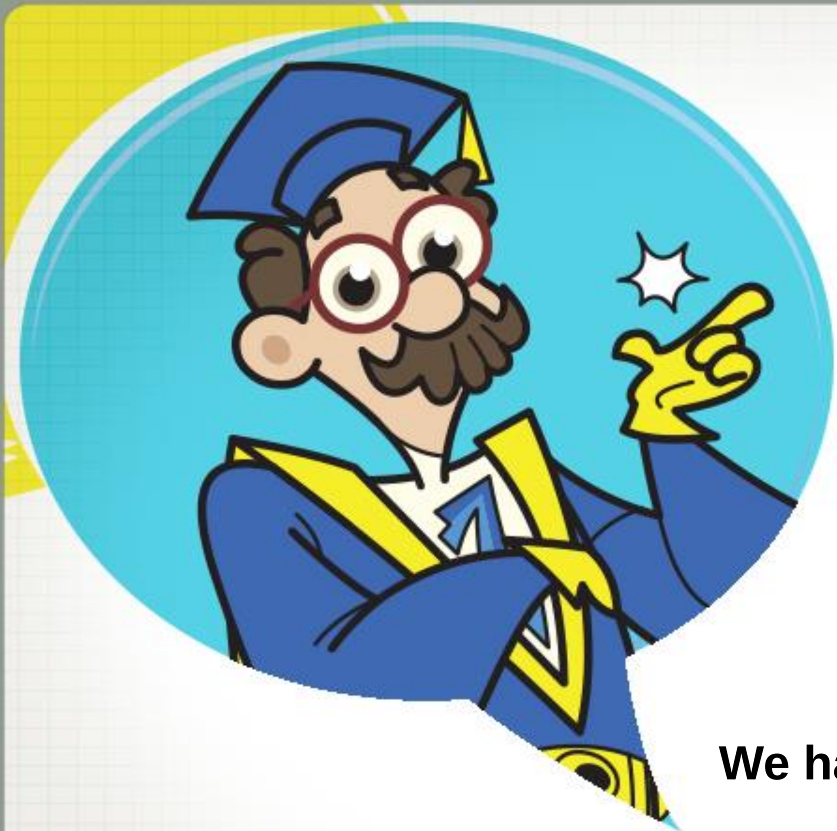
IMPORTED INFLATION

Understanding Imported Inflation

IMPORTED INFLATION



We have often heard our parents or grandparents saying that they used to manage the entire house for 100 rupees a month in “*those days*”.

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IMPORTED INFLATION

We usually smirk, and say

“*Gone are those days.*

Today we can’t even have

***one full meal in 100 rupees*”.**

IMPORTED INFLATION

Blame it on inflation. Inflation erodes the purchasing power of money such that Rs. 100 today is no longer Rs. 100 tomorrow.

We understand inflation,

but what does

imported inflation mean?

IMPORTED INFLATION

When the general price level rises in a country because of the rise in prices of imported commodities, inflation is termed as imported.

IMPORTED INFLATION

No country in the world is self-sufficient by itself.

Each country depends on other countries for goods and services which are not produced domestically.

IMPORTED INFLATION

For Instance, India imports about three quarters of its total crude oil consumption.

IMPORTED INFLATION

Therefore, if oil prices go up in the international market, inflation in India will also go up due to higher prices of the petroleum products as fuel and power have 14.91% weightage in the Wholesale Price Index (WPI) in India.

IMPORTED INFLATION

However, it is not necessary that only rise in the price of a traded commodity in the international market fuels imported inflation.

IMPORTED INFLATION

Inflation may also rise because of depreciation of the domestic currency.

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For example, if the rupee depreciates by 15% against the US dollar in a particular period, the landed rupee cost of oil will also go up by a similar proportion and will affect the price and inflation numbers.

IMPORTED INFLATION

Let us consider an example. Suppose we import Petrol at $100 a unit. And the exchange rate is Rs. 50 per dollar. This means we actually need Rs. 5,000 to first buy $100, and then pay for the Petrol purchase of one unit.

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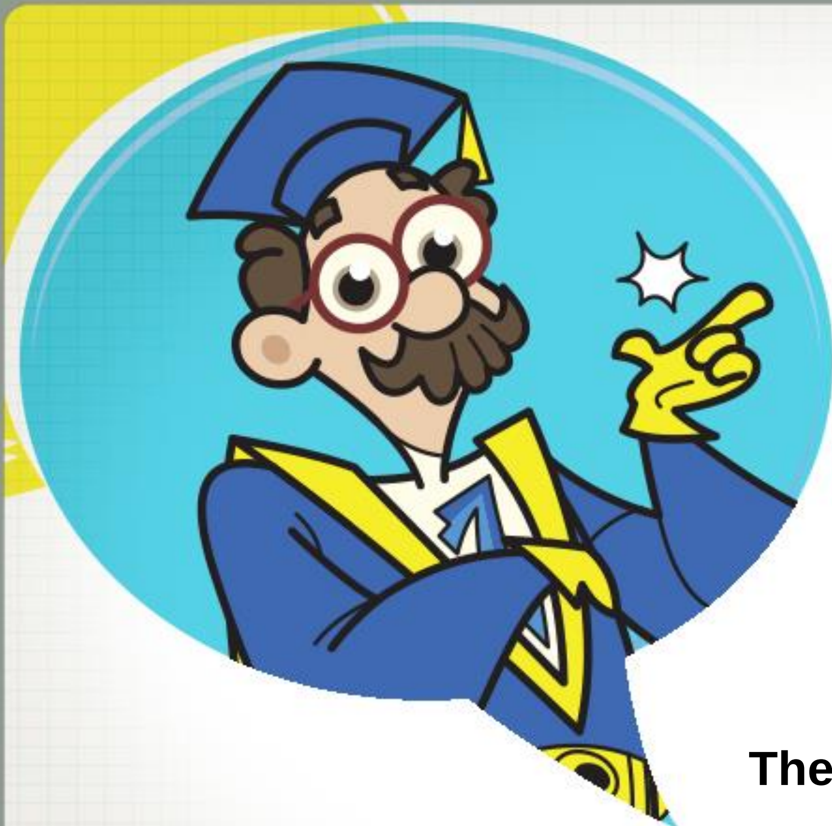

Therefore the price of Petrol depends on two factors:

1. Price of Petrol (in dollar terms)
2. Price of the dollar

IMPORTED INFLATION

As explained above, price of petrol in India is directly proportional to the price of petrol in dollars, but also is impacted by the price of the dollar.

Let's understand how.

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Suppose the price of the dollar goes up to Rs. 60 per dollar.

This means that we will have to cough up Rs. 6,000 to buy $100 for the purchase of one unit of Petrol.

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So despite the fact that the price of Petrol continues to be stable in the international market at $100, the price of Petrol in India goes up from Rs. 5000 per unit to Rs. 6000 per unit. So while there is 0% increase in the price of petrol in the international market, the price of petrol in India increases by 20%.

IMPORTED INFLATION

Therefore one often reads that the devaluation of the rupee will bring in imported inflation.

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Hope the above explanation helped you to understand the concept of imported inflation as against domestic inflation.

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