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RESEARCH ARTICLE

IMPACT OF INFLATION ON THE COST OF LIVING IN INDIA

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Abstract

An economy may be categorized as developed or developing, but "Inflation" is something which is common in both the types. Inflation is a phenomenon which cannot be avoided and is therefore a universal problem faced by all economies. If stated in simple terms, inflation is nothing but a constant rise in the prices of goods and services due to certain factors.The article critically examines the impact of inflation on the cost of living in India. All aspects of inflation are discussed in the following article.

Introduction:-

Inflation is inevitable; it can be countered with certain techniques but cannot be avoided. It is that characteristic of the economy which impacts the citizens both negatively and positively. Inthe language of common man, inflation simply means a rise in prices of goods and services ofdaily use over time. As economics is all about practical application, let's look at it this way – 10 years back, a litre of milk would cost Rs.15 and the same quantity of milk costs Rs.35 today.There have been similar rises in the prices of other essential commodities such as petrol, oil, vegetables, fruits, and many others which have had a significant impact on people's weekly budget. Thus, it is rightly said that a rise in the rate of inflation over time gradually erodes thepurchasing power of people.

As the rate of inflation increases, the purchasing power of each unit of currency reduces. Henceforth, inflation is an economic term which provides logic to why people spend more to buy a bag of wheat, fill their gas tank, or get a haircut over time. As the cost of living is the amount of money needed to cover basic expenses such as food, healthcare, and housing in a particular place at a particular time, an increase in inflation causes an increase in the cost of living. To sum it all up; let's say a person has 'x' amount of money in the year 2010 using which he can purchase 100 units of a commodity 'y' but 10 years later, in 2020, that person can no longer buy 100 units of commodity 'y' with 'x' amount of money, in fact he'll have to spend more to get 100 units of 'y'. This is exactly what is meant by "inflation gradually reducesthe purchasing power of each unit of the currency."

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The inflationary pressures started mounting from 1962-63 in India, on account of the Chinese War in 1962 and unsatisfactory supply position. The Pakistan War in 1965, and the famine conditions during 1965-66 aggravated the situation further. Inflation in India generally occursbecause of global traded commodities and several efforts made by the RBI (Reserve Bank of India) to weaken the INR against USD. This was done after the Pokhran Blasts in 1998. This has been regarded as the root cause of inflation crisis in India. The “rate of inflation as of 2021in India stands at 4.89%” (Ministry of Statistics and Programme Implementation) which is 1.31% lesser than the inflation rate in the year 2020. The average rate of inflation in India overthe past 10 years is 6.336%.

Is Inflation good or bad?

Over the past few years, inflation has been quite a debatable topic in the economic world. However, inflation has always had a dual impact on the economy; some sections have benefitted while the others have suffered. “A slowly increasing price level keeps businesses profitable and prevents consumers from waiting for lower prices before making purchases” (Sean Ross) and others also believe that the primary function of inflation is to counter deflation.

In the economy. As every story has two sides to it, of course there are others who believe inflation is less important and a net drag on the economy as rising prices make savings harder, driving individuals to engage in riskier investment strategies to increase or maintain their standard of living/wealth. To sum it all up if you owe money to someone, inflation is good foryou but, if people owe you money, then inflation is bad for you.

Factors causing inflation in India

Demand Factors

It basically occurs in a situation when the aggregate demand in the economy has exceeded theaggregate supply. It could further be described as a situation where too much money chases just few goods. A country has a capacity of producing just 5,500 units of a commodity but theactual demand in the country is 7,000 units. Hence, due to scarcity in supply the prices, the unit of the commodity rises. This is usually seen in India in context with the agrarian society wheredue to droughts, floods or inadequate rainfall leads to lesser or deteriorated output hence increasing the prices of grains as the demand still remains the same.

Supply Factors

The supply side inflation is a key ingredient for the rising inflation in India. The agricultural scarcity or the damage in transit creates a scarcity causing high inflationary pressures. Similarly, the high cost of labour eventually increases the production cost and leads to a high price for the commodity. And all these issues contribute towards a reduced supply of the commodities which further on determines the inflationary pressures. These supply driven factors have basically have a fiscal tool for regulation and moderation. Further, the global levelimpacts of price rise often impact inflation from the supply side of the economy.

