Research Paper **4**

India's Monetary PolicyAnd Rising Food Inflation

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Introduction

It's a well-known fact that monetary policy and fiscal policy should be used in conjunction to monitor and check any type of economic imbalances in the economy. However, when it comes to the problem of inflation it's widely assumed as the responsibility of monetary policy makers to address it. But in a country like India, its increasingly being discussed whether monetary policy should react to the situation of rising food prices, which is primarily due to supply side bottlenecks. While food inflation is continuously rising, non-food inflation is well within control. The paper tries to explore whether increasing policy rates would be able to control inflation, particularly food inflation or it continues to dampen the economic growth.

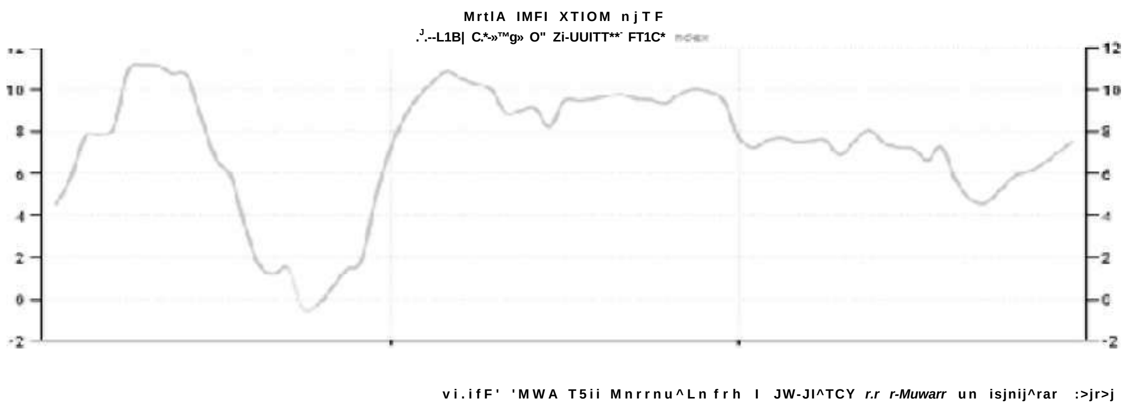
Inflation

Inflation is a continuous increase in the price of goods and services in a country. This does not necessarily mean that all price increases. There are some goods like mobile phones, camera etc. which have actually dropped in price. Inflation is usually given as the percentage increase in overall prices over a year. Continuous rise in price eats away at the value of people's money. With the same amount of money, fewer goods can be bought than before. Therefore it is said that the value of money is devaluating as inflation increases. Inflation is considered bad for the economy and for the general public. Some moderate inflation however is considered good also for any country. But the same inflation when it crosses a certain limit becomes dangerous for the economy. There are several nations in the world that faced severe crisis as they were unable to control rising prices.

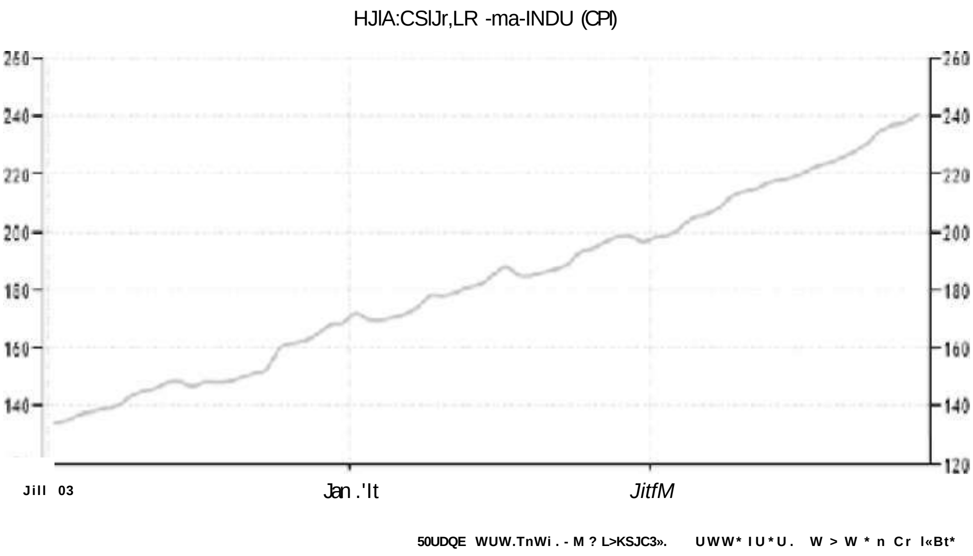
Inflation is usually caused due to an imbalance between the growth of the money supply and the expansion of an economy. If the money supply expands faster than the economy, then generally this results in high levels of inflation. As with the rising supply of money, demand for several goods goes up.Inflation can also be caused by an imbalance between the supply and demand for goods; if there is a high demand for products, their price rises and this can cause inflation. At the same time, if there are some problems related with supply side and demand continuous than also it leads towards inflation.

