Inflation

Inflation: when the general price level i.e the average prices of all goods and services increases at sustained rate and purchasing power of money dec.

* main reason behind inflationary situation in economy is increase in money supply

* for controlling inflation in ecomy

RBI (Monetary policy) | Government (fiscal policy)

By decreasing money supply

* when inflation in market is controlled by decreasing money supply it is called disinflation

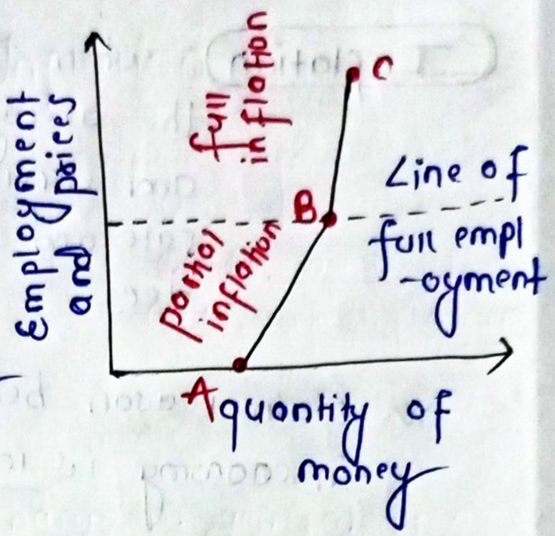
Deflation: when the general price level continuously decreases and purchasing power of money inc.

- occurs when there is less money supply in economie.

- RBI and government controll deflection by increasing money supply and this is called reflaction

Inflation as per JM kins

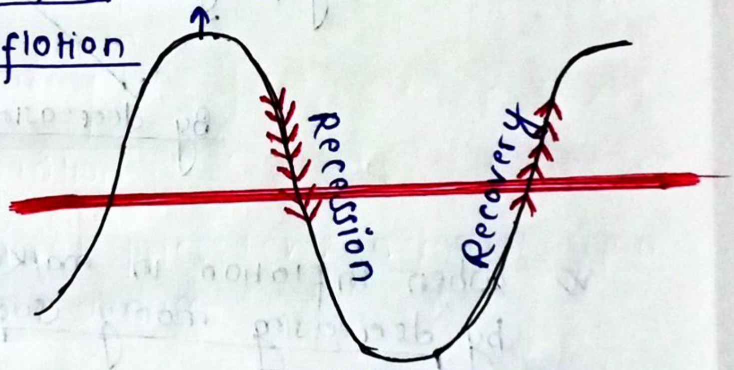
* JM kins pointed that the full inflation occurs after the Line of full employ-ment.



Effect of inflation on economy

(Business cycle)

MS ↑ : AD>AS Boom / peak
inflation



Depression

MS ↓ : AD<AS
Deflation

Case I : Boom / peak

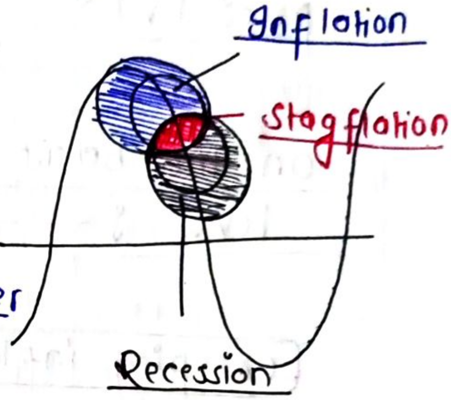
MS ↑ → AD > AS

- Stock ↓
- production ↑ (GDP ↑)
- Economic Growth ↑
- Employment ↑
- Income ↑

So, inflation is good (But with certain terms & condition) case II : AD < AS

stock ↑
production ↓ (GDP ↓)
Employment ↓
Income ↓

Stagflation



It is a situation in the economy where inflation and recession occur together

or

- Inflation inc, employment (↓)
- Inflation inc, unemployment (↑)

or

when the rate of inc in price is more than the economic growth

Economic condition

Slowdown

$Q_1 = 6\%$
$Q_2 = 5.5\%$
$Q_3 = 4\%$
$Q_4 = 3.5\%$

contraction

when there is a -ve growth rate in any one of quarter in a financial year

$Q_1 = 5\%$
$Q_2 = -2\%$
$Q_3 = 4\%$
$Q_4 = 6\%$

Recession

when there is -ve growth rate in any 2 quarter

$Q_1 = 5\%$
$Q_2 = -2\%$
$Q_3 = -3\%$
$Q_4 = 2\%$

Depression

an extreme form of recession

meltdown

meltdown : sudden crash of share market

Types of Inflation

On the basis of change in general price level.

