

# BEM Project

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IS INDIAN ECONOMY STARING  
AT STAGFLATION AHEAD?

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# ABSTRACT

The goal of this research report is to analyze, and predict if Indian economy is moving into stagflation. In the following report a detailed analysis is conducted on the factors that affect stagflation, like Gross Domestic Product, Unemployment rate, Inflation and Economic Growth.

No other factors apart from the mentioned above have been taken into consideration to conclude "If Indian Economy is starting to Stagflation?"

# INTRODUCTION

## **What is stagflation?**

Stagflation is an economic condition which is characterized by stagnant economic growth and low employment, along with high inflation. Stagflation can be indicated through reduction in Gross Domestic Product and other productivity measures.

## **What are the causes of stagflation?**

The root causes of stagflation are that economists believed to be are supply shocks, for example low oil supply, and fiscal & monetary policies.



# LITERATURE REVIEW

## **Why is stagflation a problem?**

Stagflation is where you have both shrinking economy and runaway inflation. With increasing unemployment, consumers have less money to spend, now add inflation, the money consumers have is decreasing its value every day. Now in the case of a fixed income consumer, inflation corrodes the values of their monthly salaries. If a consumer has some savings inflation eats away its value too. Such an adverse combination is expected and can present a problem for governments, as most activities aimed at lowering inflation can increase unemployment, while policies aimed at lowering unemployment can worsen inflation.

# LITERATURE REVIEW

In both social and fiscal terms, stagflation is costly and difficult to eradicate. Only a few examples may be found throughout history. The most famous occurred in the United States in the 1970s.

The first signs of stagflation the unsustainable economic policies of the US Federal Reserve during the boom years of the late 1950s and 1960s was criticized in the 1970s. The Federal Reserve took actions to keep unemployment low and encourage demands for goods and services in the 1960's. However, the decade's unusually low unemployment generated what's known as a wage-price spiral.

The 1973 OPEC oil embargo also contributed to the unwelcome economic occurrence in the United States. Excessively high costs of oil and shortages massively harmed industries across India. Industrial output plummeted as demand fell to new lows.



# LITERATURE REVIEW

The reasons of stagflation are a source of disagreement among economists. Each economics school has its own take on the subject's roots. Two basic ideas can be deduced, however: supply shock and bad economic policy.

Stagflation, according to the supply shock hypothesis, happens when an economy experiences a sudden increase or decrease in the supply of a commodity or service (supply shock), such as a quick rise in the price of oil. Prices rise in such a setting, making output more expensive and less profitable, reducing economic growth.

Stagflation, according to a second idea, can be caused by bad economic policies. For example, the government can enact policies that hurt industries while rapidly expanding the money supply. When these policies are implemented at the same time, it might result in slower economic development and higher inflation.



# LITERATURE REVIEW

## **Stagflation in India**

Due to a drop in economic growth during coronavirus lockdowns, the scenario in India suggests potential stagflation. In the April to June quarter, the second Covid-19 wave had an influence on economic activity. Covid 2.0 impacted a large number of employees across industries, while rising medical costs reduced revenue and demand. The Indian GDP shrank by 23.9 per cent in the first quarter of FY21. Consumer and investment demand, the two largest components of GDP, fell by 27 per cent and 47 per cent, respectively, in August, while food inflation rose by roughly 9 per cent.

The fall in GDP, combined with rising prices, has sparked speculation over whether India is on the verge of stagflation.

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# METHODOLOGY

The main aim of this report is to predict if Indian economy will be facing stagflation in the upcoming years.

Raw data will be collected from the previous years which is available on the internet then statistical tests will be performed.

Then comparing our results with the predicted values by The National Statistical Office (NSO).

The prediction model that used in the following report may have flaws, for the reason that only four following factors have been used to predict if the Indian economy is staring into stagflation, economic growth, unemployment, inflation, and GDP. No other factors, like technical advancement, and private investments, have been taken into consideration.

# BODY

In a survey of economists by Reuters, forecasts that the retail inflation of India has rose up to 5.80 per cent. In the month of November, 2021, inflation rates had rose to 4.91% year-on-year, from 4.48 pe cent in the month of October, 2021 was at 5.56 per cent, is significantly high then the previous months. Year-on-year inflation for the month of December, 2021, In the preceding year, December, retail inflation was at 4.59 per cent, hence the constant rise in retail inflation may lead Indian economy towards stagflation.

