Can India’s Economy Riding High in Financial Inclusion Cope-Up With Inflation?

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Recently, in the context of the eighth anniversary of the flagship financial inclusion scheme of the Pradhan Mantri Jan Dhan Yojana (PMJDY), Union Finance Minister(FM) Nirmala Sitharaman said, “Financial inclusion is a major step towards inclusive growth which ensures the overall economic development of the marginalised sections of the society."

The success of the PMJDY since 28 August 2014 is reflected in terms of opening of over 46 crore bank accounts with deposit balance of Rs 1.74 lakh crore with its expanded coverage to 67 percent rural or semi-urban areas as well as 56 per cent of women Jan Dhan account holders.

“The underlying pillars of PMJDY, namely, Banking the Unbanked, Securing the Unsecured and Funding the Unfunded has made it possible to adopt multi-stakeholders collaborative approach while leveraging technology for serving the unserved and underserved areas as well,” the FM said.

India Ahead of the Global Curve in Financial Inclusion

On financial inclusion metrics, India is now ahead of China with mobile and internet banking transactions rising to 13,615 per 1,000 adults in 2020 from 183 in 2015 and the number of bank branches inching up to 14.7 per 1 lakh adults in 2020 from 13.6 in 2015, which is reportedly higher than Germany, China and South Africa.

> States with higher financial inclusion or more bank accounts have also seen a perceptible decline in crime along with a meaningful drop in consumption of alcohol and tobaccos, according to a report by Soumya Kanti Ghosh, group chief economic adviser at State Bank of India (SBI), on the fifth anniversary of the note ban.

Huge Rollout Of Non Frill Accounts

Under the non-frills accounts scheme, the number of persons with deposit accounts at banks has significantly increased, becoming comparable with emerging economy peers and even some of the advanced economies.

In terms of the use of digital payments also, there is noteworthy progress. During the past seven years of the financial inclusion drive, the number of no-frills bank accounts opened has reached 43.7 crore with Rs 1.46 lakh crore in deposits as of 20 October 2021.

Of these, nearly two-thirds are operational in rural and semi-urban areas and over 78 per cent of these accounts are with state-owned banks, 18.2 per cent with regional rural banks, and a paltry three per cent are opened by private sector banks.

During this period, the number of bank branches in rural areas has increased from 33,378 in March 2010 to 55,073 in December 2020. The number of banking outlets in villages or Banking Correspondents (BCs) has soared from 34,174 in March 2010 to 12.4 lakh in December 2020.

In the same period, the number of commercial bank branches per one lakh adults rose from 13.5 to 14.7. The number of deposit accounts with banks rose from 1,536 to 2,031, the number of loan accounts from 154 to 267, and the number of mobile and internet banking transactions rose from 183 to 13,615 (all numbers per 1,000 adults).

Will This Benefit the Marginalised?

Public sector banks have opened 34 crore of the total 44 crore no-frills accounts and the private sector ones just 1.3 crore of them.

However, the Finance Minister’s statement and emphasis on financial inclusion, as important as it maybe, must be read in context to the situation of the ‘unbanked’ and the ‘under-banked’ i.e. the socio-economically marginalised sections of the Indian society.

While India has done considerably well in financial inclusion metrics over the last few years (see the report here) there is still the problem of 'inflation' that's acting as an invisible tax on the poor and marginalised.

