STAGFLATION- IS INDIA HEADING TOWARDS IT: AN ECONOMIC ANALYSIS

Dr. M. Nagesh Kumari*

C.V.Suganthamani**

ABSTRACT

During the last six decades a number of significant changes have taken place in the Indian economy. These changes point to the fact that the Indian economy should not be classified along with other less developed nations. It should be rather called as rapidly emerging economy. Opening its doors to globalization in the nineties led to the miraculous growth story that India is today. During 1990s India was one of the fastest growing economies in the world and has since seen a long and unprecedented period of welfare enhancement. India's trade as a proportion of GDP rose from 13.1 per cent in 1990 to 20.3 per cent in 2000. But the last decade has been one of the most tumultuous and volatile times for India. It witnessed, the most gruesome terror attacks, shocking financial scams were unearthed coupled with low growth rate and high inflation. Considering all these facts there arises a question of whether India is heading towards stagflation. In this context, the present paper attempts to discuss the looming spectre of stagflation, inflationary trends and growth rate of the economy. It also provides some solutions highlighted by leading economists.

Key Words: Economic Growth Rate, Inflation, Unemployment, Recession

* Assistant Professor, P.S.G.R Krishnamaal College for Women, Coimbatore

** Assistant Professor, Guruvayurappan Institute of Management, Coimbatore

Introduction

The Indian economy, the third largest economy in the world in terms of purchasing power, is going to touch new heights in coming years. As predicted by Goldman Sachs, the Global Investment Bank, by 2035, India would be the third largest economy of the world just after US and China. It will grow to 60% of the size of the US economy. This booming economy of today has to pass through many phases before it can achieve various milestones. Indian economy is poised with severe problems like high inflation, lower growth rates, unattractive employment opportunities which can be commonly referred as stagflationary tendencies. The word 'stagflation' has a very specific connotation in economic literature. In recent years, there have been debates about India facing stagflation type of situation regardless of its growth rate at 5 %.

Stagflation- Meaning and Definition

Stagflation is commonly referred to a situation of stagnation in growth and high inflation. It was used to describe the economic landscape in the United States in the mid 1970s when the country faced a long slump and high unemployment even as inflation raised, a combination that dominated Keynesian philosophy. The term stagflation is first believed to have been used by British politician Iain Macleod in a speech to parliament in 1965.

An Inflationary period accompanied by rising unemployment and lack of growth in consumer demand and business activity. It is a combination of the two words 'Stagnation' and 'Inflation' so it really cannot mean anything good. A state of affairs of a nation where the rate of unemployment and the rate of inflation are concurrently rising is known as stagflation, and this is a situation that requires immediate attention.

Fixing the problem requires careful analysis and implementation of monetary policy because too much focus on one problem can cause the other issue to rise to dangerous levels. Obviously no country wants to experience unemployment and inflation, and when they both occur at the same time it can spell doom and gloom for one and all.

Why Stagflation is dangerous?

In an usual low growth situation, central banks and government try to stimulate the economy through higher public spending and low interest rates to create demand. These measures also tend to elevate prices and cause inflation. So, these tools cannot be adopted when inflation is already running high, which makes it difficult to break out of low growth-high inflation trap.

Causes of Stagflation

Stagflation is an economic phenomenon that occurs when inflation is high and economic growth is low. No exact percentages exist for this event; it simply requires an upside down set of events that create a negative situation. Two basic situations can create stagflation. The first occurs when an economy experiences a sudden decrease in supply, resulting in high prices that exceed the natural market level. The second situation comes from poor macroeconomic policies, such as money supply or government regulation.

Recessions are often a result of stagflation. When prices are too high for consumers to purchase goods, businesses begin to fail. Unemployment will increase as companies begin laying off workers. This reduces the demand for goods as consumers have less money to spend on goods and services. A government can exacerbate the recession by attempting to loosen the money supply and spur economic growth which however, leads to inflation and increases stagflation. To put in a nutshell the major factors contributing stagflationary situations are high inflation, lower growth rate and unemployment.

a. Economic Growth Rate

According to the Advanced Estimates released by Central Statistical Organization (CSO) Against the backdrop of adverse macro-economic factors, India's economic growth rate during 2012-13 is estimated to be sharply lower at 5 per cent, lowest in a decade, on account of poor performance of manufacturing, agriculture and services sector. The Indian economy measured in terms of Gross Domestic Product (GDP) registered a growth rate of 6.5 per cent in 2011-12, which is the lowest annual growth rate of last decade.

