

# **Course: Indian Economy ECON(H)221**

## **Lecture 16 Inflation Measured and Controlled**



# Topics of Discussion

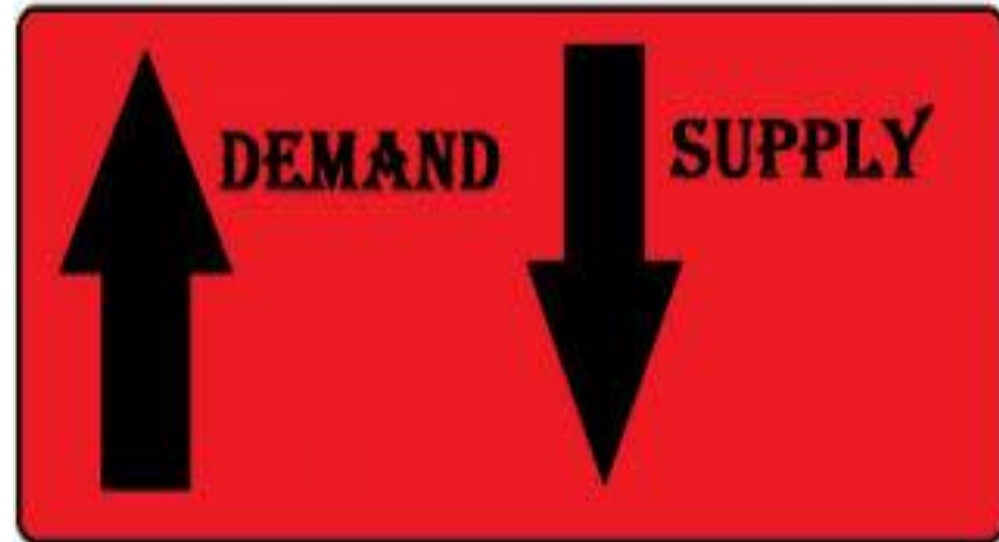
## 1. Inflation

- How is inflation measured?
- How can inflation be controlled?



# Inflation

- A process where the general price level rises and value of money depreciates.
- There are two kinds of inflation:
  - Demand Pull Inflation
  - Cost Push Inflation



# How is Inflation Measured?

## ➤ Wholesale Price Index (WPI )

- What is WPI- A weekly measure of wholesale price changes in the economy
- India- the only major country that uses WPI

## ➤ Consumer Price Index (CPI)

- measure of the average price of consumer goods and services purchased by households
- CPI indicates the change in the purchasing power of the consumer

# Measuring Inflation

- WPI is available at the end of every week (generally Saturdays), for a period of one year ended that day
- Base year 2004-05
- The wholesale price index comprises 676 items divided into three broad categories:
  - Primary Articles
  - Fuel & power and
  - Manufactured Products

# CPI

- The number of items in CPI basket include 448 in rural and 460 in urban.
- Base year 2012
- Thus, it makes it clear that CPI basket is broader than WPI basket.
- The items in CPI are divided into 6 main groups as follows:
  - Food and beverages
  - Pan, Tobacco and Intoxicants
  - Clothing & Footwear
  - Fuel & Light
  - Miscellaneous



# WPI Vs CPI

- Primary use of WPI is to have inflationary trend in the economy as a whole.
- CPI is used for adjusting income and expenditure streams for changes in the cost of living.
- WPI is based on wholesale prices for primary articles, administered prices for fuel items and ex-factory prices for manufactured products.
- CPI is based on retail prices, which include all distribution costs and taxes.
- CPI covers only consumer goods and consumer services while WPI covers all goods including intermediate goods transacted in the economy.

# Major reasons of Inflation in India

- Rise in Crude oil prices
- Rising import prices
- Black Money
- Deficit financing
- Wage rate wise
- Increased public expenditure
- Poor performance of agriculture sector





# Effects of Inflation

- Hoarding
- Increased risk
- Fixed income recipients
- Increased consumption ratio
- Lowers national saving
- Illusions of making profits
- Rising prices of imports
- Causes business cycles to go out of business

# EFFECTS/COST OF INFLATION

- Value of Money depreciates
- Gains and losses occur because of unpredictable changes in the value of money.
- Purchasing power decreases- If the value of money varies unpredictably over time, the quantity of goods and services that money will buy will also fluctuate.
- Hoarding
- Fixed income recipients adversely affected
- Lowers national saving

# EFFECTS/COST OF UNANTICIPATED INFLATION

- Redistribution of income- people with fixed income are affected the most
- Lenders are affected more if the inflation is unanticipated
- Borrowers are affected more if the inflation is anticipated
- Too much or too little lending or borrowing

# Corrective Measures

- Fiscal Policy
- Monetary Policy

# Fiscal Measures

- Reduce government spending
- Raise taxes
- Relax trade restrictions
- Increase productivity



# Monetary Measures

- Increase interest rates
- Control money supply

**Thank You 😊**