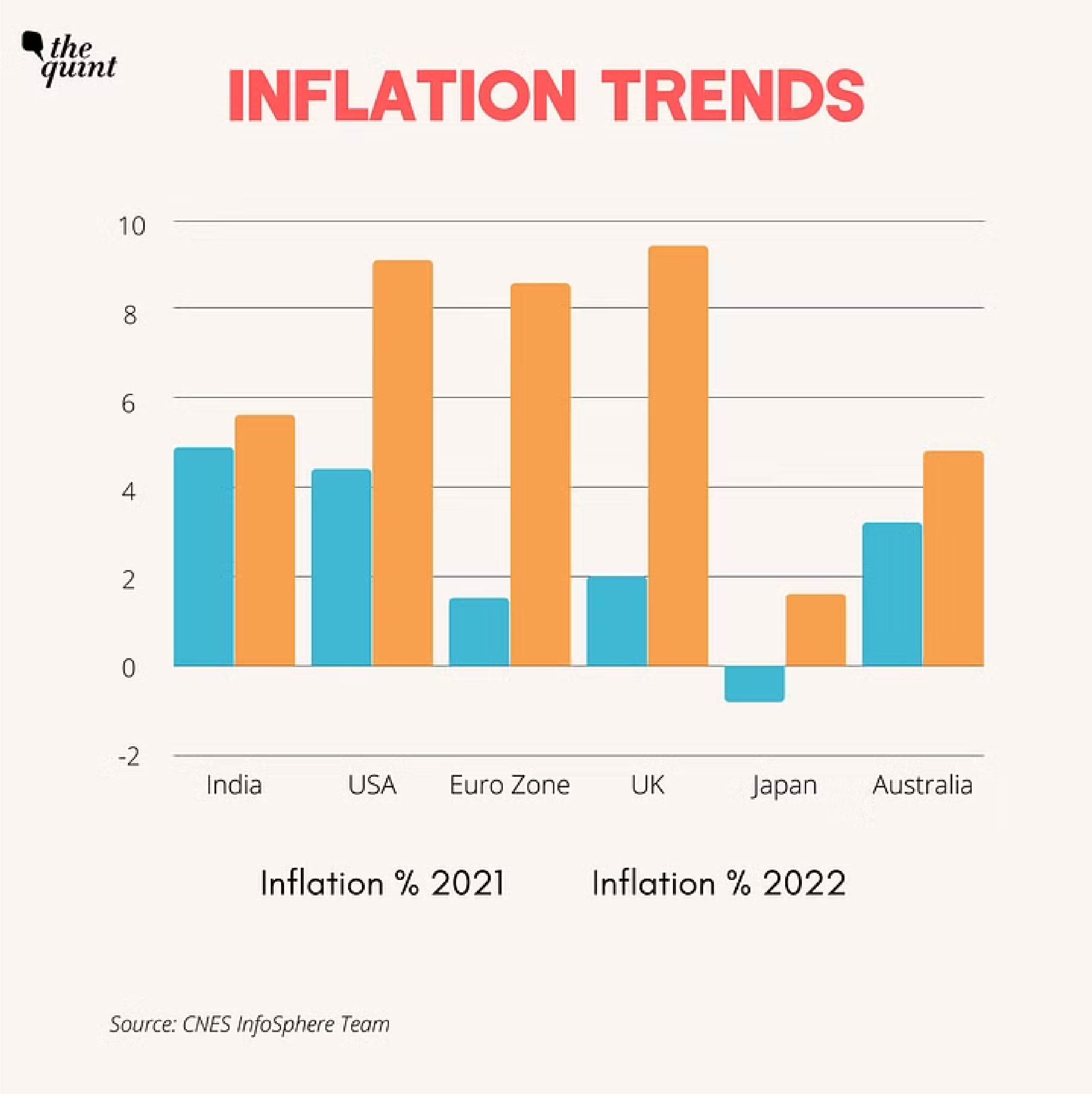
Worrisome Inflation Rate To Wreak Havoc

Inflation has continued to peak at an all-time high in all economies around the world, with food and energy prices skyrocketing to unprecedented levels. Even industrially developed nations like the USA, Canada, and the Eurozone, which experienced decades-long of stable price levels have struggles to keep prices under control.

While domestic food price inflation is high globally, Consumer food price inflation in India has increased from 0.68% to 8.38% between September 2021 and April 2022. The overall inflation rate was recently reported to be around 7% with most of the price rise stemming from high food-fuel prices.

High levels of global food inflation are being driven by multiple reasons such as the COVID-19 pandemic-induced supply chain concerns and the ongoing Russia-Ukraine war. Multiple lockdowns and subsequent disruptions in the logistics of the supply accounted for a swift rise in food inflation prices. This was further exacerbated during the economic recovery, when demand for food and essentials rose even more.

> However, just as demand-driven inflation was declining, a war in Europe caused an increase in input energy costs for commodities, worsening the inflation prices.



Factors Driving Soaring Food Inflation

To focus on the rising food inflation driven by supply side variables, our Centre's InfoSphere research team considered climatic factors, specifically the role of 'temperature' and 'rainfall'. These exogenous (or externalised) factors are important since extremes in both categories can adversely affect the production and yield of food grains.

In a recent study for our Centre, we opted for a multiple-level analytical approach, using three outcome variables: Food inflation, the Consumer Food Price Index (CFPI), and the Wholesale Price Index (WPI). This allowed us to analyse the relationship between climatic factors and inflation at multiple levels.

Here, the key relationship to observe closely is the nature of direct correlative relationship between 'food inflation' and 'temperature', which is statistically significant (see here for more details on results).

