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Inflation - A Challenge before Indian Economy

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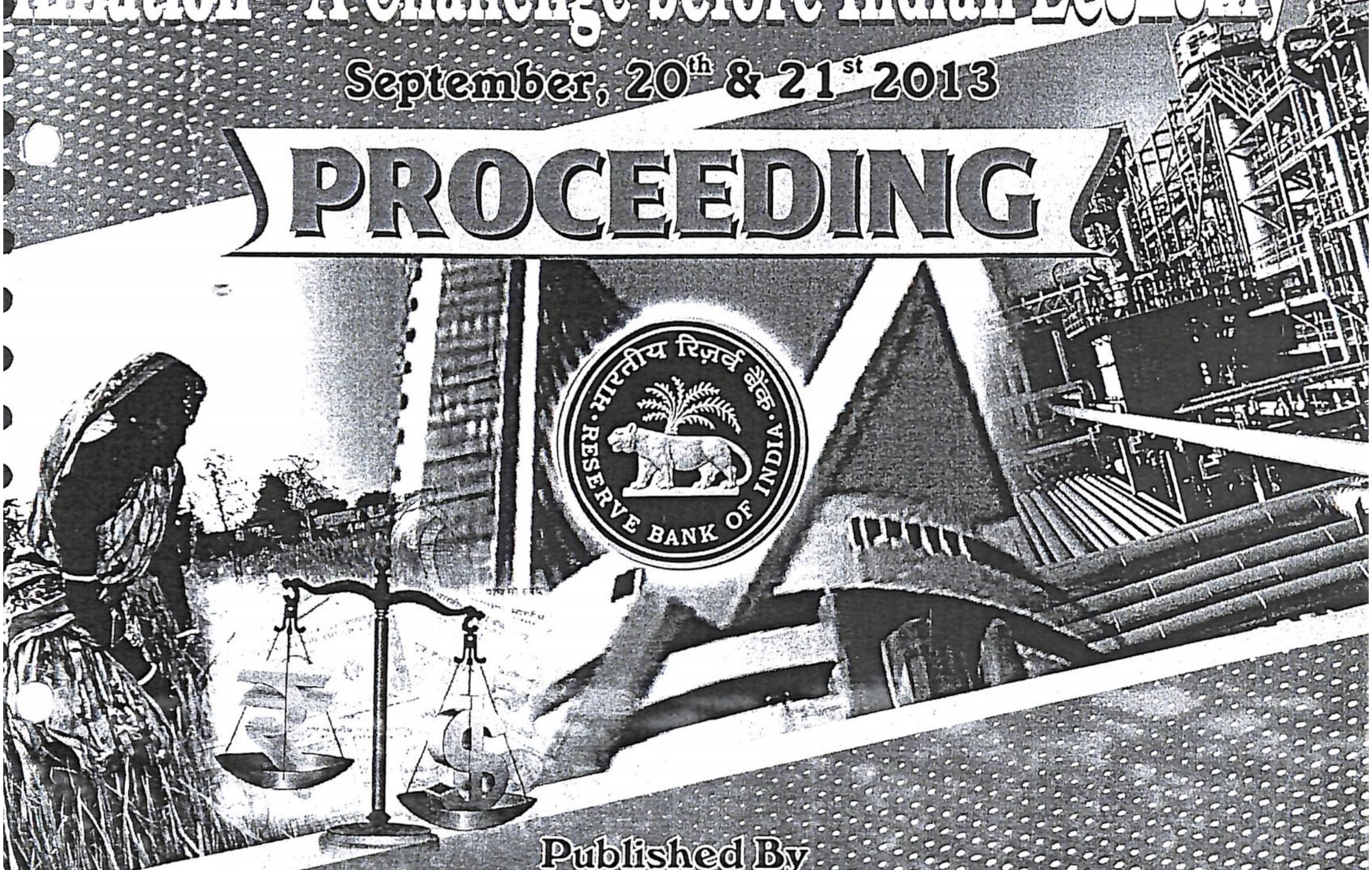
PROCEEDING



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INFLATION AND RBI POLICY

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1) INTRODUCTION:

Equitable development with internal and external stability has always been the trust of both monetary and fiscal policy in India. It is a well known fact for that all these goals cannot be achieved at the same time. Pursuit by speedy development result in monetary policy and credit expansion leading to inflationary trend with causes balances of payment problem. Speedy development often distorts distribution of income and may result in larger unemployment rates have as men are replaced by machines. Therefore the government along with the RBI has to perform a tight rope walking to ensure development and at the same time manage inflationary trends.