Measuring Inflation In India

Inflation Rate in India is reported by the Ministry of Commerce and Industry, India. In India, the wholesale price index (WPI) is the main measure of inflation. The WPI measures the price of a representative basket of wholesale goods. In India, WPI is divided into three groups: Primary Articles (20.1 percent of total weight), Fuel and Power (14.9 percent) and Manufactured Products (65 percent). Food Articles from the Primary Articles Group account for 14.3 percent of the total weight. The most important components of the Manufactured Products Group are Chemicals and Chemical products (12 percent of the total weight); Basic Metals, Alloys and Metal Products (10.8 percent); Machinery and Machine Tools (8.9 percent); Textiles (7.3 percent) and Transport, Equipment and Parts (5.2 percent). Inflation Rate in India averaged 7.71 Percent from 1969 until 2013, reaching an all-time high of 34.68 Percent in September of 1974 and a record low of -11.31 Percent in May of 1976.



Consumer Price Index (CPI) in India is reported by the Labour Bureau, Government of India. In India, the CPI measures changes in the prices paid by consumers for a basket of goods and services. Consumer Price Index (CPI) in India averaged 56.96 Index Points from 1960 until 2013, reaching an all-time high of 241 Index Points in October of 2013 and a record low of 4.32 Index Points in March of 1960.



Graph 2

It is clear from above graph that both of the measures of inflation; CPI & WPI are continuously rising. But the rise in CPI is more than WPI. Some exports believes it a failure of monetary policy, some experts hold fiscal policy as a culprit. What so ever is the reason responsible, common public especially the bottom most population is suffering the most.

Monetary Viz A Viz Fiscal Policy

Monetary policy has emerged as one of the most critical role played by the policy makers in the present time. It is accepted that low and stable inflation is important for sustainable market driven growth. Monetary policy is most critical in controlling inflation in economy. Unlike fiscal policy which has multiple targets and roles to perform, monetary policy has a direct impact over inflation. In fact in several emerging economies "Inflation Targeting" policy has become most sought after role to observe. Inflation Targeting is a framework for monetary policy, wherein, controlling inflation is the primary target used by policy makers. It is the job of the central bank, through monitoring inflation and adjusting interest rates accordingly, to strike a balance.

India, like most of the emerging economies is facing the problem of inflation. Since last few years, policies of RBI have been very closely observed and followed. Even RBI has shown a very aggressive stance by keeping high key rates to target inflation. But none of the measures adopted by them is able to check inflation. Both WPI &CPI have shown a continuous rise particularly in food segment. This raises a big question mark over the policy stance of RBI. Now the question comes that whether "Inflation Targeting" policies are actually able to target inflation or not? The fiscal policy of India is one of the most critically addressed issues now days. On one side RBI is oscillating its policy rates; on another side government seems neutral towards the situation. This dilemma over the policies has put India in a very critical situation. The declining GDP with rising inflation is a major issue for them to handle.

So now who is to be blamed for the present situation? India not only is facing the problem of rising inflation but also is passing through a phase of declining GDP. In short, India is in the grip of stagflationary condition. In such situation, country faces the problem of rising inflation coupled with declining GDP. Thus inflation targeting pulls down GDP and inducing measures to boost GDP fuels inflation.

Food Inflation

Considering India which is a poor economy, majority of population spends more than 50% of their consumption over the basic commodity particularly food. Several studies have proven that due to the rising income of people, they are consuming more of protein food including milk and milk products, eggs, meat etc. This possibly explains the problem of rising inflation in India. This type of inflation is fuelled mostly due to three factors; ballooning fiscal deficit, rising farm wages and transmission of global food inflation. Increase in fiscal deficit and its monetization induces money supply which troubles the normal demand and supply of commodities. Even Chidambaram quoted that "Demand (for food and fuel) is being stoked by the fact that we have high fiscal deficit and that fiscal deficit was not contained for a fairly long period, I think over a period of two years".