Domestic Factors

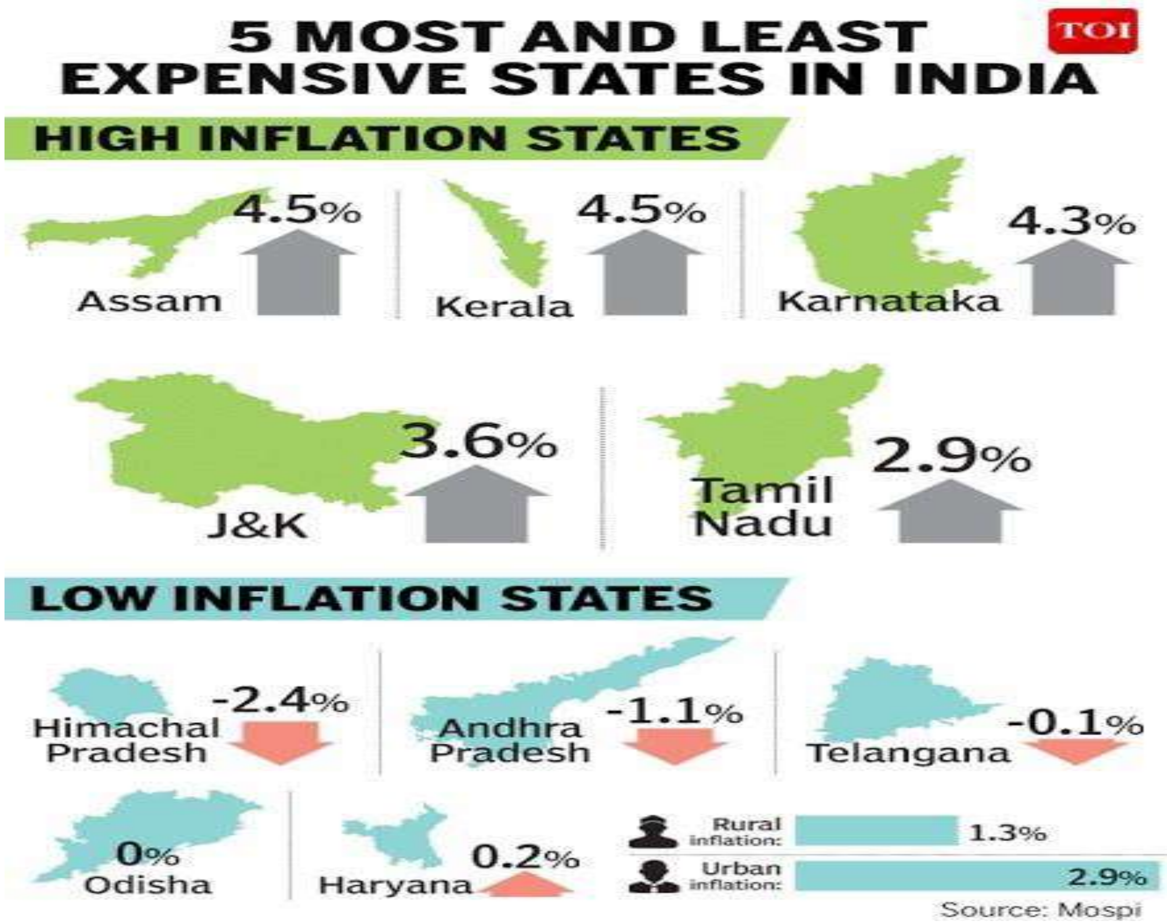
Currently, India is categorised as a developing economy and has a lesser developed financial market system which is the reason for a weak bonding between the interest rates and the aggregate demand. This accounts for the real money gap that could be determined as the potential determinant for the price rise and inflation in India. There is a gap in India for both the output and the real money gap. The supply of money grows rapidly while the supply of goods takes due time which causes increased inflation.