2) INFLATION IN INDIA:

In last 5 years India has experimented a high growth rate averaging to almost 8%. But in 2012-13 this GDP growth rate has slumped to 5%. Many internal and external factors are responsible for this fall in this GDP growth rate. Along with the development, India has been facing the problem of inflation in the last 5 years.

From 2001 to 2007 the average inflation in India was 5.14%. in 2007-08, it was 4.7% but in 2008-09, it increased to 10.20%. Throughout the year in 2010-11 inflation remained around 10%. If we analyze the inflationary trend as per primary commodities, fuel and manufactured products, we realize that the main culprits of inflation are primary consumer products, mainly agricultural commodities and rising fuel prices. In 2007-08 the inflation rate in case of primary products was 7.61% which rose to 10.06% in 2008-09, 16.46% in 2009-2010, 12.22% in 2010-11 and has remained above double digit since then. The inflation rate for fuel, electricity has also been near the double digit figure. The rising fuel cost has also raised the prices of industrial goods.

3) CAUSES OF INFLATION:

The rising population with growing consumption expenditure acts on the demand side. The stagnant agricultural production with defective public distribution system and inefficient primary agricultural produce marketing bodies leads to supply of bottlenecks. The annual rate of population growth, which is above 2%, is above the annual rate of growth in agricultural production. Therefore the per capita availability of food grains has decreased. Though we are self-sufficient in cereals we have to import pulses and edible oils. The prices of milk have increased due to monsoon failure in 2012. The prices of vegetables and fruits had too rocketed in 2012.

The growing budgetary deficits of central government and the state government are also adding pressure on the inflationary trend. The rising petroleum prices increasing the industrial cost and transport cost.

The Sixth Pay Commission has raised the salaries of the government employees. The consumption expenditure in India has increased by almost 15% from 2001 to 2010.

It is observed that both the demand and the supply side factors are causing inflationary trends in India.

4) RBI'S MONETARY PLOICY:

In the recent years we observed that the government is pursuing liberal fiscal policy leading to larger budgetary deficits. The ones controlling inflation is left to RBI and its monetary policy. The RBI in expected to fuel the growth by easing credit and interest rates and at the same time it is expected to contain inflationary trends. Since last 5 years RBI has been performed extremely well.

The Repo rate, which was 4.75% in 2009-10 was hiked to 5.25% in April 2010 and further rose to 6.75% in March 2011. In January 2012 it stood at 8.50% and now at 9%. Similarly the reverse Repo hiked from 3% in April 2009 to 7.5% in January 2012. CRR too was hiked from 5% in April 2009 to 6% in April 2010 and remains there till now. The SLR which was 24% in April 2009 was hiked to 25% in November 2009 and brought down to 24% in December 2010 and now it remains there.

It is evident that RBI has been targeting inflation by tightening the money supply in the recent past but the inflation has stubbornly remained high in the last 5 years.

5) LIMITATIONS OF RBI:

RBI has been controlling the money and credit supply through its quantitative credit control measures; but most of the factors fueling inflation are beyond its control. The most important failure is of course the growing budgetary deficits. Another factor is the supply gap in agricultural commodities, especially vegetables. Rising oil prices is adding largely to the inflationary pressure. The other important factors like growth in population, rising consumption expenditure growth in incomes, the growth of black money are beyond the control of the RBI.

The tight monetary policy pursued by RBI is now negatively to the growth of the economy. The government should care about the supply side causes and attend to the improvement of agriculture and infrastructure.

6) CONCLUSION:

Both RBI and the central government should co-ordinate efforts and pursue monetary and fiscal policies which would achieve growth with price stability. Both the demands and supply side causes have contributed to the inflationary trend in India, so RBI alone would not be in a position to control inflation through its monetary policy measures.
