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INFLATION: RESULTANT OF COVID 19 PANDEMIC

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Abstract

The Reserve Bank of India (RBI) adopted a flexible inflation targeting framework in 2014, with a medium-term target of 4% formalized in the latter half of 2016. An analysis by the RBI staff suggests that India's pre-Covid-19 inflation rate was around 4.3%. The rise observed during the pandemic is likely of a transient nature. RK Sinha's paper explains that the specific pace at which business conditions recover and return to normal, along with changing circumstances, may determine the extent and timing at which inflation transitions to a lower trajectory. A 2017 study by the RBI staff revealed that the steady equilibrium level of inflation in India over the long term was determined to be 4.1%. The Indian economy has experienced significant disruptions in the past year, including the coronavirus pandemic, supply chain disruptions, and a notable increase in the Consumer Index Rate from 139.6 to nearly 150 in December 2019.

The global pandemic has caused significant wage and unemployment reductions due to lockdown measures in several countries. The inverse correlation between inflation and unemployment suggests that higher unemployment leads to lower inflation, while lower unemployment leads to higher inflation. India has experienced record job losses, surpassing previous records in economic history. The "precariat" population in India, those lacking predictability and security, is estimated to be as large as Russia's population, significantly impacting their material and psychological well-being. The number of individuals submitting unemployment claims has increased significantly, surpassing the figures recorded during the Global Financial Crisis in 2009. The unemployment rate has risen to 23.5% in India.

Keywords: Inflation, Covid 19, Consumer Index Rate, Inflation Rates, India

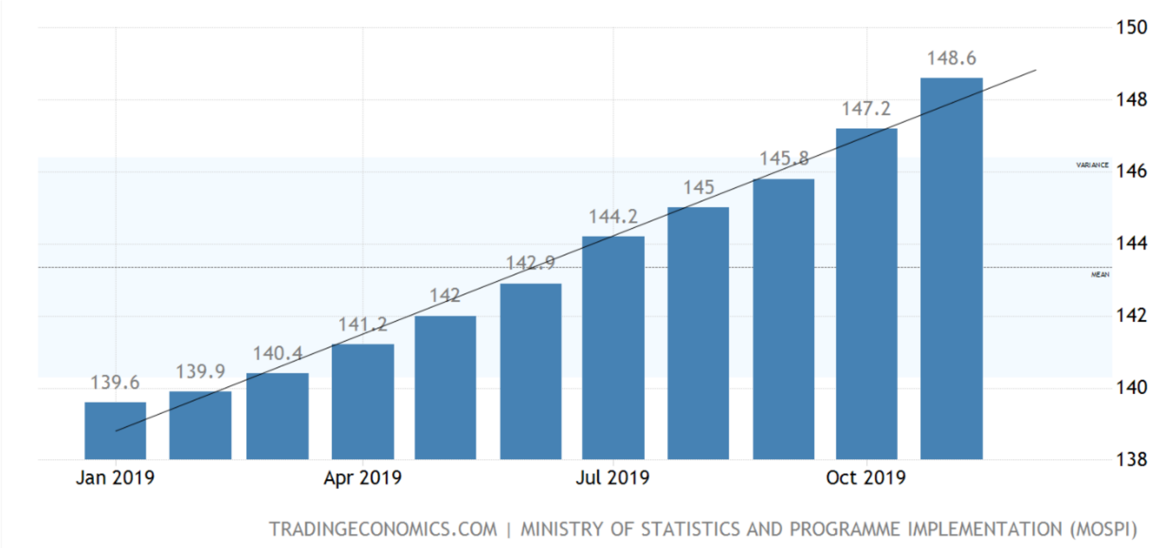
The adoption of the flexible inflation targeting framework by the Reserve Bank of India occurred in the early months of 2014, while the official acceptance of a medium-term target of 4 percent was not formalised until the latter half of 2016. According to an analysis conducted by the staff of the Reserve Bank of India (RBI), it is likely that India's inflation rate in the pre-Covid-19 period was approximately 4.3 percent. The rise observed during the pandemic is likely of a transient nature.

According to a paper authored by RK Sinha from the Monetary Policy Department, the specific pace at which business conditions recover and return to normal, in conjunction with the changing circumstances, may determine the extent and timing at which inflation transitions to a lower trajectory.

Sinha stated in his paper that in light of different shocks, there has consistently been a relevant inquiry regarding the trajectory of inflation in India during the post-FIT period, and its long-term equilibrium level.

