INFLATION: A SIGNIFICANT OBSTACLE TO THE GROWTH OF INDIAN ECONOMY

Rituranjan*

Inflation is getting increasingly generalised in the Indian economy as is evident from a gradual narrowing of the gap between 'headline inflation' and 'core inflation'. Not only is the current rate of inflation substantially higher than the targets set but the continuation of severe inflationary tendencies in the economy is per se a serious area of policy concern. For, such a significant and persistent inflationary trend could quite conceivably hamper the growth momentum and endanger inclusive growth. In view of this, the present article goes deeper into various aspects of the complex problem of inflation in India and finds that a high rate of domestic inflation is likely to put a serious obstacle in the attainment of practically all the objectives of public policy in a developing economy like India. Therefore the real challenge of monetary policy and macroeconomic management in India is one of maintaining the growth momentum in the economy along with price stability in the times to come. Towards this end, the need of the hour is to employ an optimal-mix of mutually reinforcing set of policies both on the demand-side as well as supply side as the severe inflationary pressures prevalent in the Indian economy right now are the outcome of a complexity of demand-pull and cost-push factors operating both at domestic as well as international levels.

1 Introduction

In its First Quarter Review of Monetary Policy 2011-12 released in July 2011, the Reserve Bank of India (2011a) has admitted that Inflation continues to be the dominant macroeconomic concern. For, controlling inflation is imperative both for sustaining growth over the medium-term and for increasing the potential growth rate.

Prior to this, in its Financial Stability Report released in June 2011, the Reserve Bank of India (2011b) had cautioned that Inflation remains a big challenge as high oil and commodity prices pose one of the major downside risk to India's Gross Domestic Product (GDP) growth during 2011-12.

Likewise, in the Economic Survey 2010-11 released in February 2011, the Ministry of Finance, Government of India (2011) too had observed that as the world economy has begun to stabilize in the aftermath of the global crisis, inflation has re-emerged as a

*Associate Professor, Department of Economics, Shri Ram College of Commerce, University of Delhi, Delhi.

major concern particularly in the fast-growing developing economies.

In the light of this growing concern for inflation as expressed by the monetary authority in India, it becomes pertinent to go into the genesis of this problem and analyse the root cause of the inflationary tendencies prevalent in the Indian economy. Side-by-side, it is crucial to have a closer look at the problem of inflation in India in terms of its macroeconomic impact and present dimensions so as to suggest remedial measures and derive suitable insights for policy making. Against this backdrop, the present article goes deeper into the various dimensions of the complex problem of inflation in India with a view to examining the extent to which inflation is posing an obstacle to the growth of Indian economy.

The next section explores the current state of inflationary tendencies prevailing in the Indian economy and tries to identify their likely macroeconomic repercussions. This is followed by a detailed investigation of the major trends and factors responsible for inflation in India. On the basis of such a detailed analysis of the genesis and implications of the problem of inflation in the Indian economy, suitable insights and lessons for policy making are derived in the subsequent section. And finally the main conclusions following from our analysis are recorded in the concluding section.

2 Inflationary Tendencies and their Repercussions

In its report entitled "Current State of Indian Economy-June 2011", the FICCI *i.e.* Federation of Indian Chambers of Commerce and Industry (2011) has cautioned that the inflation situation in the economy continues to be a cause for concern. For, the WPI-based annual rate of headline inflation stood at 9.1 percent in May 2011.

In its Mid-Quarter Monetary Policy Review released in June 2011, the Reserve Bank of India (2011c) has also stated that the headline WPI inflation rate which was 8.7 per cent in April 2011 rose to 9.1 per cent in May 2011. Evidently, the headline inflation of this order is way above the upper bound of the comfort zone since it exceeds the trend of 5.0 to 5.5 per cent as observed during the 2000s and is significantly higher than the medium-term objective of 3.0 per cent inflation consistent with India's broader integration into the global economy.

In this context, it is worth noting that the headline inflation in India is calculated on the basis of the Wholesale Price Index (WPI) and recently the Government has released a new series of the WPI changing the base year from 1993-94 to 2004-05. This new series was in fact employed for the first time in calculating the official rate of headline inflation for the month of August 2010. The new series is a better representative of overall commodity price inflation in as much as it significantly improves on the scope and coverage of commodities and is more adapted to the underlying economic structure in terms of the evolving consumption patterns and price trends at a disaggregated level.

More specifically, according to the 'Economic Survey 2010-11' released by the Ministry of Finance, Government of India (2011), a representative commodity basket comprising 676 items has been selected in the new WPI series with 2004-05 base. Some of the prominent items included in the commodity basket for the new series are flowers, lemons, and crude petroleum in primary articles and ice-cream, canned meat, palm oil, readymade/instant food powder, mineral water, computer stationery, leather products, scooter / motorcycle tyres, polymers, petrochemical intermediates, granite, marble, gold and silver, construction machinery, refrigerators, computers, dish antenna, transformers, microwave ovens, communication equipment (telephone instruments), TV sets, VCDs *i.e.* Video Compact Disks, washing machines, and auto parts in manufactured products. Further, the total number of price quotations has also been increased from 1918 in the old series to 5482 in the new series thereby signifying a better representation of the prices in the wholesale markets.

Of late, the RBI *i.e.* the Reserve Bank of India (2011a) has found the headline WPI inflation rate to have remained stubbornly close to double digits for the first quarter of the fiscal year 2011-12 thereby indicating that inflationary pressures continue to be broad-based in the Indian economy. As per the RBI, both the level and the persistence of WPI inflation are a cause for concern.

From the perspective of framing long-term policy, however, a preferred measure of inflation is 'Core inflation' which by definition excludes items like food and energy that face volatile price movements. According to FICCI (2011), Core inflation too has moved up from 8 percent in April 2011 to 8.6 percent in May 2011.

It must be realised that the main items of concern in non-food inflation in India are raw cotton, raw jute, raw silk, copra, castor seed, sunflower, raw rubber, copper ore, zinc, iron ore, cotton textiles, petrochemical intermediate, and industrial machinery and machine tools. In this context, even the RBI has observed that the non-food manufactured product inflation ruled above 7 per cent in the first quarter of 2011-12 thereby suggesting that producers are able to pass on the rising wage costs and other