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Inflation and Deflation Analysis in 2022

Nikita*

B.Com, M.Com, M.B.A. (Finance), Net Qualified in Commerce

Abstract - Increases in the cost of living, known as inflation, and decreases in these costs, known as deflation, are two extremes that may affect a country's economy. Both inflation and deflation are effects of the same underlying monetary system. Since the economy may rapidly shift from one situation to the other in response to inflation and deflation, it is crucial to keep the two in check, Including a research that talks about inflation, deflation, causes of deflation, the difference between inflation and deflation, and inflation and deflation rates throughout the world in 2022 in addition to the inflation rate in India.

Keyword - Inflation, Deflation, Rates

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INTRODUCTION

Inflation is the increase in the general level of prices for goods and services, whereas deflation is the drop in same levels. These two states of the economy are like two sides of the same coin; the balance between them is precarious, and an economy may swiftly flip from one to the other. Monetary policy, such as the setting of interest rates, is one tool used by central banks to monitor and control price fluctuations and prevent either deflation or inflation.

The opposite of inflation is deflation, which occurs when the price of goods and services decreases in a nation. Both inflation and deflation are equally undesirable outcomes.

Because of how rapidly the economy may shift from one situation to the other as a consequence of inflation and deflation, it is crucial that the two be kept in equilibrium. By means of interest rate setting and other monetary policy tools, the Reserve Bank of India monitors and regulates price increases and decreases inside India. [1]

Inflation

A price rise that is too rapid is called inflation. Consumers' purchasing power is one area where inflation may have an impact. Most central banks work to keep inflation low to maintain economic stability. Inflation has its benefits as well as its drawbacks.

Daily necessities including food, shelter, clothes, transportation, entertainment, and other consumer staples have all seen price increases as a result of inflation. The rate of inflation is calculated by looking at how much a standard basket of goods and services has increased or decreased in price over a certain time period. The yearly inflation report for India is compiled by the Ministry of Statistics and Programme Implementation.

A straightforward illustration of this is a hypothetical rise of 10% in the price of a kilogramme of apples from its 2019 level of Rs.100 to its 2020 level of Rs.110. The same method is used to determine the compound annual growth rate (CAGR) of a basket of goods and services whose prices have increased over time by grouping them together and using a single base year. Inflation is measured as the sum of all commodity price increases divided by 100.

The rate of inflation is a quantifiable indicator of how rapidly prices are rising throughout an economy. When the supply of an item or service decreases as a result of increased demand, inflation results. Many things may cause a drop in available resources, including natural disasters, rapid population growth, a need for more buildings, and so on. Regardless of the motivation, customers are increasingly prepared to pay a premium for the convenience of buying the products and services they want.

Inflation is often measured using the Consumer Price Index. The cost of living is calculated based on a hypothetical basket of commodities that includes things like food, medical care, and transportation. The value of the dollar is measured against the basket's prices by the government.

Those who came of age in the era of rampant inflation in the late 1970s tend to see inflation as a major danger. When prices rise by more than 50% each month on average over an extended period of time, we speak of a hyperinflation. An rise in the money supply and a decline in the actual economy typically go hand in hand with times of fast price inflation.

As terrifying as hyperinflations may be, they have been relatively uncommon in the past. Inflation is neutral in and of itself; its effects rely on the causes and the rate of inflation. In fact, as we'll see with deflation below, a total absence of inflation may be quite harmful to the economy. Because inflation erodes the purchasing power of currency over time, even a moderate rate of inflation may stimulate consumers and investors to spend and invest. For example, if an appliance costs $1,000 today, it will be $100 cheaper a year from now.[2]

Inflation Rates around the World in 2022

The Reserve Bank of India (RBI), like other central banks throughout the world, strives to keep inflation low and stable. Low or moderate inflation is good for a country's economy as a whole.

Inflation rates have been growing in several parts of the world since the end of 2021, after the global epidemic. With an annualized rate of 54.8% during the first three months of 2022, Turkey has the highest inflation rate of any country. The inflation rate in Israel has been rising fast over the last two years, like that in neighboring Turkey. So too, the U.S. inflation rate has quadrupled in only two years. Both Japan and the United Kingdom anticipate significant rises in inflation in 2022 as a result of rising food and energy costs.