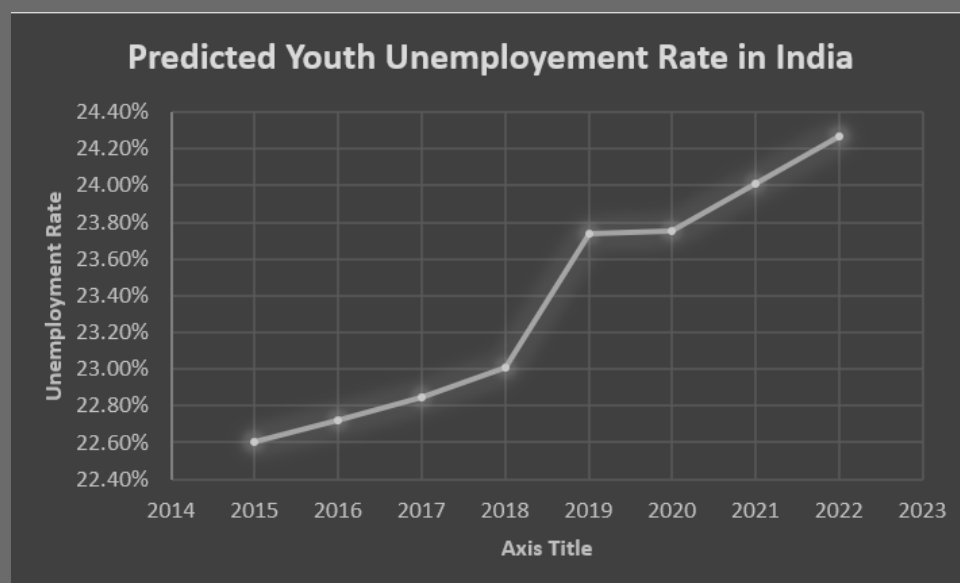
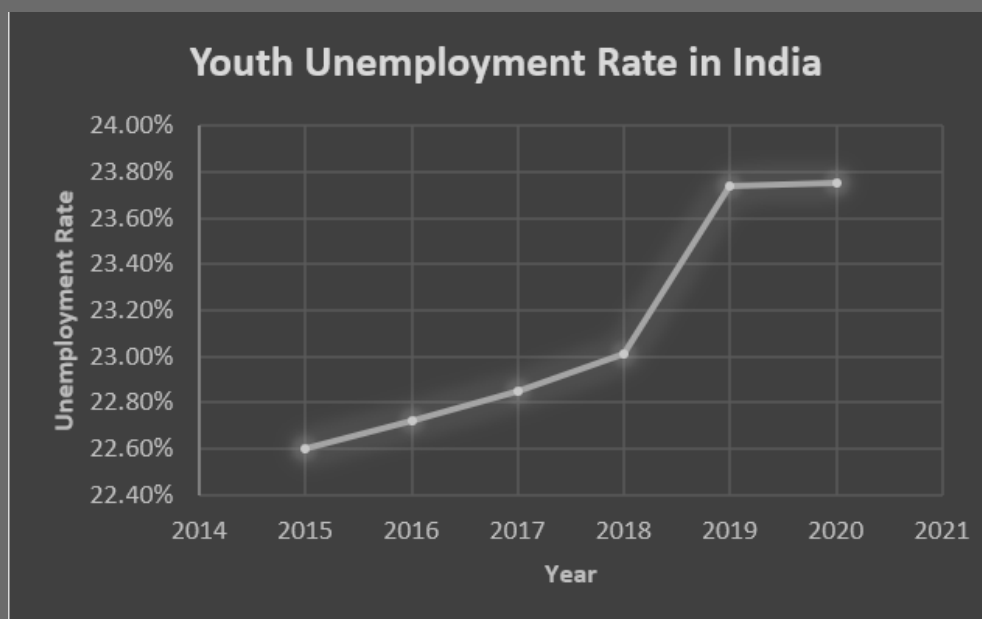
India's overall macroeconomic situation is in recovery mode, in spite of that, the economic growth is concentrated at the higher end of the economy.

India's youth unemployment rate has reached almost 23 per cent, one is the highest globally, even before the COVID-19 outbreak. Small businesses, workers and farmers are also experiencing negative growth.



