	2.3
1977-78	5.2	9.9	11.8	6.3	1.5	2.3
1978-79	0.0	-1.3	-0.7	-4.3	4.4	0.2
1979-80	17.1	13.8	8.2	14.2	15.7	20.2
1980-81	18.2	15.0	11.4	11.9	25.2	19.2

1981-82	9.3	11.3	13.1	10.5	20.7	5.2
(Base Year: 1981-82=100)						
1982-83	4.9	6.7	11.1	0.8	6.5	3.5
1983-84	7.5	10.8	13.9	11.5	5.6	6.1
1984-85	6.5	6.2	4.2	10.9	4.3	7.0
1985-86	4.4	0.2	1.7	-3.4	10.7	6.0
1986-87	5.8	9.1	10.2	11.4	6.8	3.8
1987-88	8.1	11.3	9.0	21.6	3.4	7.2
1988-89	7.5	4.9	9.9	-1.7	5.5	9.4
1989-90	7.5	2.2	1.2	3.6	3.6	11.3
1990-91	10.3	13.0	11.9	17.0	12.3	8.4
1991-92	13.7	18.1	20.2	18.0	13.2	11.3
1992-93	10.1	7.5	12.4	-0.2	14.1	10.9
(Base Year: 1993-94=100)						
1994-95	12.6	15.8	12.8	24.2	8.9	12.3
1995-96	8.0	8.2	8.3	9.0	5.1	8.5
1996-97	4.6	8.4	12.4	-0.9	10.4	2.1
1997-98	4.4	2.7	3.0	2.5	13.8	2.9
1998-99	5.9	12.1	12.7	10.4	3.3	4.4
1999-00	3.3	1.2	3.8	-5.8	9.1	2.7
2000-01	7.2	2.8	3.0	2.4	28.5	3.3
2001-02	3.4	3.3	1.8	8.2	5.5	2.6
2002-03	5.5	4.3	1.3	12.6	6.4	5.7
2003-04	6.5	3.6	2.6	0.7	10.1	6.3

(Base Year: 2004-05=100)						
2005-06	4.4	4.3	5.4	-3.3	13.5	2.4
2006-07	6.6	9.6	9.6	5.8	6.5	5.7
2007-08	4.7	8.3	7.0	11.9	0.0	4.8
2008-09	8.1	11.0	9.1	12.9	11.6	6.2
2009-10	3.8	12.7	15.3	5.5	-2.1	2.2
2010-11	9.6	17.7	15.6	22.3	12.3	5.7
2011-12	8.9	9.8	7.3	9.6	14.0	7.3
(Base Year: 2011-12=100)						
2012-13	6.9	11.4	10.9	13.3	7.1	5.3
2013-14	5.23	9.87	12.26	4.5	7.09	3.03
2014-15	1.14	2.2	5.62	-2.78	-6.10	2.48
2015-16	-3.68	-0.399	2.58	2.69	-19.68	-1.78
2016-17	1.73	3.45	4	3.38	-0.23	1.37
2017-18	2.95	1.31	2.06	-2.12	8.11	906.14
2018-19	4.26	2.75	0.34	2.92	11.57	-89.41

Source: RBI, Handbook of Statistics on Indian Economy 2018-2019

This table shows the inflation across different sectors of commodities in India.

5.0 Measures Adopted to Control Inflation

Post reform period showing improved supply response, improved financial and real economy; better monetary policy and emphasis on fiscal consolidation all helped bring down inflation. in 1992. Further, from 2002, a Central Issue Price (CIP) for rice (at Rs 5.65 per kg for BPL and Rs 3 per kg for AAY) and wheat (at Rs 4.15 per kg for BPL and Rs 2 per kg for AAY) have been maintained. (Sharma, 2014) There was a reduction of import duty on essential commodities. (e.g. import prices reduced to zero on rice, wheat pulses, edible oils (crude) and onions.)

Additionally, lower import duty was imposed on certain food products like milk powder, petrol, diesel and custom duty on crude oil in 2011. The export bans of edible oils, pulses and onions were imposed for short periods, whenever the onion prices rose. Also, Exports of Onion were property calibrated through the mechanism of Minimum Export Prices (MEP). Moreover, suspension of futures trading in rice, urad and tur dal i.e. to limit speculation. The extension of stock limit orders for pulses and rice occurred in the same year.