However, for the previous 17 months in a row, India's inflation rate has been above 10%. In August 2022, wholesale inflation in India decreased to 12.41% from the previous month's 13.93%. Wholesale Price Index (WPI) and Consumer Price Index (CPI) are used to track inflation in India (CPI). One tracks wholesale price shifts, while the other tracks retail price shifts.[3]

Compared to October's 6.77% and market expectations of 6.4%, India's annual retail price inflation dropped to 5.88% in November 2022, the lowest number since December of the previous year. Food cost climbed at a slower pace (4.67% vs 7.01%), driven by an 8% drop in vegetable prices; apparel and footwear cost increased at a slower rate (9.83% vs 10.0%). Meanwhile, home price growth remained steady (4.57% vs. 4.58%). Fuel and light increased by 10.62%, while food, cigarettes, and booze increased by 2.02%, and other items increased by 6.07%, compared to 5.9% overall. For the first time this year, inflation was below the 2-6% upper limit of the central bank's objective, although the RBI projects inflation of 6.7% for the 2022/23 fiscal year.

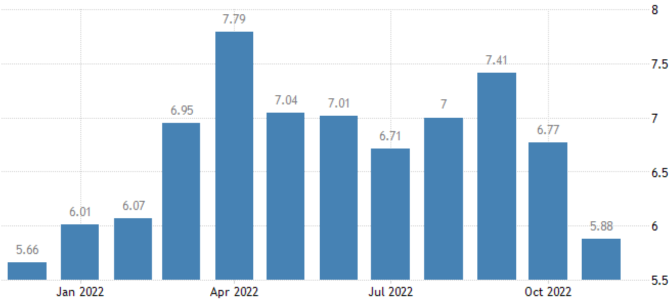

Figure 1: Inflation Rates

Overview | GDP | Labour | Prices | Health | Money | Trade | Government | Business | Consumer | Housing

	Last	Previous		
Currency	82.75	82.84		Dec/22
Stock Market	61338	61799	points	Dec/22
GDP Growth Rate	-1.4	-1.4	percent	Jun/22
GDP Annual Growth Rate	6.3	13.5	percent	Sep/22
Unemployment Rate	8	7.8	percent	Nov/22
Inflation Rate	5.88	6.77	percent	Nov/22
Interest Rate	6.25	5.9	percent	Dec/22
Cash Reserve Ratio	4.5	4.5	percent	Dec/22
Balance of Trade	-19.89	-26.91	USD Billion	Nov/22
Current Account	-23872	-13404	USD Million	Jun/22
Current Account to GDP	-1.2	0.9	percent of GDP	Dec/21
Government Debt to GDP	89.26	89.41	percent of GDP	Dec/21
Government Budget	-6.9	-9.5	percent of GDP	Dec/21
Business Confidence	134	138	points	Dec/22
Manufacturing PMI	55.7	55.3	points	Nov/22
Services PMI	56.4	55.1	points	Nov/22
Consumer Confidence	83.5	80.6	points	Nov/22
Corporate Tax Rate	34.94	25.17	percent	Dec/22
Personal Income Tax Rate	42.74	42.74	percent	Dec/22

India Inflation Rate

The food and beverage categories account for 45.86% of the total weight in India's consumer price index. Cereals and their products (9.67%), milk and its products (6.61%), and vegetables (6.04%) are all included.prepared meals, snacks, sweets, etc. (5.55%), meat and fish (3.61%), and oils and fats (0.36%). (3.56 percent). The largest single category is "miscellaneous" with 28.32%, followed by "transportation and communication" (8.59%), "healthcare" (5.89%) and "education" (4.81%). (4.46 percent). Ten percent goes into housing, six percent toward utilities (heating, cooling, lighting), six and a half percent toward apparel and footwear, and two and a third percent toward narcotics. India's high fiscal deficit, reliance on foreign energy sources, the unpredictable effect of monsoon rains on the country's large agricultural sector, the difficulty of transporting food items to market due to the country's poor roads and infrastructure, and the frequent fluctuations in consumer prices all contribute to this situation. The wholesale price index (WPI) was the primary inflation gauge until 2013, when it was replaced by the consumer price index.[4]

Causes of Inflation

Inflation is caused by multiple factors, here are a few:

Money Supply

Inflation may be caused, at least in part, by an increase in the money supply of a country's economy. This is the result of a rise in the quantity of money in circulation that exceeds the rate of economic expansion, which causes a decline in the value of the currency.

Countries no longer base their monetary values on the quantity of gold they hold in reserve in the current period. Today's monetary valuation techniques start with the quantity of currency in use and then factor in the general public's estimation of that currency's worth.