# BODY

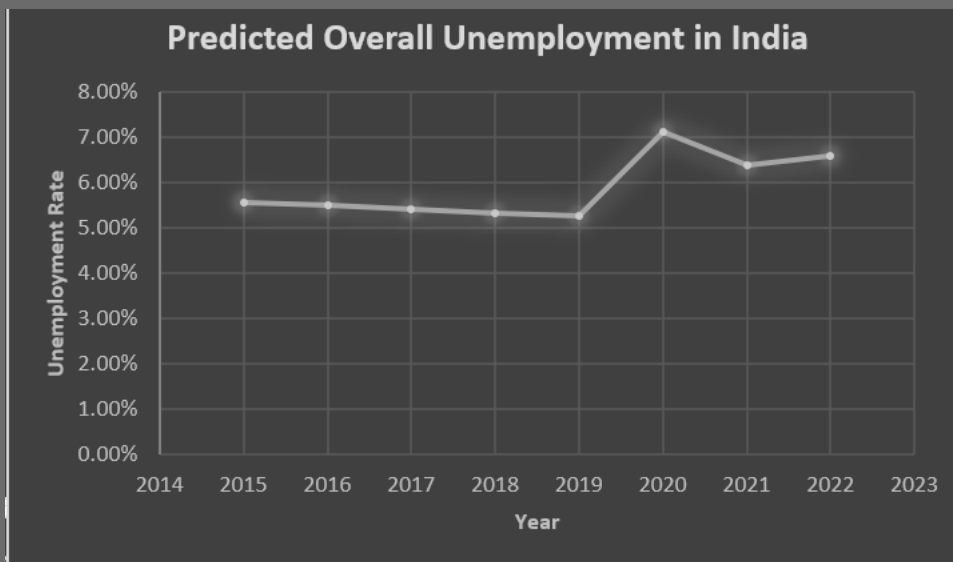
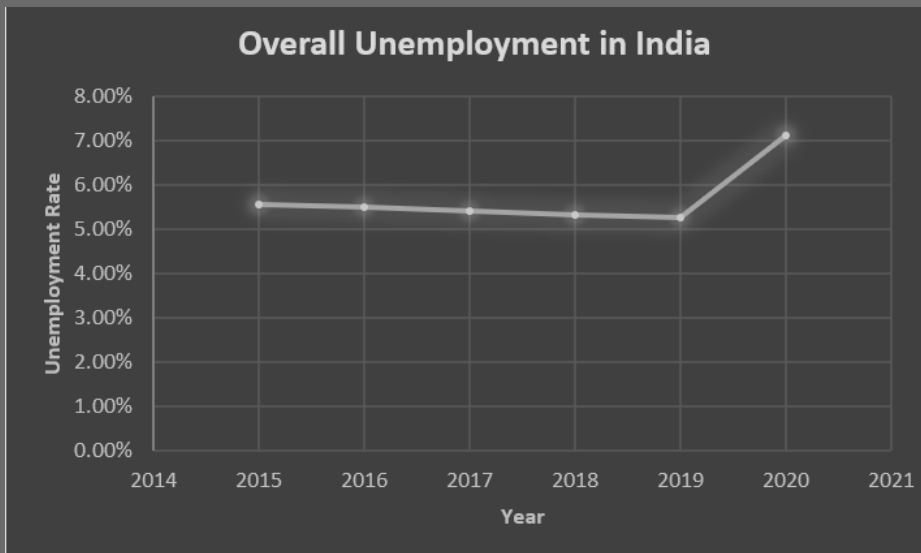
## Trend of Youth Unemployment Rate in India since 2015



With the method of linear interpolation, the predicted youth unemployment rates of India for the financial year 2021 - 2022, and 2022 - 2023, respectively are 24.01 per cent and 24.27 per cent.