Economic Impact of the Changing Climate Patterns

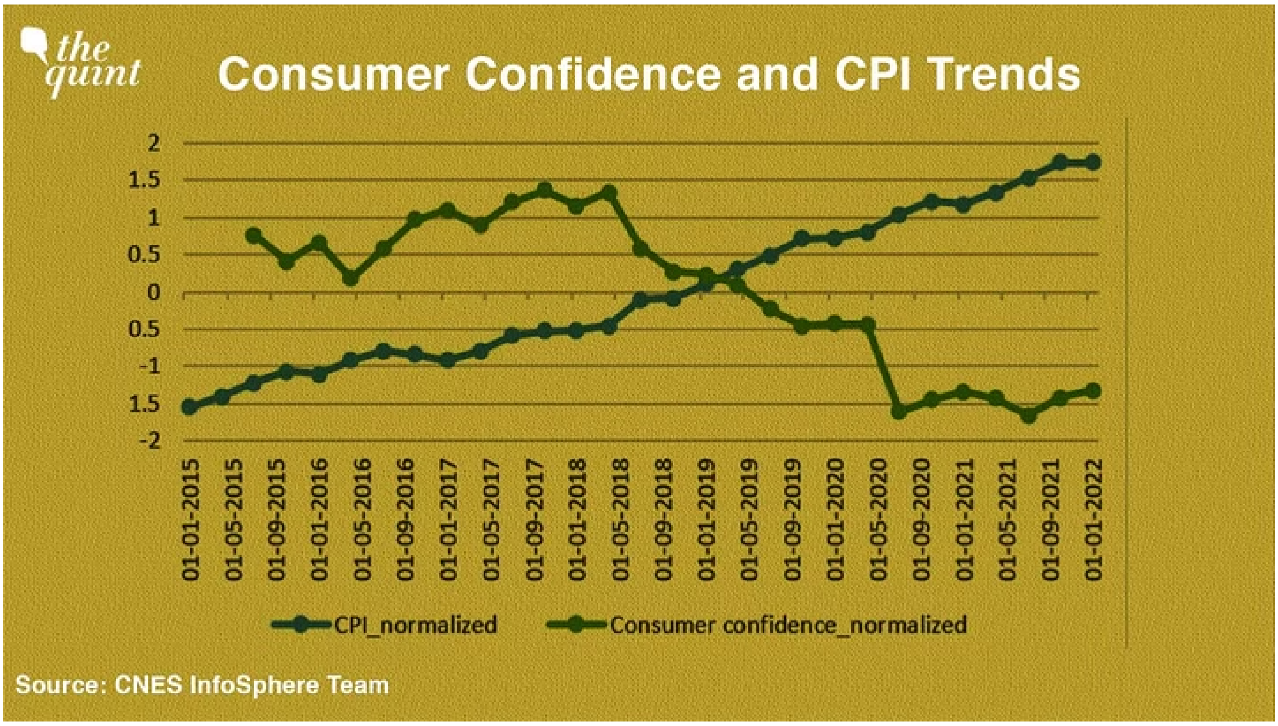
Change in overall temperature significantly predicts patterns of food inflation. From a modeled understanding of the relationship between change in 'temperature' and food inflation, we need more research to get a sense on how entwined the degree of causation is reflecting one variable's effect on another, especially given how climate change continues to be a growing concern, relationship between temperature and food inflation will need closer scrutiny-particularly by central bankers.

Though the current inflation trends were also driven by the Russia-Ukraine war, our analysis also helps in establishing the importance of studying externalized supply side factors affecting the supply chains.