In the aforementioned context, a study was conducted by the staff of the Reserve Bank of India (RBI) in 2017, which revealed that the steady equilibrium level of inflation in India over the long term was determined to be 4.1 percent. The analysis conducted by Sinha builds upon the findings of a prior study conducted in 2017.

The Indian economy has experienced a series of significant disruptions in the past year, including the impact of the coronavirus pandemic, subsequent disruptions in supply chains, and a notable increase in the Consumer Index Rate from 139.6 to nearly 150 in December 2019

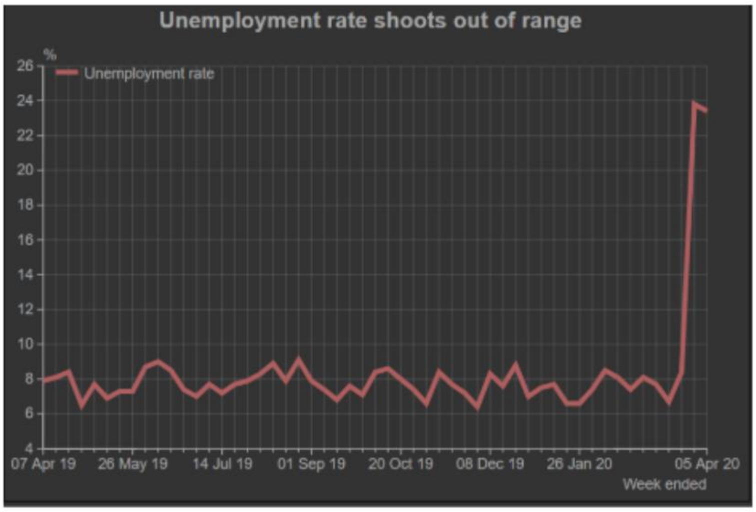


Impact of Covid-19 in India

The current global pandemic has led to a significant proportion of individuals experiencing reductions in their wages and unemployment as a consequence of several nations implementing lockdown measures. There exists an inverse correlation between inflation and unemployment, whereby higher levels of unemployment are associated with lower levels of inflation, and conversely, lower levels of unemployment are associated with higher levels of inflation. In recent weeks, India has experienced a significant increase in job losses, surpassing any previous records in the field of economic history. According to a report by The Print, the current population of individuals referred to as the "precariat" in India, denoting those who lack predictability and security in their lives, is estimated to approach the population size of Russia. This precarious state significantly impacts their material and psychological well-being. The graphical representations provided below illustrate a notable increase in the number of individuals who have submitted unemployment claims in both the United States and India, surpassing the figures recorded during the Global Financial Crisis in 2009.

The unemployment rate has seen a sharp movement upwards to 23.5% in India

INDIA'S UNEMPLOYMENT RATE



Source: CMIE 2020.

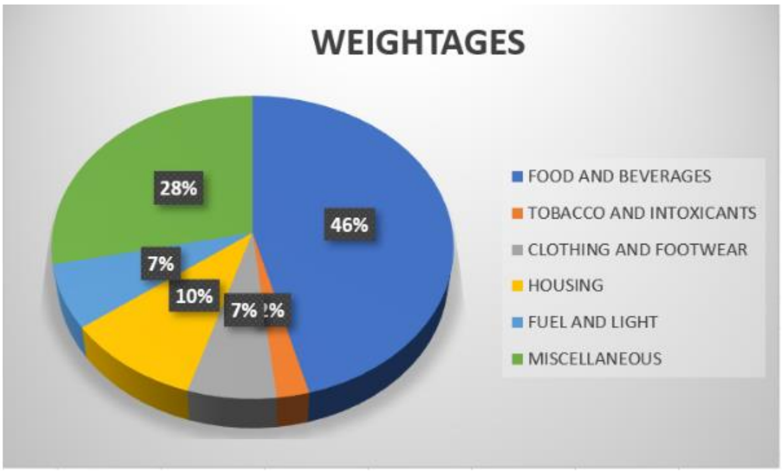
Over the course of the previous five years, India has consistently experienced an average inflation rate slightly surpassing 4 percent, as depicted in the chart provided below. In the year 2017, the inflation rate declined to a level below 2 percent. However, in recent months, there has been a significant increase in the inflation rate of the country. The inflation rates had surpassed 8 percent, but are currently exhibiting a gradual decline.

INDIA'S INFLATION RATE OVER THE PAST 5 YEARS

Over the course of the previous five years, India has consistently experienced an average inflation rate slightly exceeding 4 percent, as evidenced by the chart provided below. In 2017, the inflation rate dropped to less than 2 percent. However, in recent months, there has been a significant increase in the country's inflation rate. The inflation rates had experienced an increase surpassing 8 percent, however, they are currently exhibiting a gradual decline.

