Effects of Falling Inflation

Why in news?

Inflation at both the retail and wholesale levels has been falling for the last 4-5 consecutive months.

What is the current inflation scenario?

- The Consumer Price Index (CPI) (retail) and the Wholesale Price Index (WPI) has been falling in general for the last year or so.
- The CPI was as high as 5.21% in December 2017, following which it fell quite steadily and has come down to 2.05% in January 2019.
- This is the lowest it has been in the last 19 months.
- The WPI has similarly seen an overall decline, but has been more volatile than the CPI. Click here to know more on CPI and WPI

Why has inflation been falling?

- The main reason for falling inflation is the drop in global oil prices.
- From an average $80 a barrel in October, the Indian basket of crude oil prices fell to $57 a barrel in December 2018.
- Currently, the prices are slightly higher than that, but there is no significant increase.

How does this benefit?

- **Prices** - When global oil prices fall, inflation falls across the sectors, most notably in energy-intensive sectors.
- The effect is more pronounced in the Indian economy as it is still overwhelmingly dependent on imported oil to meet its needs.
- Falling prices in each of the sectors have an impact on other sectors dependent on them.
- E.g. falling inflation in the transport sector means that every sector that needs to transport goods will also benefit
- **Interest rates** - With falling inflation, the RBI would have more space to relax the interest rates, one of its key inflation targeting tools.
- In its last Monetary Policy Review too, the central bank cut the benchmark interest rate by 25 basis points. Click here to know more.
- **Government** - Politically, low and falling inflation always works to the

benefit of the government.
- This is especially noteworthy in the run-up to the general election.

What is the need for caution?

- Despite the above, it is to be understood that 'moderate' inflation levels are essential for the economy, to drive consumption.
- This is because, generally, higher levels of spending are crucial for sustaining the economic growth.
- This is even why the Monetary Policy Committee (MPC) has fixed the inflation levels to be maintained in the zone between 2 and 4%.

How does the future look?

- The future outlook on global oil prices suggests almost stable prices.
- Crude oil price is likely to remain in the range of $55-65 a barrel for the next three to four quarters.
- Given this, retail inflation is expected to remain subdued at 2-3% and wholesale inflation at 3-4% in the near future.

Source: The Hindu

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