On the basis of cause of inflation

On the basis of change in general price level :—

creeping inflation

when general price level increases upto 3%. per annum

walking inflation

when general price level increases upto 4-5 %. per annum

Running inflation

when general price level increases upto 9 %.

Galloping

when general price inc upto 10%. - 999%.

Hyperinflation

- more than 1000 %.
- General prices increases overnight
- when people of country start loosing faith on currency

Ex Hungary (1946) 2018 (venejaula)

Inflation targeting framework

(Monetary policy framework Agreement)

① Inflation is targeted by the government in consultation with RBI

② It is for 5 year

③ started in 2016

2016 - 21
2021 - 26 } $\boxed{4\% \pm 2\%}$

Types on basis of cause

Demand - pull inflation

when inflation occur due to inc in demand of the people in the economy and this kind of inflation occurs because of consumers.

Cause :

① Increase in money supply

when money supply in economy increases it leads to inc in the aggregate demand which in turn create inflation in economy.

② Increase in forex reserve

If the foreign exchange of any country is increasing then it needs more money supply in the economy and as a result inflation inc.

③ Increase in government expenditure

when the government enfuses more money in the economy then it results into more money supply and its leads to inflationary situation in economy.

④ Due to fiscal Stimulus

fiscal stimulus mean when the govern-ment pump more money into the economy apart of its budgetary allocation and as a result money supply inc and its create inflation.

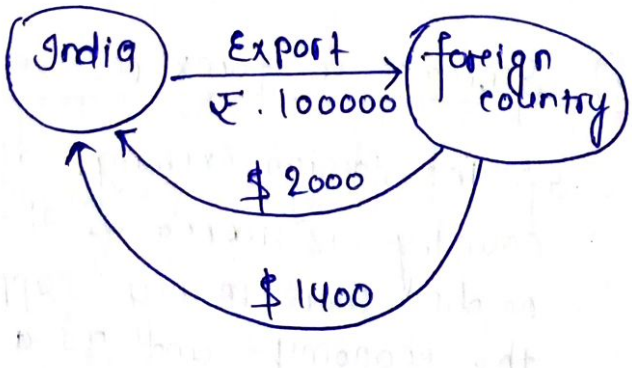
Note : During the first wave of COVID Nirmala sitaraman enfused 20 Lakh crore into the economy

- Also called helicopter money

⑤ Depreciation of currency

$1 = ₹ 50
$1 = ₹ 70

Depreciation of money



Depreciation of currency will make the Indian product more competative in the foreign market and as a result exports start increasing

⑥ Decrease in saving

when the people saves less then it means their expenditure are increasing and its leads to more money supply in economy

⑦ Black money / fake currency

It is also called the parallel economy more and more black money woulds leads to more money supply in economy

⑧ Increase in population

more population woulds leads to more demand and inflation inc.

⑨ Deficit financing

when government expenditure more than its revenue then it is called budgetary deficit and the deficit can be financied by

ⓐ By issuing new notes by RBI

ⓑ By borrowings.

Cost-push Inflation

when the cost of production of a producer increases then it needs to reduction in the aggregate supply and hence its results into inflationary situation into the economy.

factors responsible :

① Increase in price of factors of producti-on

when the price of factors of production i.e. Land, Labour, Capital, organisation increases then the cost of production inc. and as a result the supply dec and its create inflation.

② Hoarding and speculation of commodities

Hoarding and speculation leads inflationary situation in the economy. beacuse Hoarding makes dec in supply of commodities and speculation rebuy commodities at lowered price and sell it at higher price

③ Defective supply chain / supply stock / Bottleneck / structural inflation when the supply decreases drastically but the demands remain constant then it is called bottle neck inflation.

when there is improper infrastructure in the economy like improper roads, shortage of electricity etc and it leads to dec in the production and hence aggregate supply decreases called structural inflation.