Further, this growth rate also happened to be lower than the year 2008-09, the year when the financial crisis began. In that year, the Indian economy grew at 6.7 per cent. The hardening of interest rate, moderation in demand (both domestic and external), slowdown in consumption expenditure, especially in interest rate sensitive commodities, subdued business confidence and global economic uncertainty collectively contributed to the weakening of the Indian economy.

While the slowdown in the economy remained across the board, the industrial sector appeared to be the worst hit. The sector reported a meager growth rate of 2.6 per cent during 2011-12, as compared to 6.8 per cent in the previous year. With this, the sector grew at an average growth rate of 6.3 per cent in the last five years (2007-08 to 2011-12). The slowdown in industrial production appeared to be almost across all sub-sectors.

- CSO's advance estimate lowered the growth in agriculture and allied activities to 1.8% in 2012-13, compared to 3.6% 2011-12.
- Manufacturing growth is also expected to drop to 1.9% in this fiscal, from 2.7% last year.
- The latest estimate of 5% for the entire fiscal means that the pace of economic expansion has slowed sharply in the second half of 2012-13, given that GDP growth in the April-September period stood at 5.4%.
- According to the advance estimates, the services sector including finance, insurance, real estate and business services sectors are likely to grow by 8.6% this fiscal, against 11.7% during the last fiscal year
- The following table represents the trend GDP Growth rates in India in Percentage units. The primary sector which includes agriculture and allied activities accounts 2.9 per cent in the first quarter of the fiscal year 2012-13.
- The service sector accounts for 6.9 per cent during the first quarter of the fiscal year 2012-13.

Table 1: Trend GDP growth rates in India (%)

Industry	**2011-12**				**2012-13**
	Q1	**Q2**	**Q3**	**Q4**	**Q1**
Agriculture	**3.7**	**3.1**	**2.8**	**1.7**	**2.9**
Industry	**5.6**	**3.7**	**2.5**	**1.9**	**3.6**
Mining & quarrying	-0.2	-5.4	-2.8	4.3	0.1
Manufacturing	7.3	2.9	0.6	-0.3	0.2
Electricity, gas & water supply	7.9	9.8	9.0	4.9	6.3
Construction	3.5	6.3	6.6	4.8	10.9

Services	**10.2**	**8.8**	**8.9**	**7.9**	**6.9**
Trade, hotels, transport & communication	13.8	9.5	10.0	7.0	4.0
Financing, insurance, real estate & business services	9.4	9.9	9.1	10.0	10.8
Community, social & personal services	3.2	6.1	6.4	7.1	7.9
GDP at factor cost	**8.0**	**6.7**	**6.1**	**5.3**	**5.5**

Source: CSO & FICCI Research

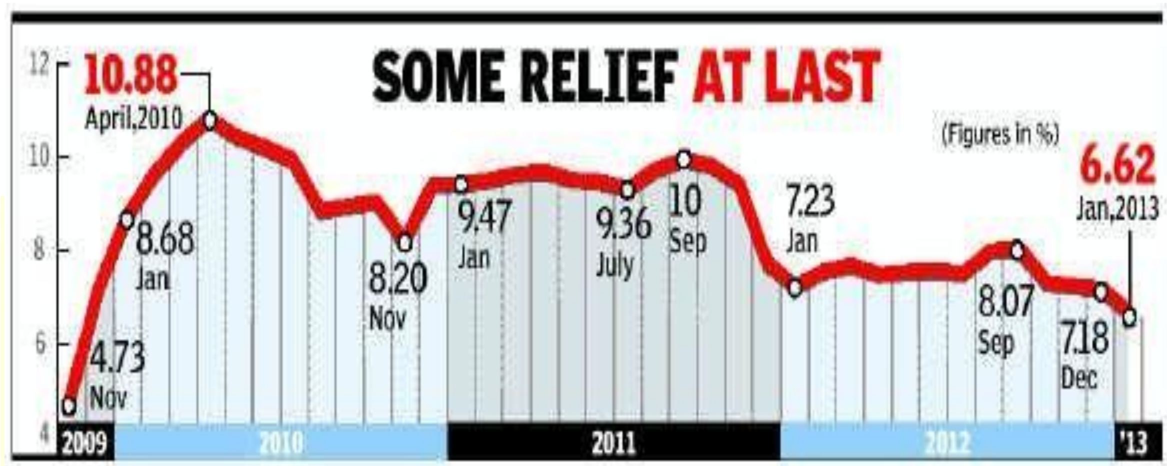
b. Inflation

It is a general rise in the price level of goods and services in an economy over a period of time. It occurs due to fall in the value of money which leads to lower purchasing power. According to Professor Crowther Inflation is a state in which the value of money is falling (i.e) prices are rising