# BODY

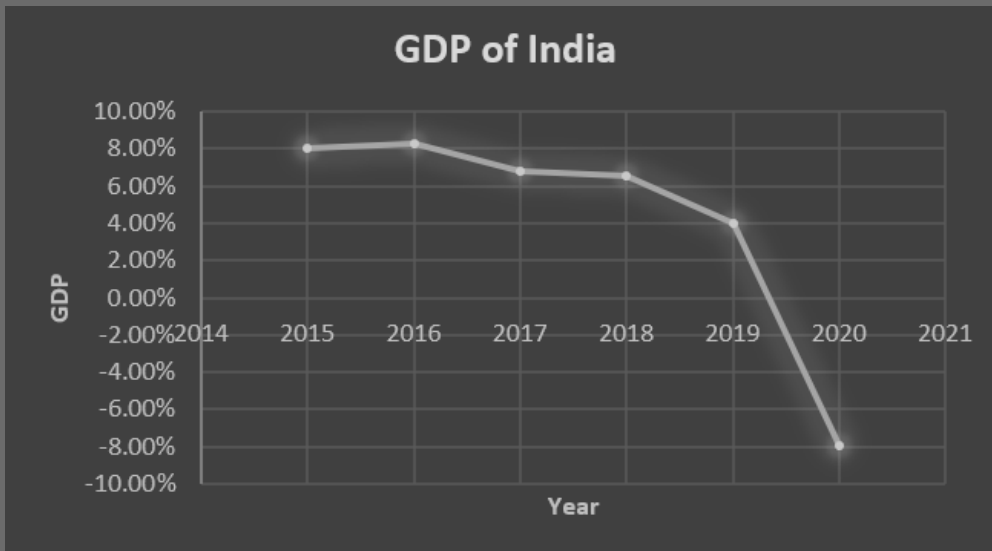
## Trend of Over all Unemployment in India since 2015



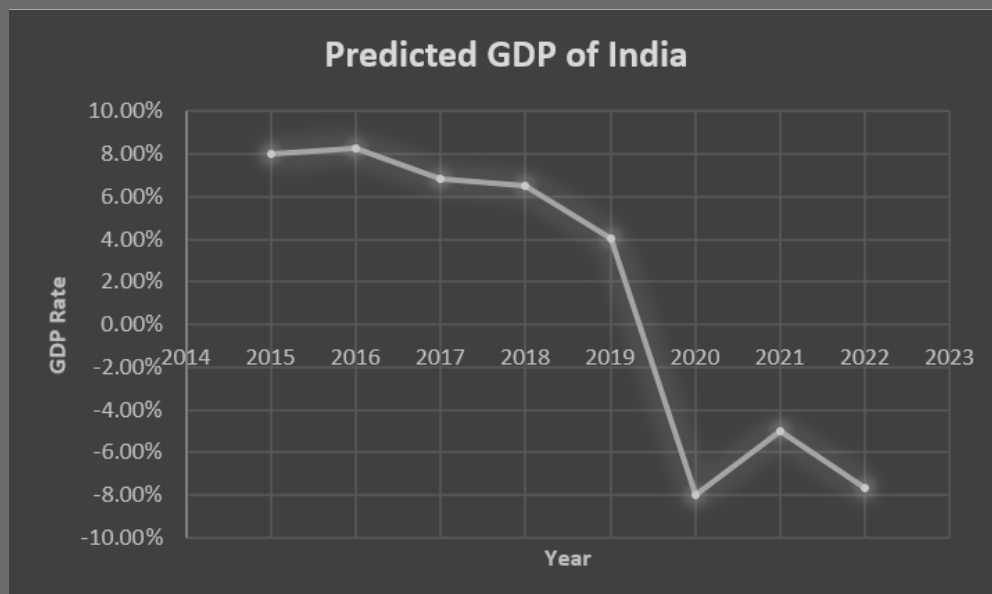
With the method of linear interpolation, the predicted overall unemployment rates of India for the financial year 2021 - 2022, and 2022 - 2023, respectively are 6.39 per cent and 6.59 per cent.