④ Decrease in direct taxes

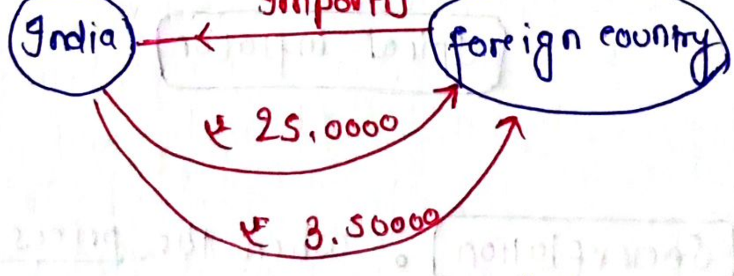
Like income tax dec then money supply increases leads to inflation

⑤ Increase in indirect taxes

Generally the indirect taxes are imposed on producers Like GST and because of higher taxes their cost of production increases

⑥ Depreciation of currency

$1 = ₹ 50
$1 = ₹ 70 (Depreciation)



Depreciation of currency would leads to inc in the cost of imports as a result cost of production inc.

⑦ Increase in the price of crude oil / Imported inflation

when the price of crude oil increases at international level then its leads to increase in the cost of production as well and it also called imported inflation.

⑧ Higher wages

Higher wages would leads to higher cost of production

Built - in - inflation / wage price inflation

This kind of inflation is in-built-into the economy as inflation is a continous process

price ↑ → wages ↑ → price ↑ → wages ↑ → price ↑ → wages ↑

Spiral inflation

Shrinkflation : when the prices of goods remains same but the quantity decreases

Ex : (parle - G Biscuit)

Inflation

Headline inflation

when the prices of all goods and serv-ices increase

It includes the fuel and food prices

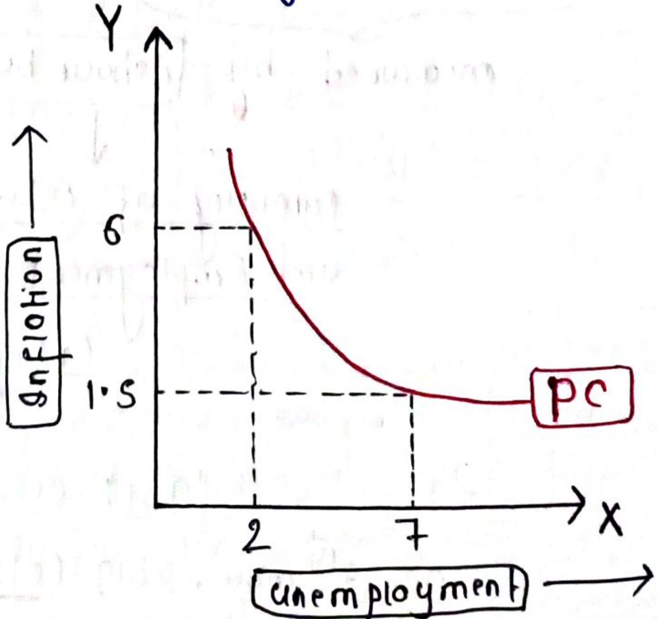
core inflation

when the prices of all goods and services increasing excluding food and fuel prices (beacuse their prices are highly volatile in nature)

Skewflation : when the prices of some commodities are increasing and prices of some commodities are decreasing.

phillips curve

- concept given by AW phillips in the year 1958
- He showed the negative relation between inflation and unemployment



Methods of measuring Inflation in India

- WPI
- CPI

CPI

- consumer price Index
- In India it measures the change in retail prices of goods and services over a period of time.
- It measures inflationary condition in the economy for consumers.

Types

CPI - Industrial workers	CPI - Rural Labourers	CPI - agricultural Labourers	CPI - Rural CPI - urban CPI - combined (R+U)
Base year: 2016 (2001 - in 2020 change)	BY: 1986-87	BY: 1986-87	BS: 2012 (initially 2010)

CPI - Industrial workers, CPI - Rural Labourers, CPI - agricultural Labourers: measured by Labour burea → ministry of Labour and Employment

CPI - Rural, CPI - urban, CPI - combined (R+U): measured by NSO → (Ministry of Statics and Programme Implementation)

NSO: National Statical office

1950 : NSSO (National Sample survey office) (Data collection)

1951 : central statical office

on 23rd may, 2019 (NSSO + CSO) → NSO

- Number of items : Rural (448)
  urban (460)
- Include both goods and services.

