INDIAN ECONOMIC ENVIRONMENT,401
MBA, IV semester,
Topic-MONETARY AND PRICE TREND

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1.INDIA'S MONETARY AND PRICE TRENDS

A serious concern for the Indian economy since the middle of the Second Plan period has been the upward trend in the general price level. The price trends are related to, among others, the trends in money supply and government budget deficits. The imbalances between demand for and supply of wage goods, particularly food, triggered the price rise in early 1960s and several other factors have made inflation a persistent feature of the Indian economy.

2.Money Supply

Money supply has increased rapidly and regularly. The money supply with the public (currency plus demand deposits, plus other deposits with RBI, referred to as M1 in RBI publications) during the 21-year period 1970-71 to 1991-92 increased at the annual average rate of 17.7 per cent. In only one year (1977-78) it registered a fall from Rs. 15609 crores to Rs. 14388 crores. In all other years, M1 registered positive growth rates. One interesting fact is that while the average annual growth rate of M1 during the 19-year period 1970-71 to 1987-88 was 13.12 per cent, during the subsequent four-year period from 1988-89 to 1991-92 it was 18.5 per cent. Thus, prior to the severe economic crisis in 1991, M1 was growing at a significantly high rate, higher than the

average for the period 1970-71 to 1987-88.

M3 is defined as M1 plus time deposits. M3 grew at an average annual rate of 20.8 per cent during the period 1970-71 to 1991-92. The high growth rates observable in respect of M3 is largely accounted for by the growth rate in time deposits.

During 1995-2001 M1 increased from 192257 crores to 472827 crores, while M3

increased from 527596 crores to 1725222 crores during the same period.

Growth Rate: Principal Factors

Money supply growth rate has been an important factor behind the Indian inflation experience. The three principal factors responsible for the expansion of money supply is:

a) Bank credit to commercial sector, (b) Bank credit to government and (c) net foreign exchange assets of the banking sector.

Inflation rate based on Wholesale Price Index (WPI) averaged 9 per cent during the period 1970-71 to 1991-92. It reached high levels during the two years 1973-74 (20.2 per cent) and 1974-75 (23.2 per cent).

Inflation rate based on Consumer Price Index (CPI) numbers (urban nonmanual employees) averaged about 9 per cent reaching the highest level of

22.2 per cent in 1974-75. Besides the government deficits and the consequent money supply growth rate, several structural and institutional factors have been at the root of inflationary rise in prices in India beginning from mid-1950s at a slow rate, accelerating from mid-1960s and recording considerably high rates during the first half of 1970s.

3. The following factors have been responsible for inflation:

1 The very plan strategy adopted for accelerating development and the consequent trends in the composition of domestic output and foreign trade with adverse influence on domestic output and foreign trade with adverse

influence on domestic price level.

2 Closely related to the above is the forced pace of structural change with little regard for sectoral balance and price stability.

3 Role of expectations emanating from inflationary psychology.

4 Plethora of controls inspired by ideological fixation with no firm economic basis and ineffectiveness in operating them leading to the growth of parallel economy making monetary and fiscal measures almost ineffective.

5 Ineffective institutional measures for redistribution of wealth and income

6 Inflationary nature of the role of distribute trade prompted by the seller's market conditions.

7 Exogenous shocks such as wars and oil price hikes.

8 International transmission of inflationary pressures.

The rate of change in wholesale and consumer prices suggest that the overall trend in prices has been on decline since 1992. One striking trend noticeable is the growing divergence between the rate of inflation based on wholesale prices and that for consumer price index since 1993-94. Until 1993-94 the two rates generally converged. Since 1995-96, the consumer price index-based rate of inflation has exceeded the based-on wholesale prices by a wide margin. The divergence trend in the wholesale and consumer prices has been explained in terms of the change in the weighting scheme for the two indices.