The Bubble of 'Benign' Inflation

Inflation management should not be a legislative mandate, but a holistic development goal.

The 2019 general elections were perhaps the first of a kind in India that did not have "inflation" amongst the electoral agenda. And rightly so, because over the past five years inflation, especially the headline inflation rate, in this country has been bridled. From 2014 till April 2018, the year-on-year inflation rate—estimated as the rate of change of the consumer price index (CPI)—declined steeply from 6.65% to 2.42%. But what potentially has given legitimacy to the numerical value of these estimates is the concept of the "permissible" range of 2%–6% of inflation, as provided by the inflation targeting framework of the Reserve Bank of India (RBI).

The macroeconomic (policy) discourse on the relationship between inflation and economic growth recognises the significance of a "threshold level" of inflation. Though there is a consensus that inflation above the threshold limit hurts economic growth, empirical evidences of the effect of low inflation rate on growth are mixed yet predominated by instances of either positive or insignificant consequences. Given such evidences alongside the RBI's mandated inflation range, the current hike in CPI-based inflation in India, even if to its five-month high of 2.92% in April 2019, can still be considered "benign" in the RBI's parlance. So much so that the RBI could slash down its policy rate to 5.75% from 6% in a quick succession within three months. The objective is to stimulate private investment and consumption expenditure so that the gross domestic product (GDP) growth can be revived from its current low of 5.8% to reach the 2019–20 target of 7%, notwithstanding the consequences of such circumspect tactics of economic growth on wider socio-economic objectives.

For almost five decades now economic literature has pointed out that the evolution of GDP as a mono-measure of economic achievement is underscored by the idea of an individual circumscribed by their own utility maximisation, undermining some important areas of human behaviour and inspiration, namely sympathy, sociability, social commitment and collective actions. It is not unlikely that inflation targeting, being a GDP-stimulating strategy, will be premised on a similar notion. For instance, recall that while skyrocketing consumer (food) prices were among the election planks on which the Bharatiya Janata Party (BJP) had fought the 2014 general elections, its victory was led by the electoral swing of the middle class, which also dominates the consumer markets in India. Consequently, inflation management of the BJP-led government has shown bias towards dousing consumer prices, even if that is tantamount to declining producer prices, as evidenced in the agricultural sector. On the other hand, the middle class has never demonstrated any social camaraderie by levitating such issues related to the lives and livelihoods of their agrarian counterparts.

In such a context the very concept of "benignity" of inflation is rather provocative, for inflation with its multiple measures (such as CPI, wholesale price index [WPI], or the GDP deflator) and the relative price behaviour of the numerous services and commodities has different relevance for different players in the economy. And thus, the legislative mandate for inflation rate targeting fits well into the bill of the politics of segregation/alienation, which in turn confounds the prudence of the electorate—especially the opinion mobilisers—by ascribing them a "beneficiary" status vis-à-vis their electoral counterparts.

Conceptually, the CPI is a better indicator of inflation for guiding monetary policy decisions than the WPI, because it captures retail inflation. But technically, the RBI's inflation targeting apparatus have little impact on the CPI wherein food and beverages have a combined weightage of almost 46%. And much of the food price inflation/deflation in India is driven by supply-side issues—such as the fluctuation in the brent crude oil prices in the global market and/or the variability of domestic crop production—over which the RBI has little control. Riding on the back of these economic factors were political interventions of the government of the day, either for supply management such as imposition of export and stockholding restrictions on farm goods and duty-free imports, or with policies like the demonetisation and the goods and services tax that led to a market devoid of liquidity and buyer confidence.

Given that the benignity of the consumer prices is a matter of chance, an inflation rate, even within the RBI's legislated mandate, may not be as innocuous for the consumers as it appears to be. First, because it is driven by food inflation, which, measured in terms of the WPI, has hit a 33-month high of 7.4%, primarily led by the sequential acceleration of the prices of key food items. On a year-on-year basis the pulses inflation is hovering at 14%, while that of cereals is at 8.5%. Second, the meteorological department is not very optimistic about the abundance of the southwest monsoon, implying a looming risk of underproduction and further price hike. And third, due to geopolitical uncertainties oil prices might exceed the current low of $60 a barrel, thereby exerting upward pressure on the food prices.

Alternatively, the farmers' ability to benefit from such price surge will depend upon the state's ingenuity in managing the food economy. Will the current BJP-led government go beyond its hyperbolic promises of inclusive development, and adopt a holistic approach for development management in practice? Or will it continue using the inflation targets for chasing GDP fetishism?