- **National Debt**

The borrowing and spending habits of a country are only two of the many contributors to its overall debt load. There are only two paths open to a nation when its debt level rises.

- ➢ Taxes can be raised internally.
- ➢ Additional money can be printed to pay off the debt.

- **Demand-Pull Effect**

The demand-pull effect implies that as the economy expands and wages rise, consumers will have more disposable income and spend it on products and services. In order to maintain a healthy supply and demand ratio, businesses will need to raise the prices their customers are willing to pay to meet the increased demand.[5]

- **Cost-Push Effect**

According to this economic theory, corporations will raise prices for consumer products in order to maintain their profit margins if the cost of producing such things rises, as is the case whenever the cost of raw materials or employee salaries.

- **Exchange Rates**

The value of the dollar is crucial to the functioning of an economy that interacts with global markets. Inflation rates are mostly determined by exchange rates in a global commercial economy.

Effects of Inflation

When a nation has inflation, consumers have less buying power because goods and services cost more. When a currency's value drops, it raises or lowers prices across the board. Increases in the cost of living, brought on by a high inflation rate, slow economic expansion.

However, a healthy inflation rate (between 2 and 3 percent) is seen as desirable since it leads to rising salaries and corporate profitability and keeps capital moving in a developing economy.

Steps to offset Inflation and its effects on Your Retirement

Inflation adjustment is a crucial step in budgeting. The key issue is whether or not you have calculated how much money you will need to retire comfortably. Keep inflation in mind while planning your retirement and use these strategies. [6]

- **Invest in long-term investments.**

Spending money on investments now might help you reap the benefits of inflation later on if you plan ahead.

- **Save More**

Retirement requires more money than one might imagine. The two ways to meet retirement goals are to save more or invest aggressively.

- **Make balanced investments**

Though investing in bonds alone feel safer, invest in multiple portfolios. Do not put all your eggs in one basket to outpace inflation.

Deflation

In general, deflation refers to a drop in consumer prices when the inflation rate drops below zero. Limiting a country's access to its currency will inevitably lead to deflation. Deflation is a sign that the economy is in a downward spiral.

Large numbers of unemployed people and poor product production are often associated with deflation. Deflation is often misunderstood to mean disinflation. In contrast to deflation, which occurs when prices drop across the board, disinflation occurs when inflation rises but at a more manageable pace.[7]

When there are too many items on the market or not enough dollars in circulation, deflation happens. Because of this, consumer prices have dropped.

If one model of automobile suddenly skyrockets in sales, for instance, competitors may respond by producing their own versions of "me too" cars. As soon as automakers produce more of a certain model than the market can absorb, prices must be lowered to encourage sales. Having an excess of stock on hand forces businesses to reduce expenses, which typically means laying off employees. Unemployed people have less disposable income, thus businesses must reduce prices to get them to make a purchase. (Deflation should not be confused with disinflation, which is defined as a decrease in the positive rate of inflation from one period to the next.)

Financial institutions often cut the amount of credit they give when they see a drop in pricing. Since customers can't get loans to buy expensive goods, stocks pile up at businesses, contributing to greater deflation.

For an economy, prolonged episodes of deflation may be detrimental, since they can reduce growth and raise unemployment.

A deflationary spiral may be just as harmful as hyperinflation if prices fall too quickly or too far. Recessions and depressions are common times for this to happen because economic production drops and consumers and investors lose interest. As companies try to unload stock that consumers no longer want to purchase, asset values might fall as a result.[8]

Everyone, from individuals to corporations, starts hoarding cash to protect themselves against future financial disaster. When people save more of their income, they have less to spend, which further reduces aggregate demand. Now that inflation expectations have been decreased, individuals are starting to save cash. When consumers believe their current currency will be worth more tomorrow, they are less likely to make a purchase now.

Forecasts from Trading Economics' panel of global macro models and experts project that India's GDP Deflator will rise to 154.87 points by year's end 2022. Based on our economic forecasting models, we expect India's GDP Deflator to average 167.94 points in 2023 and 175.67 points in 2024.

