Understanding Inflation

INDIAN POLITY & ECONOMY

COMMUNICATIVE ENGLISH AND MEDIA STUDIES

COMMONLY SPEAKING

- The phenomenon of rise in prices of goods and services is called inflation.

- In other words, when a fixed amount of your money starts buying less than what it used to then an inflationary trend is said to have set in.

- Suppose with Rs 100 you bought 5 kg potato last month but in the current one you can buy only 4 kg of potato with the same amount of money. So, the month-wise rate of inflation in this case is 25%

- What has actually happened is that the **purchasing power of** [redacted]

WHAT CAUSES INFLATION

There are two sets of factors that can cause inflation:

1. DEMAND PULL FACTORS

- Rise in population
- Black money (which is unearned money or ill gotten money)
- Rise in income
- Excessive government expenditure

2. COST PUSH FACTORS

- Infrastructure bottlenecks which lead to increased production and distribution costs
- Rise in Minimum Support Price (MSP)
- Rise in international prices
- Hoarding and black marketing
- Rise in indirect taxes

THE THREE MEASUREMENT LEVELS

- Producer level: In India, there is no index to measure inflation at this level. A Product Price Index (PPI) is proposed, but yet to see the light of day.

- Wholesale level: The index used to calculate inflation at this level is called the Wholesale Price Index (WPI) and is the most popular methodology to calculate inflation. The rate of inflation calculated through this method is called **Headline inflation**. It is released by the Ministry of Industry and Commerce.

- Retail level (Consumer level): Inflation experienced by consumers at retail shops is the actual reflection of price rise in an economy. It also reflects the cost of living better. The index which shows the inflation at the retail level is known as Consumer Price Index (CPI). The Central [redacted]

HEADLINE Vs CORE INFLATION

- **Headline inflation** is the measure of total inflation within an economy. It includes price rise in food, fuel and all other commodities. The rate of inflation expressed in WPI usually denotes the Headline inflation. Though CPI values are often higher, WPI values generally make headlines.

- **Core inflation** is also a term used to denote the extent of inflation in an economy. But Core inflation does not consider the inflation in food and fuel. This is a concept derived from Headline inflation. There is no index for direct measurement of Core inflation. **It is measured by excluding food and fuel items from WPI or CPI.**

- Since Core inflation does not reflect rise in prices of food and fuel items, which are volatile, it gives a real picture of the state of the economy to [redacted]

WPI Vs CPI

- Though the Reserve Bank of India used WPI for most of its policy decisions before 2014, the WPI-based inflation calculation was not fool-proof.

- WPI shows the combined price of a commodity basket comprising **676** items. But it does not include services. It also neither reflects the bottlenecks between producer and wholesaler nor between wholesaler and retailer (consumer).

- CPI is based on **260** commodities, but includes certain services too.

- Since 2014, as part of the reforms initiated by the then Reserve Bank of India Governor Raghu Ram Rajan, the central bank shifted to CPI for policy decisions.

CONTROLLING INFLATION

- There are two broad sets of measures to tackle inflation: Fiscal and monetary measures. Both try to control the circulation of money in the economy.

- Fiscal measures are in the domain of the government and relate to taxes, both direct (income-tax, capital gains tax) and indirect (GST, excise).

- Monetary measures are decided by the Reserve Bank of India which controls the money supply by fixing such rates as Repo, Reverse Repo, CRR, etc.

- Beyond these measures, there are certain administrative measures by the government like the Public Distribution System which tries to curb inflationary tendency.