Changing Demand Trends Based on Consumer Confidence

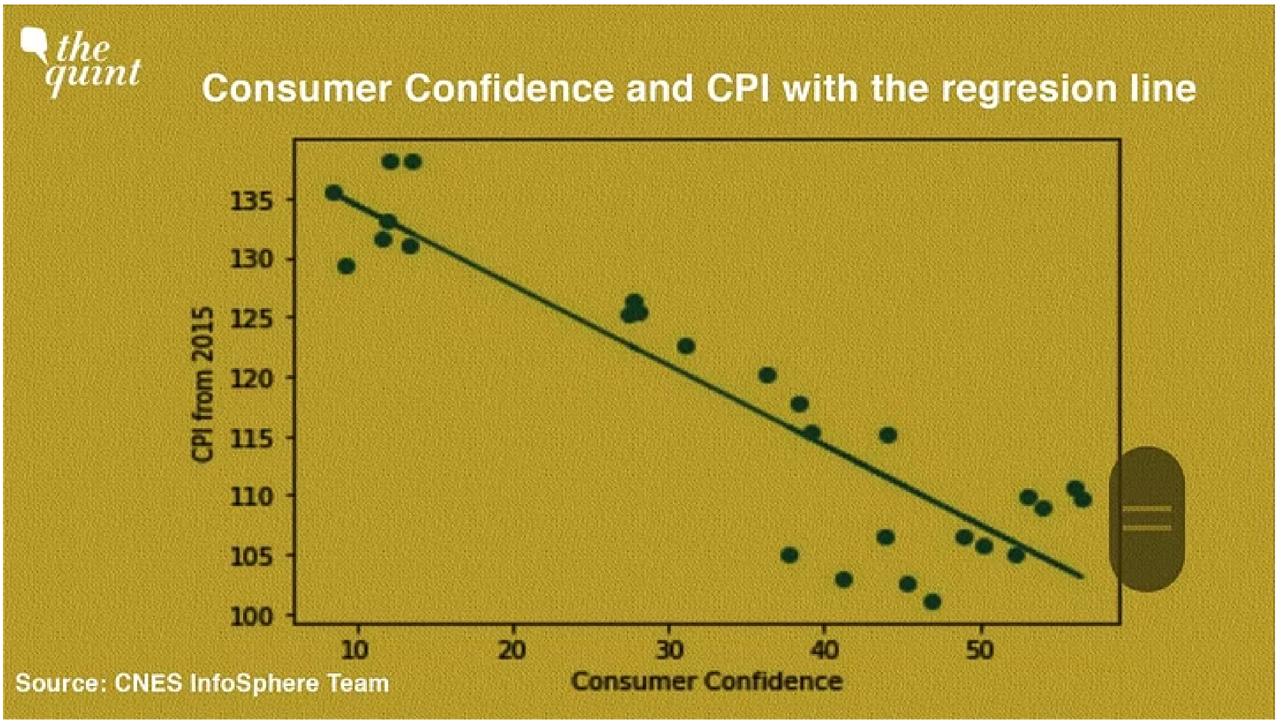
Given that inflation in 2021 was majorly demand-driven, it was essential to check if demand-side factors also played any role in the recent rise in commodity prices. Using consumer confidence data as a proxy for consumer demand, we compared it with CPI trends for the last 7 years.

From the graph below, it can be observed that CPI had been continuously rising since 2015 while consumer confidence has started to dip since 2018, suggesting a negative relation between the two variables. While the CPI has kept growing, a sudden dip in consumer confidence is also observed in 2020 owing to the onset of the pandemic.



Our analysis here does not show, however, the direction of this (negative) relationship and the probable cause. More detailed research here may help figure out whether the change in consumer confidence affects CPI (Consumer Price Index) or vice versa particularly in the Indian context.

Also, consumer confidence has been consistently declining since 2015, however, the increase in inflation trends was noted quite recently. This signifies that demand-side variables didn't play a significant role in driving up the recent general price levels.



One of us has previously argued how a formulaic approach to inflation measurement has concerns.

> In an informalised space, as in India, if a *chai-waala* operating near a construction site in Delhi sees a surge in demand for tea after unlocking, he would immediately need a greater quantity of milk from his regular distributor.

If the source of this milk happens to be a dairy operation in a state that still has covid restrictions in place, then milk supplies could be disrupted or delayed. In such a scenario, the price of tea would go up.

Will Inflation Keep Ticking Up?

Interpreting such micro-level observations is critical to understanding the price behaviour and its impact on economically vulnerable sections of the society.

An interplay of localised factors -in recent times- has coalesced with a high degree of uncertainty in the lives and livelihoods of various economic agents across India, and this is likely to keep inflation on an incline.

It is extremely hard to take a formulaic approach to address such a rise in inflationary expectations. Monetary policy may be ineffective. Fiscal Policy on the other hand, requires a more context-driven approach to help those affected by price rise with direct support.

Domestically, the other challenge for India despite the bright spot seen in its financial inclusion story would be to address the challenge of inflation and its consequential effects against all other macroeconomic factors or concerns stemming from: a collapsing Rupee; a high current account and trade deficit; an eroding foreign currency reserve scenario; a capital flight in portfolio investment markets etc, all of which, present a clear vulnerability on the side of its balance of payment accounts, discussed here.

(Deepanshu Mohan is Associate Professor and Director, Centre for New Economics Studies, Jindal School of Liberal Arts and Humanities, OP Jindal Global University. He is Visiting Professor of Economics to Department of Economics, Carleton University, Ottawa, Canada. This is an opinion piece and the views expressed are the author's own. The Quint neither endorses nor is responsible for them.)

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