Rising Inflation in India

For Prelims: **Consumer Price Index**, **Consumer Food Price Index** , **Reserve Bank of India**, **Food inflation**, **Heatwaves**, **Central Statistical Office**

For Mains: Economic Impact of Inflation, Monetary Policy and Inflation Management

Source: PIB

Why in News?

The **Ministry of Statistics & Programme Implementation (MoSPI)** recently reported that the **Consumer Price Index (CPI)** or the **retail inflation** surged to 6.2% in October 2024 and the Food inflation, as per the **Consumer Food Price Index (CFPI),** rose to 10.87%.

- This marks the **highest inflation rate since August 2023**, surpassing the **Reserve Bank of India's (RBI)** upper tolerance limit of **6%.**
- Despite global inflation easing, India faces persistent price pressures, leading experts to reassess forecasts and interest rate impacts.

What Factors have Contributed to High Retail Inflation in India?

- **High Food Inflation**: A significant contributor to the surge was **food inflation,** which hit a 15-month high at 10.8%.
  - Vegetable prices shot up by 42%, marking a 57-month high. Fruit prices rose by 8.4%, and pulses saw a 7.4% increase.
- **Core Inflation Uptrend: Core inflation,** which excludes food and fuel prices, has also edged upwards, signaling persistent inflationary pressure beyond just food.
  - Inflation in household services is climbing, reflecting higher living costs.
- **Global Price Volatility:** A sharp **rise in global edible oil prices,** driven by supply disruptions and other international market factors, has directly impacted India's inflation.
  - Since **India is a major importer of edible oils,** any increase in global prices results in higher costs for domestic consumers, **contributing to food inflation**.
- **Extreme Weather Events: Heatwaves** have negatively impacted crop yields, leading to **supply shortages and higher prices**

What are the Implications of High Retail Inflation on RBI’s Monetary Policy?

- **Delay in Interest Rate Cuts:** The RBI **inflation target is 4%, with a tolerance band of 2% to 6%.** With inflation exceeding this threshold, immediate interest rate cuts are unlikely.
  - Experts predict that the RBI might only consider **reducing rates in 2025 if inflation shows a sustained decline.**
- **Focus on Inflation Control:** The RBI will continue to **prioritize controlling inflation to maintain price stability,** as unchecked inflation undermines economic growth and purchasing power.

- The RBI had projected inflation to moderate to **4.8% in Q3 and 4.2% in Q4 of FY 2024-25,** but this now seems less likely, affecting the future trajectory of interest rates.

- **RBI's Policy Dilemma:** The RBI faces a difficult decision, while it must curb inflation, it must also **avoid stifling economic growth**. Rising food prices and supply disruptions are major contributors to inflation, complicating policy decisions.
  - Given the persistent inflationary pressures, the **RBI may adopt a cautious approach,** waiting for inflation to decline before adjusting interest rates. Alternatively, it could implement a **tight monetary policy,** which, while controlling inflation, may also **impact economic growth.**
- **Potential Risks of Unchecked Inflation:** The RBI stated that continued inflation could undermine the **real economy, particularly industry and exports.**
  - If rising input costs are passed on to consumers, it could reduce consumer demand and negatively **impact corporate earnings.**
  - This may especially affect sectors like manufacturing, which **rely on stable input costs and margins.**

Note:

The **Monetary Policy Framework Agreement (MPFA)** between the Government of India and the RBI aims to **maintain price stability while considering growth.**

- According to this agreement, if **inflation stays outside the 2% to 6% range for three consecutive quarters,** the RBI must report to the central government, explaining the reasons, proposing corrective actions, and estimating when inflation will return to the target range.

What is the Consumer Price Index?

- **About:** The CPI measures the change in retail prices of goods and services commonly purchased by households for daily consumption.
  - It is used to track inflation, with the base year for the CPI being 2012.
- **Purpose:** CPI is a widely used **macroeconomic indicator of inflation,** used by governments and **central banks for inflation targeting** and price stability monitoring, and as **deflators** in national accounts.
  - CPI is also used to **index dearness allowance to employees for increases in prices.**
  - CPI helps understand the cost of living, **purchasing power,** and the expensiveness of goods and services.

What is the Consumer Food Price Index?

- CFPI measures inflation that focuses exclusively on the price changes of food items in a consumer's basket.
- CFPI tracks price changes of a basket of commonly consumed food items like cereals, vegetables, fruits, dairy, meat, and other staples.
  - Like the CPI, the CFPI is **calculated monthly with the base year presently used as 2012.**
- The **Central Statistical Office (CSO),** MOSPI releases CFPI for three categories (rural, urban, and combined) separately on an all-India basis.

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Drishti Mains Question:

Examine the implications of high retail inflation on the Reserve Bank of India's monetary policy.

UPSC Civil Services Examination, Previous Year Questions (PYQs)

Prelims

Q 1. The lowering of Bank Rate by the Reserve Bank of India leads to (2011)

(A) More liquidity in the market
(B) Less liquidity in the market
(C) No change in the liquidity in the market

(D) Mobilization of more deposits by commercial banks

Ans: A

Q.2 Consider the following statements: (2020)

1. The weightage of food in Consumer Price Index (CPI) is higher than that in Wholesale Price Index (WPI).
2. The WPI does not capture changes in the prices of services, which CPI does.
3. Reserve Bank of India has now adopted WPI as its key measure of inflation and to decide on changing the key policy rates.

Which of the statements given above is/are correct?

(a) 1 and 2 only
(b) 2 only
(c) 3 only
(d) 1, 2 and 3

Ans: (a)

Q 3. If the RBI decides to adopt an expansionist monetary policy, which of the following would it not do? (2020)

1. Cut and optimize the Statutory Liquidity Ratio
2. Increase the Marginal Standing Facility Rate
3. Cut the Bank Rate and Repo Rate

Select the correct answer using the code given below:

(A) 1 and 2 only
(B) 2 only
(C) 1 and 3 only
(D) 1, 2 and 3

Ans: B