⇒

Items	weightage
food and Beverage	→ 45.86%
pan, tobacco and intoxicant	→ 2.38%
Clothing and footwear	→ 6.53%
Housing	→ 10.07%
fuel and light	→ 6.84%
Miscellaneous	→ 28.32%

Wholesale Price Index (WPI)

- It measures the change in the wholesale price of goods. ~~and services~~
- It measures inflationary conditions for producers and wholesellers.
- WPI is measured by : office of Economic Advisory (OEA)

  * Department for promotion of Industry and Internal Trade.

  Comes under $\boxed{\text{MOCI}}$
  ⇓
  ministry of commerce and Industry

- Base year : 2011-12 (2004-05)

- Number of items : 697 (goods only)

- WPI Items

Items	weightage
primary item (grains, fruits vegetables, minerals) →	22.62 %
fuels and powers (coal, electricity and oil) →	13.15 %
Manufactured product →	64.23 %

Note : In India the main method of measuring inflation is CPI-combined (Rural + urban)

Reason behind CPI over WPI :

(i) It includes the retail prices

(ii) It includes services as well

(iii) ~~The~~ In CPI the more weightage is given to food items than WPI

- currently, July 2023 in India the inflation is 7.44 %

Producers price Index (PPI)

- It measures the change in the prices which are received by producers in the domestic and international market

- Includes both goods and services.
- BN Goldar Committee recommended by PPI
  - (i) In India, for measuring inflation the PPI must be used by basis.
  - (ii) PPI must include services as well
- Base year : 2011 - 12

WPI food index

- Started in 2017
- measured by DPIIT

CPI food price Index

- Started in 2017
- measured by NSO

FAO food price Index

- Food and Agricultural organisation
- FAO comes under USA
- Its measures the change in food prices at international level.
- It includes vegetable oil, meat, Diary products, sugar and foodgrains prices.

Point-to-point method / year-on-year method

$$\boxed{CPI = P_1/P_0 \times 100}$$

P_1 : current year price

P_0 : Base year price

Base year: $\boxed{\text{CPI : 2012 (100)}}$

July 2023 : ₹ 550
July 2023 : ₹ 500

$$\frac{550}{500} \times 100 = 110 \ (10\% \uparrow)$$

- currently, in India the rate of inflation is being measured by point - point basis.

- In this method, we measure inflation rate on comparing current years month with the same month in previous year.

Effect of inflation

① Rich and poor :

→ During inflation the income and wealth redistributes in favour of rich.

→ As in the underdeveloped and developing country just as India there is a huge income disparity and during inflation rich people will get more benifited.

② consumer and producers

→ As during inflation the producer will get higher price of their commodities and will get benifited.

③ Fixed income group and flexible group

→ fixed income group includes saleries pensions, pensioners etc and flexible include service provider and traders and because of inflation flexible income group gets more income.

④ Creditor Debtor

Creditor : Loan provider
Debtor : Loan receiver

→ Debtors will get more benifited because the purchasing power of money decreases.

⑤ Small and Big Farmers

Small farmers are being like consumer as they generally involve in subsistance farming and big farmer like producers. Hence the Large farmers get more benefited during inflation

⑥ Share holders and Debenters

Share holders will get more price during inflation.

⑦ Balance of payment (BOP)

BOP

favourable
Export > Import

unfavourable
Import > Export
⇓
inflation

During inflation the export become less competative in international market. Hence Export would be less.

⑧ <u>foreign Exchange Rate</u>

Due to <u>more import</u> and <u>less export</u> the indian rupees start depreciating.

⑨ <u>on Employment</u>

In short run <u>inflation and employment</u> are <u>positively related</u> with each other. But, not possible in long run.

⑩ <u>on savings</u>

As <u>during inflation</u> prices of commodities <u>increases</u> and hence <u>people saves less</u>.

fiscal policy

- It is the policy of ministry of finance.
- Also called budgetory policy
- In this policy the government control inflation with the help of it government revenue and expenditure.

Objectives of fiscal policy

① Price stability

with the help of fiscal policy govern-ment threw its revenues and expenditure, controls liquidity. for controlling price fluctuation.

② Economic growth

The main objective of fiscal policy is economic growth so as, to increase the investment in the economy with the help of this the GDP growth can be perfeird.

③ Equal distribution of income

Government with the helps of its ~~income~~ revenue and expenditure make equal distribution of income in economy.

- In the underdeveloped and developing country there is a huge income disparity among people of the country.

- Equal distribution of income can be achieved through.

① By imposing high taxes on rich.

② reducing taxes of the poor people.

