Constraints faced to control Inflation

Constraints in controlling cost push inflation
- Prices of imported commodities – crude oil prices increased
- Depreciation of rupee
- Food inflation because of defective supply chain
- Low growth of agriculture sector
- Increase in interest rates
- Increase in Public Expenditure and Budgetary deficit

Constraints in controlling demand pull
- Foreign investment is increasing
- Depreciation of rupee

Note: Out of the two types of Inflation, it is the Cost-Push type of inflation that is hard to control because these are real problems faced by the economy (like droughts, floods, supply chain management problems). On the other hand, Demand-Pull type of inflation can be controlled by controlling money side factors.

Impact of Inflation

Positive Impact
- Inflation is good for the economy up to reasonable limits. This according to RBI is 5%.
- Moderate inflation stimulates growth.

Negative Impact
- Real income of people would decrease.
- Inflation is regressive in nature.
- Would increase income inequalities.
- Capital formation is adversely affected.
- Interest rates were increased by RBI.
- Distorts Resource allocation.
- Promotes generation of Black Money.
- Standard of living would reduce.
- Promote hoarding and speculation.
- Adversely effects BOP situation.

Measurement of Inflation

Inflation is measured with the help of Index numbers. Index numbers are numbers that measure change in any variable.

There are two types of Index numbers
- Wholesale Price Index (WPI)
  - Based in 676 commodities
  - Estimated by Min of Industry and Commerce
  - Measured on a monthly basis, but with a lag of 14 days.
  - Base year is 2004-05

<table>
<thead>
<tr>
<th>Item Groups</th>
<th>No of Items</th>
<th>Weightage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primary articles</td>
<td>102</td>
<td>20.12</td>
</tr>
<tr>
<td>Fuel and Power</td>
<td>19</td>
<td>14.91</td>
</tr>
<tr>
<td>Manufactured Items</td>
<td>555</td>
<td>64.97</td>
</tr>
<tr>
<td>Total</td>
<td>676</td>
<td>100</td>
</tr>
</tbody>
</table>
Note: WPI was revised in 2010. It was revised on the recommendation of Prof. Abhijit Sen committee. Earlier the base year for WPI was 1993-94. In India, general rate of inflation is measured by WPI.

Different methods to measure WPI
- **Point to Point inflation**
  Inflation is compared between two points in time, usually a month’s inflation rate.
- **52 week average method**
  Average of previous 52 week’s point to point inflation is taken.

- **Consumer Price Index (CPI)**
  - It shows the impact of inflation on a common man (increase in cost of living).
  - CPI is considered to provide Dearness Allowance to Central government employees.
  - CPI is based on retail prices.
  - Is available on a monthly basis.

There are four types of CPI:
- **CPI for Industrial Workers (CPI-IW)**
  - Base year: 2001
  - Weightage of food items is 46%
  - Measured by Labour Bureau
  - This is used for the grant of DA

- **CPI for Urban Non-Manual Employees (CPI-UNME)**
  - Base year: 1984-85
  - This is used to provide grant by some MNC’s

- **CPI for Agricultural Labourers (CPI-AL)**
  - Base year: 1986-87
  - Used for the fixation of minimum wages
  - This is used for revision of wages under MNREGA

- **CPI for Rural Labourers (CPI-RL)**
  - Base year: 1986-87

**New CPI introduced by CSO**
In 2011, CSO introduced three new CPI’s
- CPI – Urban
- CPI – Rural
- CPI – Combined

The reason to introduce these new CPI’s was that there was no single CPI that could give the effect of inflation as a common man residing in India would experience. Base year for all the three CPI’s is 2010.

**Why Inflation is high on CPI as compared to WPI?**
- Weightage of food is high in CPI than when compared to WPI.
Sub-Prime loans
These are loans that are provided to risky borrowers or in other words, clients who have high probability of defaulting.

Impact of Sub-prime crisis on Indian Economy
Banks and Financial Institutions suffered losses as a result withdrawal of money by Financial Institutions. This resulted in demand being reduced. This in turn resulted in inflation decreasing in India.
Remedies: Government provided Fiscal stimulus (taxes reduced, govt expenditure increased), Expansionary monetary policy was adopted by RBI and Support packages was required.

Terms Related with Inflation
1. Inflation: Persistent increase in price level
2. Disinflation: Reduction in the rate of inflation
   - Price level decreases
   - No adverse effect on economy
3. Deflation: Persistent decrease in price level (negative inflation)
4. Reflation: Price level increases when economy recovers from recession

Based on value of inflation
1. Creeping inflation – If rate of inflation is low (upto 3%)
2. Walking/Trotting inflation – Rate of inflation is moderate (3-7%)
3. Running/Galloping inflation – Rate of inflation is high (>10%)
4. Runaway/Hyper Inflation – Rate of inflation is extreme

New terms
1. Stagflation: Inflation + Recession (Unemployment)
2. Misery index: Rate of inflation + Rate of unemployment
3. Inflationary gap: Aggregate demand > Aggregate supply (at full employment level)
4. Deflationary gap: Aggregate supply > Aggregate demand (at full employment level)
5. Suppressed / Repressed inflation: Aggregate demand > Aggregate supply. Here govt will not allow rising of prices.
6. Open inflation: Situation where price level rises without any price control measures by the government.
7. Core inflation: Based on those items whose prices are non-volatile.
8. Headline inflation: All commodities is covered in this.
9. Structural inflation: Due to structural problems like infrastructural bottlenecks.