

INFLATION

Pratyashi Tamuly
September 2025

Inflation is a fundamental economic concept referring to the general rise in prices of goods and services over a period of time, leading to a decrease in the purchasing power of money. In simpler terms, when inflation occurs, the same amount of money buys fewer goods and services than before, which affects consumers, businesses, and policymakers alike. Inflation is usually expressed as a percentage change in a price index, such as the Consumer Price Index (CPI) or Wholesale Price Index (WPI), over a year.

Thus, Inflation refers to the general rise in prices of goods and services over time, which leads to a decrease in the purchasing power of money. While inflation has both advantages and disadvantages, its impact depends largely on its rate and stability in the economy.

Meaning of Inflation

Inflation in India represents the increase in the cost of living faced by Indian consumers and businesses. It reflects changes in prices of essential commodities like food, fuel, housing, transportation, healthcare, and education. The Indian government and the Reserve Bank of India (RBI) closely monitor inflation because it impacts economic stability, purchasing power, and growth.

For example, if inflation in India is 5%, something that cost ₹100 last year will cost ₹105 this year on average. If wages don't increase at the same rate, people can afford fewer goods, which affects their lifestyle.

Types of Inflation in India

1. **Demand-Pull Inflation:** It happens when aggregate demand exceeds aggregate supply in the economy. For instance, in good monsoon years, increased rural incomes boost demand for goods, sometimes outpacing supply, driving prices up.
2. **Cost-Push Inflation:** Caused by rising input costs like higher fuel prices or wages. For example, a sudden increase in crude oil prices raises transportation costs, making goods more expensive in India.
3. **Built-In Inflation:** This occurs due to the wage-price spiral, where workers demand higher wages because of expected inflation, and companies pass costs on by raising prices. This feedback loop has been observed in wage negotiations in many Indian industries.

Causes of Inflation in India

1. **Food Price Volatility and Supply Constraints:** Since food accounts for a large portion of the CPI basket in India (nearly 46%), poor monsoon rains or supply chain disruptions affect food availability and push prices higher.
2. **Fuel Price Fluctuations:** India is largely dependent on oil imports, so global oil price movements directly impact inflation. When crude prices rise, inflation usually follows.
3. **Monetary Factors:** Excess liquidity or money supply without adequate economic output can cause inflation. India's RBI manages money supply through monetary policy to control inflation.
4. **Fiscal Deficit and Government Spending:** High government spending financed by borrowing can increase money supply and demand, fuelling inflation.

5.External Factors: Global commodity price changes, currency depreciation weakening the rupee, and import tariffs can also push inflation upwards.

Measuring Inflation in India

A. Consumer Price Index (CPI): The primary measure capturing retail price changes for a basket of goods and services consumed by households. It covers food, housing, fuel, etc.

B. Wholesale Price Index (WPI): Measures price changes in goods at the wholesale level. It was the primary measure till 2014 but now CPI is preferred.

Recent data (July 2025) shows retail inflation in India at about 1.55% year-on-year, reflecting moderation primarily due to falling food and fuel prices. This low inflation impacts purchasing power positively for Indian consumers.

Example of Inflation Impact in India- Imagine that in 2024, the price of a kilogram of rice was ₹40. With an inflation rate of 5%, in 2025, the price of the same kilogram may rise to ₹42. If household incomes do not rise equivalently, families will find it harder to afford even staple foods. Over time, this increased cost erodes savings and reduces overall consumption, affecting economic growth.

From 2013, India experienced higher inflation, peaking near 10%, causing hardships especially for low and middle-income groups. Conversely, inflation around 2-3% in years like 2025 is considered manageable and stable by RBI's standards.

Thus, Inflation in India is a dynamic phenomenon influenced by domestic factors like agriculture, fuel prices, monetary and fiscal policies, and external global economic conditions. It affects cost of living, savings, investments, and overall economic health. Managing inflation within a reasonable range is crucial for sustainable economic growth and the wellbeing of Indian citizens

Advantages of Inflation in India

- 1.Encourages Economic Growth: Moderate inflation motivates businesses to increase production and investment, leading to economic expansion.
2. Helps Adjust Real Wages: Inflation allows relative wage adjustments without cutting nominal wages, helping employers reward productivity and manage labour costs.
3. Reduces Unemployment: Demand-pull inflation can lead to higher demand for goods and services, pushing firms to hire more workers.
- 4.Erodes Real Debt Burden: Inflation reduces the real value of debt, benefiting borrowers including government and individuals with fixed-rate loans.
5. Avoids Deflation: Moderate inflation is preferable over deflation, which can cause economic stagnation and increased debt burden.
6. Promotes Investment: Inflation encourages spending and investment rather than hoarding cash, helping circulation of money in the economy.
7. Facilitates Price Adjustment: Inflation allows prices to reflect changes in supply and demand, helping resource allocation.
8. Boosts Government Revenue: Inflation increases nominal tax revenues without raising tax rates, helping fund public services.
9. Discourages Hoarding of Money: With rising prices, holding cash loses value over time, encouraging people to invest or spend, stimulating economic activity.

10. Benefits Exporters: Inflation targeting exchange rates can sometimes improve competitiveness of exports if inflation is moderate compared to global rates.

Disadvantages of Inflation in India:

1. Reduces Purchasing Power: Inflation diminishes the value of money, making everyday essentials more expensive, impacting especially low and fixed-income households.
2. Creates Uncertainty: High inflation creates unpredictability, deterring long-term investment and economic planning by businesses.
3. Hurts Savers: Inflation erodes the real value of savings, particularly if interest rates do not keep up with rising prices.
4. Distorts Income Distribution: Inflation disproportionately affects fixed-income earners, pensioners, and those with savings, widening inequality.
5. Reduces International Competitiveness: Higher inflation relative to trade partners makes Indian goods more expensive globally, affecting exports adversely.
6. Increases Cost of Living: Rising food, fuel, and housing costs strain household budgets, potentially leading to social unrest.
7. Creates Menu Costs: Businesses face increased costs adjusting prices frequently, adding to inefficiencies.
8. Leads to Wage-Price Spirals: Inflation can trigger a vicious cycle of rising wages and prices, making inflation difficult to control.
9. Higher Interest Rates: To control inflation, RBI raises interest rates, which can slow down borrowing and economic growth.
10. Undermines Economic Stability: Persistent high inflation can lead to loss of confidence in the currency and economic instability.

Inflation is a sign of a growing economy but requires balance. Moderate inflation encourages spending, investment, and growth, while very high inflation harms consumers, savers, and economic stability. Understanding inflation's pros and cons helps students make better financial decisions, like when to borrow, save, or invest.