# BODY

**Trend of GDP of India since 2015**



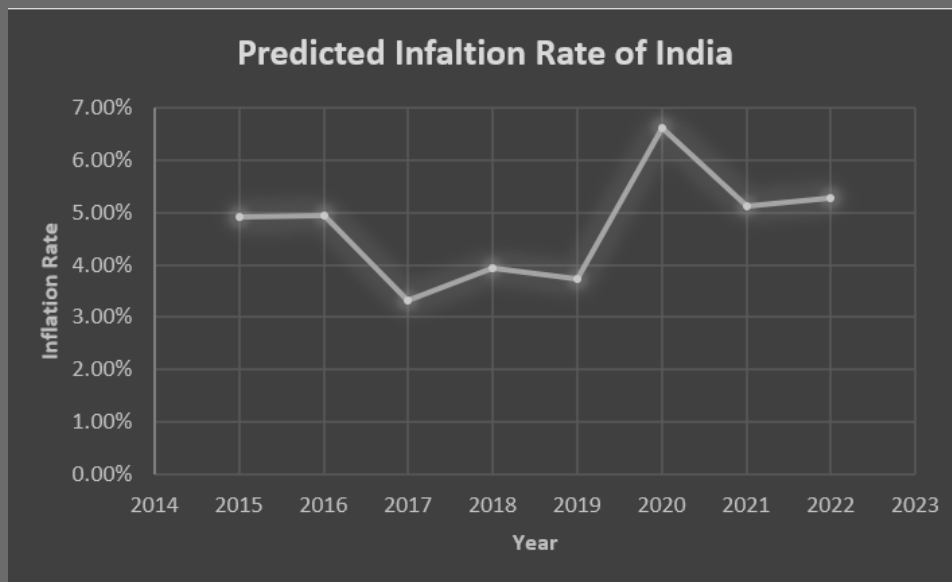
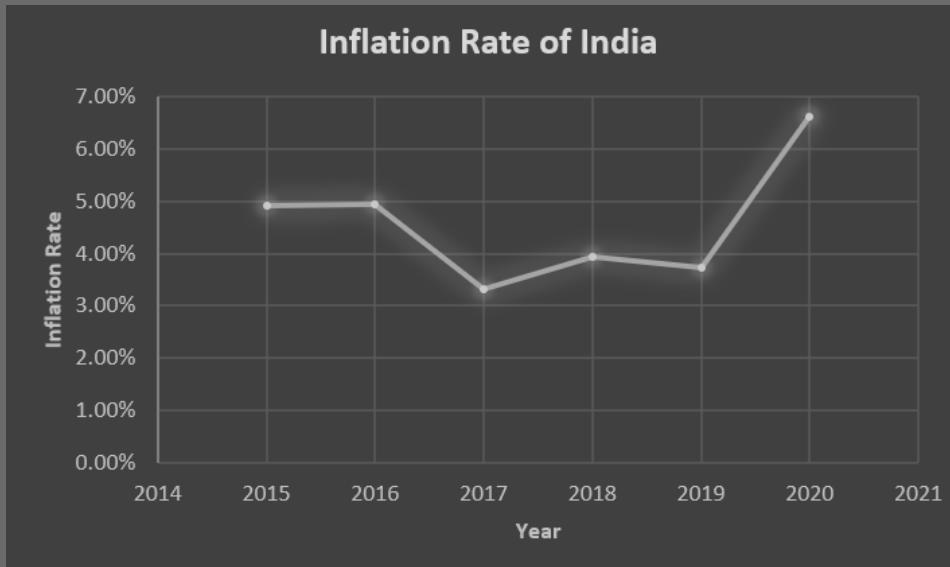
On the other hand, India's GDP is estimated to grow to approximately 9.2 per cent in the current financial year, 2021 - 2022, compared to a contraction of 7.3 per cent in the preceding fiscal year, this increase in GDP is said in the view of the fact due to the improvement in the performance of agriculture and manufacturing sectors.



With the method of linear interpolation, the predicted youth unemployment rates of India for the financial year 2021 - 2022, and 2022 - 2023, respectively are -4.99 per cent and -7.64 per cent.

# BODY

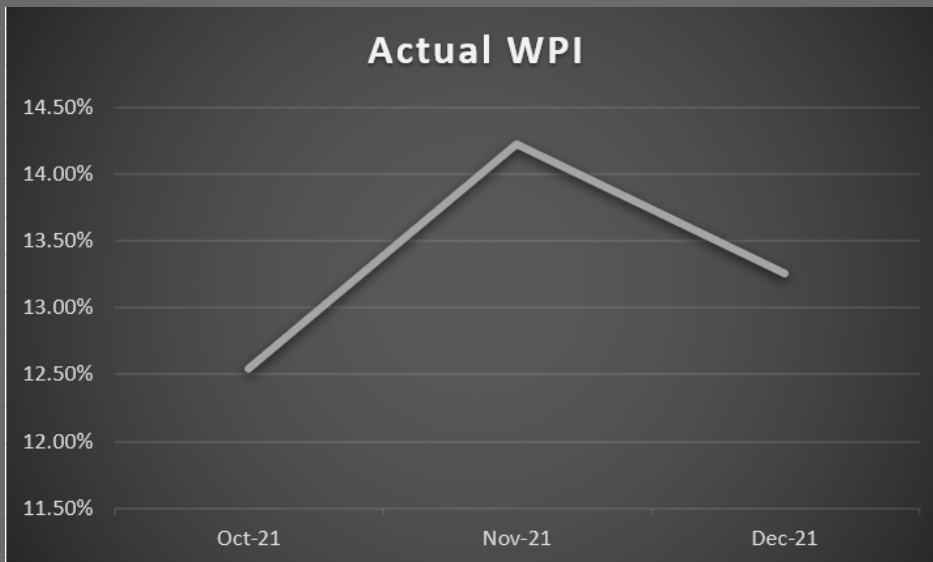
## Trend of Inflation rates since 2015



With the method of linear interpolation, the predicted inflation rates of India for the financial year 2021 - 2022, and 2022 - 2023, respectively are 5.12 per cent and 5.25 per cent.