③ Through different government scheme the government can distribute money to low income people.

④ for employment activites, the government can increase

④

① By establishing more and more public sector

② By providing subsidies and reducing taxes of the private sector.

Sukanya Samridhi Yojana : 0 – 10 year
min inv : 250 per FY
max inv : 1.5 Lakh per FY

- KVP - Kishan vikash patra
- Amount double in 115 month

fiscal policy

Government Expenditure

- public work (Road, Dam Bridges)
- public welfare (Scholarship old age pension)
- Defence
- Subsidies

Government Revenue

- Tax
- Disinvestment
- public borrowings
  ↓
  Govt Bond
  (Ex: NSC, for 5 year KVP etc)

National Saving Certificate (in post office)
- min : 1000

MS↓ Inflation	Deflation MS↑
(i) Government Expenditure ↓	(i) Government expenditure ↑
(ii) Tax ↑	(ii) Tax ↓
(iii) Disinvestment ↑	(iii) Disinvestment ↓
(iv) public borrowings ↑	(iv) public loan ↓

Types of fiscal policy

Contractionary fiscal policy	Neutral fiscal policy	Expansionary fiscal policy
Gov Exp < Gov Rev	No change in the government revenue and expenditure	Gov Exp > Gov Rev
(for controlling inflationary situation)		(for controlling deflationary situation)
(surplus Budget)		(Deficit budget)

Sub-prime crisis: It is a situation where Banks provide loan to such people those who do not have the capability of paying back the loan amount.

* It has been observed in 2008 USA. where the gianed bank like Lymen brothers suffered from huge looses.

fiscal cliff : It is related with the sub-prime crisis of USA. In this the congress in America reduced the tax rate and decided a particular time i.e, mid-night of 31st dec 2012.

- with the effect from 1 Jan 2013 the government increases tax rate
- Due to this higher tax rate and reduction in government expenditure made to reduce the negative effect of sub-prime crisis.

fiscal Drag : By imposing higher taxes on rich people and controlling the economic situation.

fiscal Consolidation : when the government controls in loan and Debt deficit

fiscal glide : The sysmatic implementation of fiscal consolidation

fiscal slippage : when the government fails to achieve the targated deficit

Monetary Policy

Monetary policy commitee

- formed in 2016. by the recommendation of urjit patel commitee

- for the introduction of mpc → RBI act 1934 section 45-2B.

- 6 members in mpc

  (i) chairman - RBI governor.

  (ii) mpc incharge - one of DY governor of RBI

  (iii) one of the director of RBI.

  (4)
  (5) → government ~~RBI~~ members
  (6)

• Jayant R Verma. ashika goel and shasant behede. (government members)

- The government members are nominated for 4 year.

- Atlest 4 sitting of mpc

- In every sitting there must be atleast (4 members)

- In case of tie, then the RBI governor has casting votes.

Monetary policy

Quantitave / General Instrument

- Bank Rate
- Repo Rate
- margin standing facility
- Reverse Repo Rate
- standing Deposit facility

policy Rate

- Cash ~~Credit~~ Reserve Ratio
- statutory Liquidity Ratio

Reserve Ratio

- open market operation

Qualitative / Selective Instrument

- margin Requirements
- Rationing of credit
- consumer credit Regulation
- moral pressure/suasion
- Direct Action

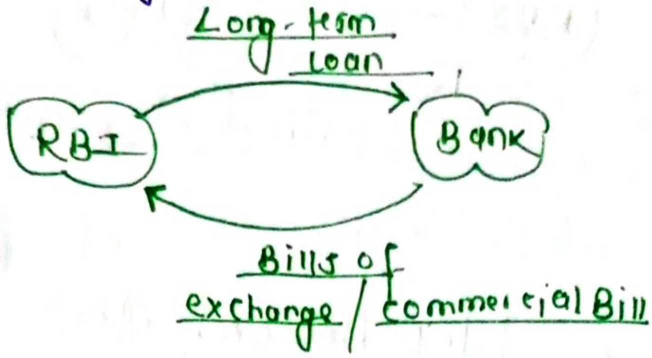
Policy Rate

Bank Rate

- It is the rate at which RBI provide long term loan to all the commerical bank.

- In bank rate banks need to deposit the commerical bills / Bill of exchange with the RBI. Hence, it is also called 'Re-discounting' bills of exchange.

- currently it is 6.75%.