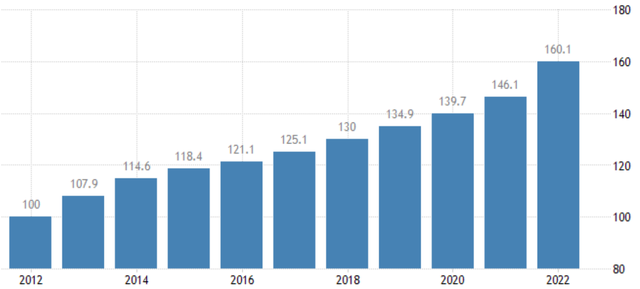

Figure 2: Deflation in Consumer Prices

Causes of Deflation

Deflation can be caused by multiple factors:

Structural changes in capital markets

As a cost-cutting measure in a cutthroat market, businesses often provide discounts on their products and services to attract and retain customers.

- **Increased productivity**

Increased production efficiency is made possible by technological innovation, which in turn leads to cheaper consumer products and services. The overall economic health may be influenced by innovations that boost the output of certain sectors.

- **Reduced availability of currencies**

Price reductions as a result of a decline in the money supply will make basic necessities more accessible to the public.

Impacts of Deflation

The following are some of the effects deflation may have on a country's economy:

Drop in Profits for Businesses

As a result of deflation, firms will need to dramatically lower their prices in order to maintain a profit margin. As reductions in prices take place, revenues begin to drop.[9]

- **Lowered Wages and Layoffs**

When sales decline, companies must find ways to save money in order to continue operating. As an example, salaries might be lowered and employment opportunities eliminated. As a result, consumers will have less disposable income, which is bad news for the economy.

Difference between Inflation and Deflation

Macroeconomics makes extensive use of the phrases inflation and deflation. Each and every nation on Earth has to deal with these two occurrences. One may say that deflation is the other side of inflation's coin.

When the general price level of goods and services increases, a condition known as inflation occurs, Inflation is characterized by a decline in the purchasing power of money across the economy.

There are two distinguishing features of inflation: (1) a persistent and widespread price increase that is not cyclical and has a propensity to persist for a long period of time, and (2) a lack of control over the rate of increase. (2) It affects the majority of the economic system.

If inflation is the increase of prices, then deflation must be the decrease of same prices. While a consequence of this scenario, the purchasing power of money rises dramatically as the general price level of products and services falls rapidly. If an economy is experiencing deflation, consumers will have greater buying power and will be able to buy more goods for the same amount of money.

The terms "inflation" and "deflation" refer to the same economic phenomenon: changes in the general level of prices for goods and services in an economy. Inflation leads to a rise in the demand for goods and services. In a deflationary market, consumer demand falls. Because of inflation, incomes are not distributed fairly. Deflation causes an increase in the national unemployment rate.[10]

CONCLUSION

Generally speaking, inflation is when the price level of goods and services rises, whereas deflation is when it falls. These two states of the economy are like two sides of the same coin; the balance between them is precarious, and an economy may swiftly flip from one to the other. Monetary policy, such as the setting of interest rates, is one tool used by central banks to monitor and control price fluctuations and prevent either deflation or inflation. When the inflation rate drops below 0%, the overall trend is a decrease in pricing for goods and services, which is referred to as deflation. If there is a limit on the amount of money that may enter a country's economy, deflation will occur automatically. When prices in an economy start to fall, it's a sign that things are becoming worse. Deflation occurs when the overall price level in an economy falls, whereas disinflation occurs when inflation rises but at a lesser pace than previously seen. By 2022's close, the GDP Deflator in India is expected to have risen to 154.87 points, according to the global macro models and expert projections compiled by Trading Economics. According to our econometric models, we expect the India GDP Deflator to average approximately 167.94 points in 2023 and 175.67 points in 2024. Annual retail price inflation in India dropped to 5.88% in November 2022, the lowest number since December of the previous year and far lower than market expectations of 6.4% and 6.77% in October. Costs for both food (4.67% vs 7.01%) and apparel and footwear (9.83% vs 10.1%) were moderated by a drop in vegetable costs of 8%. In the meanwhile, house price growth showed no change (4.57% against 4.58%). Fuel and light increased more rapidly in price than food and non-alcoholic beverages (9.93% against 9.62%), followed by tobacco and alcoholic beverages (2.02% versus 1.87%) and other items (6.0% versus 5.9%). For the first time this year, inflation was below the central bank's upper goal of 2-6%, but the RBI still expects it to reach 6.7% in the 2022/23 fiscal year.

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Corresponding Author

Nikita*

B.Com, M.Com, M.B.A. (Finance), Net Qualified in Commerce