Over the course of the last five years, the inflation rate in the United States has averaged approximately 1.5 percent. This period was characterised by initially low inflation rates in 2015, followed by a gradual upward trend. Both India and the United States employ an inflation targeting mechanism. In India, the Reserve Bank of India (RBI) has set a target range of 4+-2 percent for inflation, indicating its desired level of price stability. Conversely, the Federal Reserve in the United States aims to maintain inflation within a range of 1 to 2 percent, reflecting its objective of price stability within the country.

The transition from the Wholesale Price Index (WPI) to the Consumer Price Index (CPI) in India has necessitated a comprehensive understanding of the components comprising the Indian CPI basket. This understanding is crucial in order to gain insights into the potential trajectory of inflation in light of the ongoing COVID-19 pandemic. The Consumer Price Index (CPI) in India is classified into the following categories:

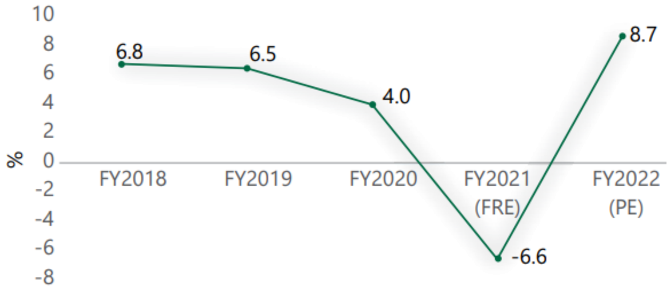


Source: Numberbasket, 2020

The Recovery Path

Following a span of two years and three successive waves of the COVID-19 pandemic, the Indian economy commenced its recuperation from the second quarter of the fiscal year 2022, albeit with certain sectors encountering challenges in restoring their pre-pandemic growth trajectory. Multiple high-frequency indicators, growth figures, and sectoral indicators have indicated a potential recovery.

India achieved a growth rate of 8.7% in its gross domestic product (GDP) during the fiscal year 2022, surpassing the level observed before the pandemic (Figure 1.1). This development has rekindled our aspirations of attaining the position of the third-largest global economy by the mid-2030s. The implementation of expansionary fiscal policies and monetary, regulatory, and liquidity measures that placed a greater emphasis on promoting economic growth, as opposed to other objectives, contributed to the recovery of the Gross Domestic Product (GDP) during the second and third quarters of the fiscal year 2022. However, the momentum of this recovery was somewhat hindered in the fourth quarter of the fiscal year 2022 due to the emergence of COVID-19 Omicron infections and ongoing global geopolitical conflicts. The growth rate was relatively high as a result of localised lockdown measures, the ability to adapt COVID protocols, and the implementation of vaccination campaigns. The business community experienced enhanced expectations and consumer confidence, which in turn positively impacted the investment climate. This was evident in the increased ratio of gross fixed capital formation to GDP, which rose to 32.5% in comparison to the previous fiscal year's ratio of 30.5%.



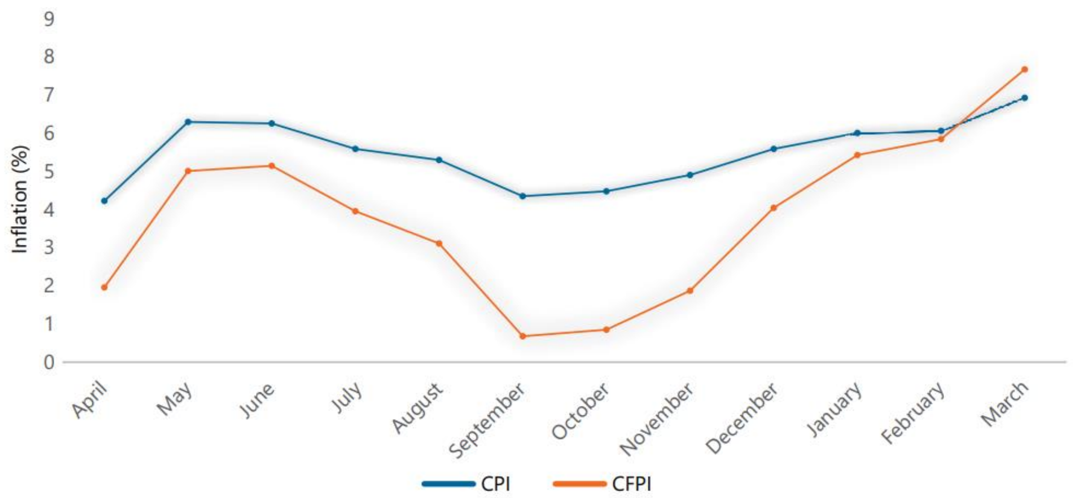
Note: FRE = First Revised Estimates; PE = Provisional Estimates.
Source: National Statistical Office, Ministry of Statistics and Programme Implementation, Government of India.