Repo Rate

- It is the rate at which RBI provide short-term loan to all commercial Bank.

- Here Bank needs to deposit government securities

- Generally, Banks use Repo Rate for fullfiling the temporary mismatch of fund.

- Introduced in 1992

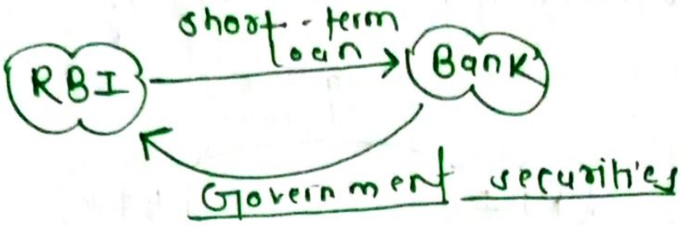
- Repo stands for — Repurchase option

- Repo Rate is also called Benchmark policy rate, beacuse by this RBI implements monetary policy and monetary transmission mechanism

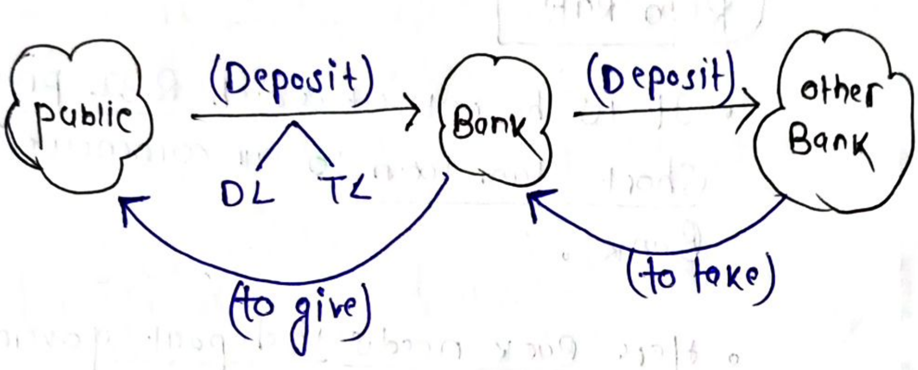
Repo Rate

Overnight Repo
- for one night
- upto 0.25% of NDTL

Term Repo
- 3 days, 7 days, 14 days and 28 days
- 0.75% of NDTL

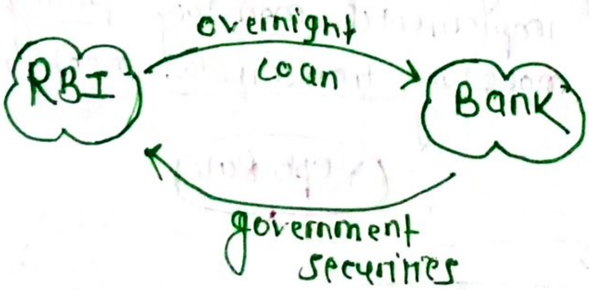


Net Demand And Time Liabilities



Margin standing facility

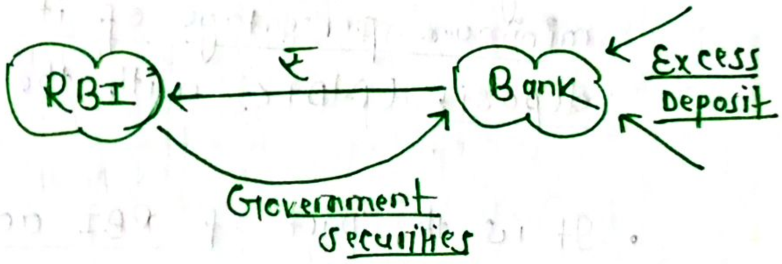
- It is the rate at which RBI provide overnight loan to all the commercial bank.
- Introduced in 2011.
- It can be upto 2% of bank NDTL and in the multiple of ₹ 1 crore.



Note: from 2011 onward MSF = Bank Rate.
* Always greater than Repo Rate.

Reverse Repo Rate

- It is also called fixed Reverse Repo Rate.
- It is rate at which RBI borrows money from Bank by depositing G.S.
- It is generally used when Banks have excess deposits / Liquidity i.e, it is the tool with the Banks to park their excess reserves with the RBI.
- It is always less than Repo Rate.
- Introduced in 1996



Standing Deposit facility

- urjit patel committe
- Announced in Budget 2018-19
- Introduced / Implemented in 2022
- Introduced by amending section 17 of RBI Act 1934
- In this Banks deposit their excess Liquidity with RBI but RBI does not provide any security.
- It is uncollateralised Deposit facility with Bank.