Adequate availability of sugar for the households covered under Targeted Public Distribution System (TPDS). It was ensured that the levy obligation on sugar factories was restored to 10 per cent for sugar season in 2011-12. Additionally, stock limits were also imposed to stop hoarding often for select essential commodities viz. pulses, edible oil, and edible oilseeds and in the case of paddy and rice for specific seven states till March 2012.

In the next year, the MSP was increased by the government by only 5% and thus contributed to declining inflation subsequently in 2014., may have been an important contributor to the decline in inflation which started in 2014. Also, the "Scheme for Supply of Imported Pulses" at Subsidized rates to States and UTs for distribution under PDS to BPL cardholders with a subsidy element of Rs.20/- per kg to be paid to the designated importing agencies up to the maximum number of BPL cardholders for the residual part of the current year and extended the scheme for subsidized imported edible oils w.e.f. 1.10.2012 to 30.9.2013 with a subsidy of Rs.15/- per kg for import of up to 10 Lakh tonnes of edible oils for this period. (Sharma, 2014)
There was good food management by the government coupled with a solid, stable monetary policy in 2015. The Government also allocated rice and wheat under the Open Market Sales Scheme.

5.1 Monetary measures

Apart from the basic functions that a central bank (RBI) performs vis-à-vis changing bank rates, CRR, through open market operations, etc.; it used new tools to control inflationary fluctuations:
Credit Monitoring Arrangement (CMA): From October 1988, it replaced the earlier Credit Authorization Scheme (CAS) which originally required banks to obtain RBI's authorization

before sanctioning any fresh credit in excess of the prescribed limit. Under CMA, RBI performs post-sanction scrutiny of large credit proposals sanctioned by the banks. The main objective is to prevent anticipation of credit by large borrowers and ensure its just distribution among all.

The two new instruments that have been added to the armoury of RBI are the reserve repo and repo rates and are operated through the Liquidity Adjustment Facility (LAF) introduced in 2000. Under the LAF, the liquidity is managed on a day-to-day basis through the absorption or injection of liquidity by way of sale or purchase of securities followed by their repurchase or resale under the repo/reverse repo operations. The main intention behind the introduction of LAF has been the modulation of liquidity in the economy so as to keep the money supply in the desired trajectory. Also, The Reserve Bank of India (RBI) had announced 14 consecutive increases in interest rates from March 2010 till March 2014.

5.2 Other measures

The Prevention of Black Marketing and Maintenance of Supplies of Essential Commodities Act, 1980: This act empowers the central govt. or a state govt. to detain people who are engaged in activities like hoarding, creating artificial scarcities of essential commodities in the market and pulleys up the prices.

6.0 Inflationary Impact on Indian Economy

Overall, inflation creates a multidimensional effect that causes both short-term and long-term damages to an economy and leads to a slowdown in the economy hampering the efficiency of its operations and curtailing growth. Even though its impacts are similar but the degree of its impacts vary between a developed and an underdeveloped/ developing country. In an underdeveloped country like India the level of investment that is needed to break the vicious circle of low income- low savings, it is not always feasible to meet such investment requirements by taxations and current saving solely. A certain amount of credit creation to finance such activity becomes the need of the hour. It thus leads to frictions and pressures which thereby get reflected in the general pricing. (Khatkhate, 1959).

Even in the case of the investment expenditure being limited by the current and available savings, the rate of the capital formation, if it outstrips the population, has to be on a large scale.

This implies that the replacement by the investment has to be substantial leaving a very small amount of current consumption. The growth itself means that new resources have to be employed for new investment opportunities. A rise in prices in such a phase will seriously deteriorate the potential by hampering growth.

In underdeveloped countries like India, one of the major problems rests due to overly populated disguised unemployment which reduces an extensive amount of the savings potential in the nation. Thus, this causes a lack of finance and within it, inflation gives the entire dilemma a twin blow. Given the lack of savings and the increased prices for consumption of essential commodities like food, this inflation will drain the consumption level of such weak economic classes. Having reduced the disguised unemployment, the financial strength of the country will improve, but eradicating it completely is theoretically and practically impossible. Inflation will lead to deterioration of gross domestic savings and less capital formation in the economy and less long term economic growth rate of the economy.