Inflationary Pressure

The average retail inflation in India, as measured by the consumer price index, experienced an increase from 3.4% in FY2019 to 4.8% in FY2020. Subsequently, it rose to 6.2% in FY2021 before declining to 5.5% in FY2022. The inflationary pressures were a consequence of the supply chain disruptions, economic stagnation, and increased food prices brought about by the pandemic.

Source: Ministry of Statistics and Programme Implementation, Government of India.

The fiscal year 2022 experienced a significant increase in inflation, with the rate rising from 4.2% in April to 6.3% in both May and June. This upward trend can be attributed to the escalating prices of food and commodities. However, the months following, specifically July (5.6%) to September (4.4%), experienced a decrease in inflation due to the ongoing reduction in food prices, particularly vegetables. This is evident in the food inflation rate of 0.7% in September, although fuel inflation remained elevated. The time frame spanning from October 2021 to March 2022 exhibited a consistent rise in inflation, starting at 4.5% and reaching 6.7%. This surpassed the tolerance threshold of 6% set by the Reserve Bank of India (RBI). This phenomenon can be attributed to a significant increase in food inflation, which escalated from 0.9% to 7.7%. The Reserve Bank of India (RBI) has forecasted a retail inflation rate of 6.7% for the fiscal year 2023.14 However, the phenomenon of global inflation has the potential to exacerbate inflationary expectations in India.



Note: CPI = Consumer Price Index; CFPI = Consumer Food Price Index
Source: Ministry of Statistics and Programme Implementation, Government of India.

Moreover, the Reserve Bank of India (RBI) was compelled to take action in response to the United States' implementation of quantitative tightening and a succession of interest rate increases. These measures were implemented in the face of the highest inflation levels seen in four decades, which exceeded the target rate by more than fourfold. As a result, the RBI had to ensure that it did not fall behind in addressing the inflationary pressures that had breached the established targets and proved India was compelled to address a range of challenges, including the flight of capital, depreciation in the value of the Indian Rupee, a deteriorating current account deficit, imported inflation, and volatility in the financial markets. India's foreign exchange reserves were utilised, resulting in a decrease to $596 billion, although the current level remains satisfactory.

The developments in the money and debt market can be attributed to the implementation of fiscal and monetary policies and the establishment of specific priorities. Throughout the duration of the pandemic, the Reserve Bank of India (RBI) placed emphasis on fostering growth and maintaining ample liquidity within the system. This was achieved by maintaining a low repo rate of 4% for a period spanning nearly two years, until May 2022.In the second half of the year, the money markets experienced an abundance of liquidity, resulting in an increase in short-term interest rates that were aligned with the floor of the Reserve Bank of India's liquidity adjustment facility. This rise in rates can be attributed to the rebalancing of liquidity. The hardening of yields in the debt markets during the latter half of the year can be attributed to significant bond and securities issuances by governments, as well as varying monetary policy approaches adopted globally.

India has set ambitious goals of achieving a $5 trillion economy by the fiscal year 2026, followed by a further target of reaching $10 trillion by the mid-2030s. However, the current global and domestic economic conditions discussed in this chapter have dampened the prospects.

Following a period of two years during which policy emphasis was placed on promoting economic growth and implementing accommodative monetary measures, influenced by global inflationary forces and interest rate increases by central banks in significant economies, the Reserve Bank of India (RBI) made the decision to raise the repo rate during an off-cycle monetary policy announcement.

The financial implications and market dynamics related to debt and money would have an impact on NABARD's financial situation, costs, and business operations in the upcoming fiscal year. The operation would take place within a context of high and rising interest rates, as inflation forecasts for FY2023 stand at 6.7%. This is occurring alongside a continuous downward revision of India's growth prospects by multiple agencies. In its April resolution, the Reserve Bank of India (RBI) forecasted a projected economic growth rate of 7.2% for the fiscal year 2023. This projection represents a decrease of 60 basis points compared to the pre-war estimate.

Notwithstanding these advancements, the objectives for expansion can still be achieved through the implementation of extensive reforms and the promotion of liberalisation within various sectors, including manufacturing, services, agriculture, and exports. This should be complemented by the establishment of a burgeoning start-up ecosystem.

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