- Generally RBI uses it for absorbing excess liquidity from the economy.

- RBI declared that it would be less than 0.25% from Repo-Rate.

Note : Basis point (bps)

$\boxed{1 \text{ bps} = 1/100 \%}$

$25 \text{ bps} = 25/100 \% = 0.25\%$

Cash Reserve Ratio

- Every commercial bank deposit a minimum percentage of it total deposit (NDTL) with the RBI.

- It is the part of RBI act 1934 section $\boxed{42\text{-}2}$

- RBI does not provide any ~~CRR~~ interest on CRR.

- It must be only in cash form

- In 2006 the minimum and maximum limit of CRR (3-15) has been removed.

- 4.5%

Statutory Liquidity Ratio

- Every commercial bank have to maintain a fixed percentage of NDTL within itself.

- It comes under banking regulation act 1949 section : $\boxed{24 (2A)}$

- It can be in the form of cash or Liquid assets (gold, government bond, government security, foreign currency etc)

- In 2007 the minimum limit of SLR has removed but it can be maximum $\boxed{\text{upto } 40\%}$

- 18%

Open market operation

- It mean buying and selling of government security b/w RBI and bank.

* Qualitative Instrument *

Margin requirement

- It is the difference between the value of security offered by Bank to the RBI and actual loan amount guarded by RBI to the bank.

Rationing of credit

- It is the fixation of credit by RBI for the different business activities of the bank.

priority sector Lending Norms :

- atleast 40%
- There are 8 priority sector

1. Agriculture (18%)
2. MSME (7.5%)
3. Education
4. Housing
5. Export credit
6. Renewable energy
7. social infrastructure
8. Miscellinous / other

Consumer credit regulation

- RBI makes the rules regulation related to the loan given by the bank to their customers.

Moral pressure / suasion

- RBI makes that bank must follow the guidance given by the RBI

Inf		Def
↑	BR	↓
↑	RR	↓
↑	MSF	↓
↑	ReRR	↓
↑	SDF	↓
↑	CRR	↓
↑	SLR	↓
↑	OMP (Sell)	(Buy)

(Buy) ⇒ Cheap / Easy / Loose / Dovish / Accomodative monetary policy

(Sell) ⇓ Dear / Tight Hawkish monetory policy

Direct action

If bank don't follow the guidelines drawn by RBI. then RBI has the right to deorganised or cancle the license of the bank or can impose any kind of penalty on them.

Non - conventional Monetary policy

Helicopter money

- Concept given by milton friedman.
- It is used for increasing money supply in the economy.
- In helicopter money RBI prints notes in large quantity and distributes it to the public.
- Generally it is used during recession.
- In this RBI does not take back the money.

Quantitave Easing

- when RBI purchases / Buy government securities from banks in large quantity for increasing liquidity in the economy.

fed Tapering

- It means when federal reserves gradually slow down the purchasing of securities. i.e, reducing the process of quantative easing.

operation Twist

- It is based on US approach and it has been used by US for first time in 1961.
- In India it is used in 2019
- In operation twist the central Bank purchases Long-term securities and simultenously sell for term security.
- It is used for redcing the long term interest rate in economy.

Swith operation

- when RBI purchases short term operation and sell long term security

Incremental CRR

- It is used by RBI for reducing additional liquidity from the economy.

Note RBI from [16 sep 2016 - 11 Nov 2016]
I CRR - 100%.
from [19 may 2023 - 28 July] 2023 = 10%.

Market stabilisation scheme

- Introduced in 2004
- for reducing excess liquidity from the economy RBI sells securities to the bank.

MSS	OMO
* only sell	* Buy and sell
* to dec Liquidity (↓)	* for increasing Liquidity (↑)

Long - Term Repo operation

- Introduced in 2020 (India)
- first time used by European central bank in 2008.
- increasing money supply.
- In LTRO bank can took loan from RBI for 1 - 3 year at repo rate.

Administrative policy

(i) Imposing restriction on hoarding and speculation.

(ii) Direct price control - (fixing the prices of necessary goods) and

(iii) using Buffer stock

(iv) Imposing restriction on exports

(v) Importing commodities which are in deficiency for fulfilling domestic need.