Circling around how inflation changes things and the behaviour of different colours in an economy, we find:

- People (retail consumers) begin to consume/buy fewer goods and services as their income is now limited. This leads to a slowdown not only in consumption but also in production. This is an indirect cause since now the manufacturers will produce fewer goods due to high costs and anticipated lower demand.
- Banks will increase interest rates as inflation increases otherwise real interest rates will be negative. (Real interest = Nominal interest rate – inflation). This makes borrowing costs for both consumers and the corporate sector. Thus people will buy fewer automobiles, houses and other goods. Industries will not borrow money from banks to invest in capacity expansion because borrowing rates are high.
- Higher interest rates further become the bottlenecks of the economy. They lead to an increase in unemployment because companies start focusing on cost-cutting and reducing hiring and increasing layoffs.
- Rising inflation can prompt trade unions to demand higher wages, to keep up with consumer prices (even though wage indexations are an efficient solution to this problem).

Rising wages in turn can help fuel inflation.

- Inflation affects the productivity of companies. They add inefficiencies in the market and make it difficult for companies to budget or plan long-term. Inflation can act as a drag on productivity as companies are forced to shift resources away from products and services in order to focus on profit and losses from currency inflation.
- Though inflation raises prices for a farmer's harvests it also increases the input costs. This rising input cost thus leads to cash flow problems for farmers and increases the necessity of a high level of operational management and conservative financial strategies. Individual farmers can possibly counteract the effect of input price inflation through increases in productivity and economizing on costs. Present competitive structures may however possibly result in accelerated input price inflation if increases in productivity and economizing on costs occur for agriculture in aggregate.
- Inflation takes a toll on the investor whose aim is to uplift her long term purchasing power. It is a threat for the investors in the sense that it chips away at real savings and investment returns. Inflation puts this goal at risk because investment returns must first keep up with the rate of inflation in order to increase real purchasing power. For instance, an investment that returns 2% prior to inflation in an economy, which now has a 3% inflation rate will thereby produce a negative return (−1%) when adjusted for inflation.

Inflation can be harmful to fixed income returns, in particular. Many investors buy fixed income securities because they want a stable income stream, which comes in the form of interest (or coupon, payments.) However, because the rate of interest, or coupon, on most fixed income securities remains the same until maturity, the purchasing power of the interest payments declines as inflation rises.

Additionally, rising inflation erodes the value of the principal on fixed income securities. Suppose an investor buys a five-year bond with a principal value of $100. If the rate of inflation is 3% annually, the value of the principal adjusted for inflation will sink to about $83 over the five-year term of the bond. Equities have often been a good investment relative to inflation over the very long term because companies can raise prices for their products when their costs increase in an inflationary situation. Higher prices will translate into higher earnings.

But over shorter time periods, stocks have a tendency to show a negative correlation to inflation and can be especially hurt by unexpected inflation. When inflation rises suddenly or unexpectedly, it can heighten uncertainty about the economy, leading to lower earnings forecasts for companies and lower equity prices.

7.0 Conclusion

Overlooking at inflation with a generic view, its high rates in any economy proves to be detrimental but the planners of all nations see an inflation rate of 2-3 per cent as ideal. This is because they want to ensure that the wage earners of their economy are satisfied with the general raises in their wages/salaries (even though such an increase is only nominal.) Analysing the overall inflationary scenario in India, we see that the inflationary rates have remained constantly vulnerable to high dependence on monsoons and oil prices. Certain remedies that will help India to constrain its inflation rates within ideal limits and help it fight against high inflation (in case) could be:

India is a developing country and thus looking at the trends above, it has a high dependence on agriculture which thereby depends on the monsoons. What will improve the core of such fluctuating amounts of crop yields is that the inputs used on farms should be efficient enough to make the soil and crops robust to such external conditions. Hence, this calls for technological advancement for the farm sector. Importing inputs and setting up units for research and manufacturing inputs should be targeted. When the inputs are available in the economy, the government should then focus on making them accessible to the farmers. For this to be achieved, two factors must be taken into account: providing these inputs at subsidized rates and increasing the efficiency of credit formal and informal markets. When these two factors are focused upon and strengthened via schemes or inclusion in five-year plans, the direct ramification is seen on the economic growth by the growth of its most prominent sector.

MSP controls the government on essential commodities ensuring that inflationary fluctuations don’t affect the immediate and daily needs. It should be targeted to wax between a certain ‘safe limit’. Strict ban on hoarding of commodities to ensure that fair distribution and a better Public Distribution system should be focused upon.

Reducing dependence on oil as raw materials in industries and finding substitutes. Further, necessitating wage indexation for investments is the easiest way to induce the Indians to save and invest. This will lead to a much-needed increase in capital which is a long-term growth driver. Indexation shields savers from bearing a heavy burden of taxes when they invest in any asset (in the long term). Indexation also brings about 'real returns' from any investment. And finally, Provide insurance for investors against losses due to inflation.

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