To explain the phenomena in simple word; rising fiscal deficit induces more supply of money in the economy. This definitely increases the demand of several commodities including food items. Since food production is different, in the sense, that its production cannot be immediately matched with rising demand, is most vulnerable to price fluctuations. Thus price of food items always fluctuates. To add insult to injury, in India black marketing and hoarding practices are always there.

Trends In Food Inflation In India

India is the second largest producer of vegetables in the world. Still food prices in India between 2004-13rose by 157%. All vegetables prices rise shockingly by 350% during the period. The hike led particularly by fluctuating onion and potato prices have put a big question in front of policy makes that how to deal with it.Even the price of pulses which is common source of protein for most of people increased by 123%.

Price increase ^uj-i-iuij

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AllfDdd item:.	157	Milk	lit*
nice	137	LOOS	1^4
wheat	117	CO ntf intent*	119
All Pulses	123	Sugar	106
A H	3SO	Salt	B5
Potato	1ft*5	15M	
Onion	S ? I		
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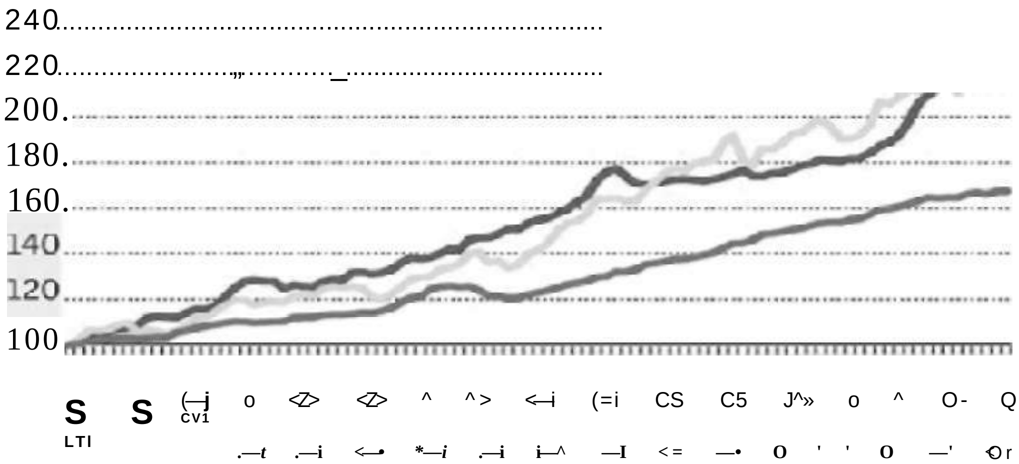
Chart 1

Food prices have risen mu **than** general prices

Wholesale Price Indices since May 2005



All commodities Food articles Food grains

Chart 2

Chart 2, which shows the monthly movements of the Wholesale Price Index (WPI) for all commodities as well as for food, indicates that food inflation has significantly outstripped the increases in the general price level. This is a serious matter for India, as being a poor nation maximum consumption is incurred over the food items. Thus the economic and social cost of inflation is becoming tremendous.

Discussion

The only way to deal with the problem of food inflation is via investing in agriculture. This needs more investment in research and development, irrigational support; increasing cultivated land for agriculture etc. along with bringing better and latest technology we need efficient farm management also for agriculture sector.Proper emphasis has to be given on reforming agricultural marketing practices to cut down the margins between consumer and farmer price. Removal of middleman and encouraging direct farm to market practices should be adopted.

With the rising population and per capita income, India's consumption of vegetables, fruits, oils and dairy products are projected to increase. This has to be matched with rising production or else long term sustainable development cannot be achieved. Inflation targeting monetary policy and Anti-Inflationary policies by the Government of India need to work together. In fact, more responsibility lies over the fiscal policy as several reforms needed for the sector depends on the government. Rationalization of excise and import duties on food items, liberalizing tariff and trade policy, strengthening public distribution system and following strict fiscal discipline are some of the most important measures to be observed. Just revising and linking monetary policy rates to inflation may not give desirable results. In fact this could result in declining GDP which may prove even more challenging for the policy makers to boost.

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