The inflation rate in India was recorded at 6.84 percent in February of 2013. Inflation Rate in India is reported by the Ministry of Commerce and Industry. Historically, from 1969 until 2013, India Inflation Rate averaged 7.74 Percent 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. 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. Policymakers said they expect inflation to moderate further and estimated it to be around 6.5% by end-March but urged the government to release food stocks to ease price pressures. C Rangarajan, chairman of the Economic Advisory Council to the Prime Minister commented that the decline in inflation is a welcome and reassuring sign and expect March-end inflation to be 6.5%. The latest data raised hopes of a monetary easing when the Reserve Bank of India reviews policy. "...the mild moderation in core inflation in January 2013 combined with weaker-than-expected industrial performance in December 2012 boosts the likelihood of monetary easing in the next mid-quarter policy review," said Aditi Nayar, senior economist at ratings agency ICRA.

CHART NO.1

INDIA'S INFLATION RATE



Source: www.tradingeconomics.com – Ministry of commerce and Industry

c. **Unemployment**

For the last two decades, India had one of the world's fastest-growing economies. Even in recent years, when the global recession and complacent policymaking have slowed progress, growth has remained a healthy 5 percent to 6 percent. Recent studies have shown that in the five years between 2005 and 2010 fewer than 3 million new jobs were added to the economy. This is worrying when one considers that about 12 million people join the workforce every year. The malaise is particularly serious in the manufacturing sector, which shed as many as 5 million jobs between 2004 and 2005 and between 2009 and 2010 and has been unable to absorb the (to some extent desirable) exodus from agriculture in India's modernizing economy. Without large-scale job creation, India's growth becomes, lower down, a fiction to millions of people looking for structured work and unable to find it.

Is India facing stagflation type of situation?

Considering all these facts there arises a question of whether India is heading towards stagflation like situation. Moody's Analytics research ratings agency reported that India had entered into a stagflation phase with notably weaker growth but inflation still stubbornly high. Fitch ratings had also said that that the combination of high inflation and slow GDP growth implies that India may have entered into stagflation. But Prime Minister Manmohan Singh says he refuses to believe those who claim that stagflation has hit the Indian economy."There is no stagflation. There is a slowing (of economic growth)".

Madan Sabnavis, Chief Economist, CARE Ratings indicated that two successive quarterly negative growth rates in industry are regarded as a sign of recession. Our growth in industry has been low but positive. The GDP growth rate has been declining over the four quarters of the last financial year and hit a low of 5.3 per cent in the January-March quarter, but there is no negative growth. Moreover, recessions are characterized by large-scale job losses, which is definitely not visible in our context except in certain multinational corporations in the services sector.

Technically, it is not right to say India is faced with stagflation. Consumer inflation is high but the economy is still growing at 5%, though well below the high rates it has clocked in past few years. However, high fiscal deficit and high inflation has put a limit on policy intervention to boost growth. This is the reason RBI has been unable to cut rates even as growth has moderated.

Conclusion

Stagflation is one of the worst economic conditions a country can be in, and United States have just entered it. Most recently Greece, Spain and Portugal are experiencing severe doses of this dreaded economic condition. It is extraordinarily difficult to work through and often destroys wealth for generations. It usually results in a very long, severe recessions. Clever manipulation of statistics by the government has avoided talks of stagflation until now. Lowering the interest rate was the best card in our hand and we played it too early. Our last options are to lower the corporate tax rate and practice quantitative easing (which will cause more inflation). We need to take off our government blindfolds and see with clear eyes the bleak position of our economy in order to protect our livelihoods. While Stagflation is rare, it is not new. Hence it is too early to say whether stagflation will become a reality in our modern economy.

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