External Factors

The exchange rate determination is an important component for the inflationary pressures that arises in India. As the prices in United States rises it impacts India where the commodities arenow imported at a higher price impacting the price rise.

Inflation and Cost of Living

Cost of living is the amount of money needed to cover basic expenses such as housing, taxes, food, and healthcare in a particular place and time period. On the other hand, Inflation refers to an increase in the price levels of goods and services over time in an economy. Inflation is a commonly occurring phenomenon in an economy, however it can have a profound impact on your cost of living. Inflation can hurt your standard of living by eroding your purchasing power which increases your daily expenses (cost of living).



Inflation affects your standard of living because it can reduce your spending power. Retirees are often greatly affected by inflation because many retirees live on a fixed income. While their pension income remains flat, prices rise. Consequently, their disposable income is reduced as day-to-day expenses consume an ever-growing portion of their income. Wage earners experience the same problem if wages stay flat or if inflation outpaces wage increases.

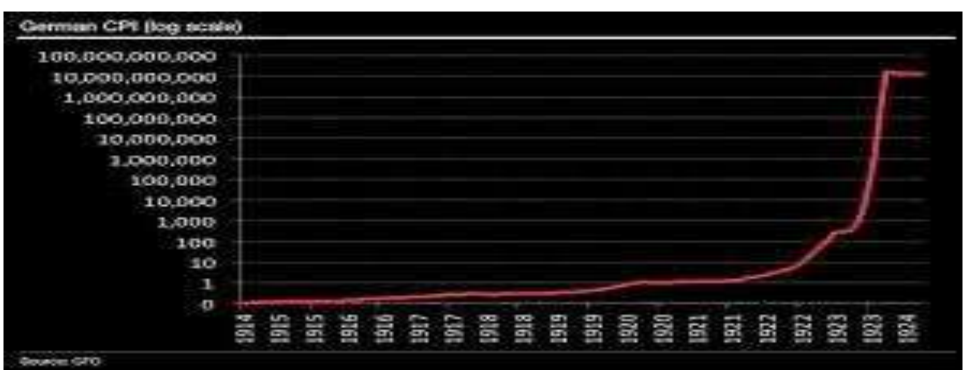
When faced with inflation, you can either curb your spending or borrow the funds needed to maintain your current standard of living. If you choose the latter, debt payments eventually erode your earnings in much the same way as inflation. You can combat a small decrease in your spending power by eliminating discretionary expenses such as gym memberships or magazine subscriptions. A more dramatic loss of spending power could force you to move intoa smaller home or to rely on public transportation rather than a personal vehicle.

What is hyperinflation? Examining the hyperinflation crisis in Germany, 1923 Hyperinflation occurs when price hikes spiral out of control. In such an economy, you may exhaust your entire budget buying basic essentials such as food and water. As the word itself suggests; hyperinflation means very high and typically accelerating inflation. It quickly erodesthe real value of the local currency, as the prices of all goods increase.

One of the worst instances of hyperinflation was seen in Germany, 1923. In November 1922, Germany defaulted on its reparation's payment as scheduled. The first reparations payment had taken all the country could afford to pay. The French believed Germany could make the repayment but were choosing not to, however the German government argued they could not afford to pay. In response, France and Belgium had sent troops into Ruhr valley, German industrial area to confiscate goods as the second instalment wasn't paid by Germany. The German government then ordered the workers to refuse to work or cooperate with the foreign troops. This led to violence in the industrial area in which "132 were killed and more than 150,000 were expelled from the area" (BBC UK).

The immediate consequences of this disturbance were severe; the German government decidedto print more money to pay the workers in the region. This flood of money being printed by thegovernment led to hyperinflation as the more money was printed, the more prices rose.

Gradually prices ran out of control, for example a loaf of bread, which costed 250 marks in January 1923, had exponentially risen to 200,000 million marks in November 1923. By the autumn of 1923, it costed more to print a note than the note was worth. During the crisis, workers were often paid twice per day because prices rose so rapidly that their wages were virtually worthless by lunchtime. From the case studied above, it’s quite evident how much ofa profound impact inflation can have on the cost of living.



