

Stagflation

May 24, 2020

Why is it news?

Various news articles questioning the status of the Indian economy and whether is it heading towards stagflation?

What is Stagflation?

- Stagflation= **stagnant** growth + rising **inflation**. → Inflation + a decline in gross domestic product (GDP).
- It is also called as ***recession-inflation***
- Typically, inflation rises when the economy is growing fast. That's because people are earning more and more money and are capable of paying higher prices for the same quantity of goods.
- When the economy stalls, inflation tends to dip as well – again because there is less money now chasing the same quantity of goods.
- Stagflation is said to happen when an economy faces stagnant growth as well as persistently high inflation.
- That is the worst of both worlds → with ***stalled economic growth***, unemployment tends to rise and ***existing incomes do not rise fast*** enough and yet, people have to contend with ***rising inflation***. So people find themselves pressurized from both sides as their purchasing power is reduced.

Has it happened in the past?

- The most famous case of stagflation happened in the early and mid-1970s when OPEC (The Organization of Petroleum Exporting Countries), which works like a cartel, decided to cut supply and sent oil prices soaring across the world.
- On the one hand, the rise in oil prices constrained the productive capacity of most western economies that

heavily depended on oil, thus hampering economic growth. On the other hand, the oil price spike also led to inflation and commodities became more costly. For instance, just in 1974, the oil prices went up by almost 70%; consequently, inflation in the US, for example, reached almost double-digits.

- The net result was lower growth, higher unemployment, and higher price level. That's stagflation.

Why is everyone asking about Stagflation in India?

- Over the past six quarters, economic growth in India has decelerated with every quarter.
- In the second quarter (July to September), for which the latest data is available, the GDP grew by just 4.5%.
- In the coming quarter (October to December), too, GDP growth is likely to stay at roughly the same level.
- ***For the full financial year, the GDP growth rate is expected to average around 5% – a six-year low.***
- ***Yet, in October and November, retail inflation has soared.***
- In fact, the October inflation was a 16-month high and the November inflation, at 5.54%, is at a three-year high.
- ***Inflation for the rest of the financial year is expected to stay above the RBI's comfort level of 4%.***
- So, with growth decelerating every quarter and now inflation rising up every month, there are growing murmurs of stagflation.

So, is India facing Stagflation?

- Although it appears so at first glance, India is not yet facing stagflation. There are three broad reasons for it.
- India is still growing at 5% and is expected to grow faster in the coming years. India's growth hasn't yet stalled and declined → our GDP has grown in absolute

numbers, ***not declined.***

- It is true that retail inflation has been quite high in the past few months, yet the reason for this spike is temporary because it has been caused by a spurt in agricultural commodities after some unseasonal rains. With better food management, food inflation is expected to come down. ***The core inflation – that is inflation without taking into account food and fuel – is still benign.***
- Retail inflation has been well within the RBI's target level of 4% for most of the year. A sudden spike of a few months, which is likely to flatten out in the next few months, it is still early days before one claims that India has stagflation.