# BODY

India is already suffering from constant rise of inflation and unemployment. According to the Ministry of Statistics and Programme Implementation (MOSPI) and the Ministry of Labour and Employment, the annual wholesale price inflation rate in India was 14.23 per cent, in December 2021, which has eased down to 13.26 per cent in January 2022, which was the highest in more than 10 years.



According to our calculations, it was predicted that the annual wholesale price inflation rate in India was going to rise to 15.87 per cent.

# BODY

## **Stagflation in India 2020**

Inflation is frequently portrayed as the economic enemy. Inflation is defined as a general increase in the price level in a given economy. Inflation causes a currency's buying power to erode as commodities and prices become more expensive. Simply said, we would be able to buy less products for the same amount of money.

When rising inflation is combined with stagnating output, the impact is even worse. The economy would be in a state of stagflation in such a scenario. The oil price shock in the mid-1970s pushed several economies into stagflation. Stagflation is a dangerous scenario since there is no agreement on the policy mix needed to cope with it. For example, in the event of falling aggregate output, the government / central bank's initial policy response would be to pursue a lax fiscal / monetary policy. When the economy is coping with rising prices, however, a policy mix of loose monetary and fiscal policy could push prices further higher.

A tight monetary policy to limit inflation, on the other hand, would result in increased borrowing costs, which would have a negative impact on consumption and investment demand. As a result, the economy's overall output would be reduced.

Currently, there is debate as to whether the Covid-19-induced economic crisis will cause a stagflationary shock in the main economies. With the announcement of GDP numbers for the first quarter of FY21, the discussion in India is heating up. In Q1FY21, the Indian GDP shrank by 23.9 per cent. Consumption and investment demand, which are two of the most important components of GDP, shrank by 27 per cent and 47 per cent, respectively. The economy would contract in the second quarter as well, though not to the same extent as in the first.

# BODY

In August, however, the inflation rate, as measured by the Consumer Price Index (CPI), broke beyond the upper band of 6 per cent for the fifth month in a row, reaching 6.69 per cent. The rise in food costs was a major contributor to the rising inflation rate. In August, the pace of increase in the food inflation rate was around 9 per cent. Similarly, despite dropping demand, core inflation (that is, inflation excluding food and fuel) remained strong at 5.4 per cent. The fear of stagflation in the Indian economy is fueled by the reduction of GDP and rising inflation rates.

However, for the previous four months, the wholesale price index (WPI) was negative until rebounding to 0.16 percent in August. When retail inflation was at a peak of 7.5 per cent in January 2020, wholesale inflation was at 3.5 per cent. Inflationary pressure exists solely at the retail level in the current system, not at the wholesale level. This could be due to supply-side disruptions brought on the lockdowns. Once the limits are lifted, the inflation rate may begin to moderate. Nonetheless, the increased number of Covid-19 instances continues to be a problem.

Similarly, August's heavy rains may constrain supplies, driving up food costs at both the wholesale and retail sectors. In this context, the government has imposed a ban on the export of onions as a preventative measure. Lockdown regulations and irregular rainfall are making it difficult to keep inflation under control. In addition, the central bank's policy actions are guided by the inflation rate.

Though it is too early to determine if the economy has entered a stagflationary phase, the growth-inflation conundrum in India will undoubtedly become more evident in the days ahead.

# BODY

## Stagflation in India 2022

According to former World Bank Chief Economist Kaushik Basu, India's general macroeconomic condition is improving, but growth is concentrated at the top end of the market, which is a concerning tendency.

Basu, who formerly served as Chief Economic Advisor to the Indian government under the UPA regime, said the country is experiencing stagflation and that "very carefully curated policy measures" are needed to solve the situation.

Basu is currently an Economics professor at Cornell University in the United States. While the overall economy is rising, "the bottom half of India" is in recession, he said, adding that it is unfortunate that the country's policy has been mostly centred on major firms in recent years.