Rate of Inflation and CPI

The rate of inflation is the rate at which the general rise in the level of prices, goods and servicesin an economy occurs and how it affects the cost of living of those living in a particular country.The Consumer Price Index (CPI) is a measure that examines the weighted average of a particular set of consumer goods and services associated with the cost of living, such as health care, food, and housing. CPI is calculated by considering the price changes for each item in the predetermined set of goods and averaging them. Changes in the CPI are used to analyze the price changes related to the cost of living. These changes when represented in percentage giveus the rate of inflation.

In India, CPI is declared as the new standard for measuring inflation. CPI numbers are typicallymeasured monthly, and with a significant lag, making them unsuitable for policy use. India uses changes in the CPI to measure its rate of inflation. The WPI (Whole-Sale Price Index) measures the price of a representative basket of wholesale goods. In India, this basket is composed of three groups: Primary Articles (16.8% of total weight), Fuel and Power (2.3% of total weight) and Manufactured Products (80.9% of total weight). WPI numbers were typically measured weekly by the Ministry of Commerce and Industry. This makes it more timely than the lagging and infrequent CPI statistic. However, since 2009 it has been measured monthly instead of weekly.

Government Policies to tackle inflation in India

One popular method of tackling inflation used by the government is through a contractionary monetary policy. The goal of a contractionary policy is to reduce the money supply within an economy by decreasing bond prices and increasing interest rates. This helps reduce spending because when there is less money to go around: those who have money want to keep it and save it, instead of spending it. It also means there is less available credit, which can reduce spending. Reducing spending is important during inflation because it helps halt economic growth and, in turn, the rate of inflation.

There are three main tools to carry out a contractionary policy

Increasing Repo Rates

The first tool is to increase interest rates through the Reserve Bank of India (central bank). Reporate is the rate at which the central bank of a country (Reserve Bank of India in case of India) lends money to commercial banks in the event of any shortfall of funds. When the RBI increases this repo rate, banks have no choice but to increase their rates as well. When banks increase their rates, fewer people want to borrow money because it costs more to do so while that money accrues at a higher interest. So spending drops, prices drop and inflation slows.

Increasing Reserve Requirements

The second tool is to increase reserve requirements on the amount of money banks are legallyrequired to keep on hand to cover withdrawals. The more money banks are required to hold back, the less they have to lend to consumers. If they have less to lend, consumers will borrowless, which will decrease spending.

Reducing Money Supply

The third method is to directly or indirectly reduce the money supply by enacting policies thatencourage the reduction of the money supply. Two examples of this include calling in debts that are owed to the government and increasing the interest paid on bonds so that more investorswill buy them. The policy raises the exchange rate of the currency due to higher demand (through capital inflows if your rates are increasing relative to foreign rates) and, in turn, increases imports and decreases exports. Both of these policies will reduce the amount of money in circulation because the money will be going from banks, companies and investors' pockets and into the government's pocket where it can control what happens to it.

Investments, a necessary evil to counter inflation

Most of the financial difficulties that common people face is caused by inflation. In simple terms, inflation means a steady rise in prices of commodities and services. As the rate of inflation increases year by year, goods and services become more expensive thereby decreasing the purchasing power of the people. Since the market prices cannot be controlled by the people unless there is a sharp rise in the overall demand, the only way to get ahead of inflation is by earning more money. However, money just doesn't grow on its own. For money to grow, it needs to give returns either in the short term or long term.

The most ideal way of earning returns is to invest money. In this way, no additional work is required to be done by the people, it's the money invested which is going to give returns to theinvestor. Investing does not require you to do actual work, but one must wisely select the right instrument of investment that can range from equity and small savings to insurance plans and physical assets like gold or real estate. Additionally, it also requires one to understand how markets operate along with a thorough knowledge of the regulations in place. The value of an asset depends on its market demand and what price people are willing to pay for it, so it is advised to carefully assess all important information about the asset, which the investor is opting to invest in.

Smart investments help us in accumulating capital for a rainy day. We can never predict what kind of financial difficulty one might face in future. There is no better time to start thinkingseriously about making good investments as the pandemic has exposed to all of us how unpredictable life really is.

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