"The general macroeconomic situation in India is improving... The fact that this increase is concentrated at the upper end is causing concern" In an interview with PTI, Basu stated.

He further claimed that before the COVID-19 outbreak, the country's youth unemployment rate had reached 23 per cent, making it one of the highest in the world. He went on to say that workers, farmers, and small businesses are all seeing negative growth.



# BODY

While India's GDP is expected to expand 9.2 per cent in 2021-22, according to Basu, this follows a decrease of 7.3 per cent in 2019-20 owing to the epidemic, making the average growth rate for the last two years 0.6 per cent. In its first advance estimate, the National Statistical Office (NSO) forecasted 9.2 per cent GDP growth for the fiscal year April 2021 to March 2022, whereas the Reserve Bank of India forecasted 9.5 per cent growth for the same period.

The World Bank is the most pessimistic, forecasting growth of 8.3 per cent, while the Organisation for Economic Cooperation and Development (OECD) predicts growth of 9.7 per cent.

Basu said the current situation in India is a significant problem for Finance Minister Nirmala Sitharaman and the entire fiscal policy apparatus, whether the government should opt for fiscal consolidation or continue with boosting measures in the upcoming Budget.

The Indian economy is experiencing stagflation, which is far more painful and necessitates very carefully crafted policy interventions, he added, noting that inflation was even higher 15 years ago, close to 10 per cent, but there was one major difference.

"At the time, India's actual growth rate was close to 9%... thus, even with inflation, the average household was getting 7 or 8% better off per capita," he explained.

What makes the current scenario so bleak, according to Basu, is that the near-5 per cent inflation is occurring over a two-year decline in real per capita income.



# BODY

"Because we're in a stagflationary position, the big objective is to create jobs and aid small businesses... the task now is to create jobs while growing output," he explained.

According to the latest official data, retail inflation jumped to 5.59 per cent in December 2021, owing primarily to an increase in food costs, while wholesale price-based inflation defied the 4-month rising trend and fell to 13.56 per cent last month.

Stagflation is characterised as a situation in which a country's economy has persistently high inflation, high unemployment, and stagnant demand.

While the usual Keynesian approach of forcing workers to do any activity, even if it is unproductive, and compensating them for it works in deflation, Basu believes it is a mistake to do so during stagflation.

"As a result, the continuous work on the Central Vista project in the midst of a pandemic and with so much economic distress, with the massive spending — some estimates put the cost at approximately USD 2 billion for the government — is an embarrassment," he said. It has no effect on productivity.

The goal, according to Basu, should be to get money into the hands of the poor and even certain middle classes, but this must be done while simultaneously increasing output, upgrading infrastructure, and alleviating supply bottlenecks.

# BODY

"I'm sure India's finance ministry has the expertise to design these adjustments," he said, "but I'm not sure if it has the political room to do so." When asked about the impact of the US Federal Reserve's 'taper tantrum,' or removal of monetary support, on India, Basu said he does not believe the policy will be too concerning because "we have enough foreign exchange reserves now to weather this."

On cryptocurrency, Basu stated that he feels India is doing the right thing. "I have no doubt that, at some point in the not-too-distant future, the entire globe will abandon paper currency," he stated, adding that blockchain technology will be adopted by central banks and that cryptocurrency will become widely used.

"This is a complicated issue, and rushing through it with politicians in charge of the design would be a mistake. I am relieved that the government is taking notice of this "He made a point. India intends to introduce a bill in Parliament to address the issues raised by unregulated cryptocurrencies.

There are currently no specific restrictions or prohibitions in place in the country regarding the usage of cryptocurrencies.



# CONCLUSION

According to our prediction model, we predicted the Indian inflation rate to increase to 5.25 per cent, Wholesale Price Inflation to increase to 15.87 per cent, Gross Domestic Product to decrease to -7.64 per cent, Youth Unemployment to increase to 24.27 per cent and the over all unemployment to increase to 6.59 per cent. All these values add up to a decrease in economic growth, hence concluding that Indian economy will face stagflation in the upcoming years.

The prediction model that we have used has a high probability of false prediction as a consequence of not taking in any other factors into considerations, for example, private investments, and technology advancement.

In a statement made by Basu, he believes that Gross Domestic Product is going to increase to 9.2 per cent, following a 7.3 per cent decrease in the preceding year, he made a statement that the Indian economy is currently going through stagflation and will be recovering in the next few years.

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