Four-Year High Wholesale Price Inflation

What is the issue?

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- The Wholesale Price Index (WPI) rose 5.77% on a year-on-year basis to a 54-month high in June 2018.
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- The inflation scenario demands a closer look at the macro-economic conditions.
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What are CPI and WPI?

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- Both measure the inflationary trends i.e. movement of price signals within the broader economy.
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- WPI tracks year-on-year wholesale inflation at the producer or factory gate level.
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- It is a marker for price movements in the purchase of bulk inputs by traders.
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- Consumer Price Index (CPI) tracks changes in prices levels at the shop end.
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- It is thus reflective of the inflation experienced at the level of consumers.
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- The two indices differ in the manner in which weightages are assigned.
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- This applies to food, fuel and manufactured items as well as their sub-segments.
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- E.g. weightage of food in CPI is far higher (46%) than in WPI (24%).
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- Also, WPI does not capture changes in the prices of services but CPI does.
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What are the driving factors for WPI rise?

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- Rising crude oil prices has persistently driven inflation.
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- Inflation in the fuel and power group has risen every month in the recent period.
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- Food articles, especially vegetables, have been on a rising trend as well.
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- The inflation in politically sensitive duo of potatoes and onions is a notable cause.
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- Manufactured products (largest weight in the WPI) are also on an inflationary trend.
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- WPI rise is also to be seen from the perspective of an unfavourable base effect.
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- It is the effect of the previous year taken as the base for calculation.
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- This is because the WPI inflation in June 2017 was just 0.9%.
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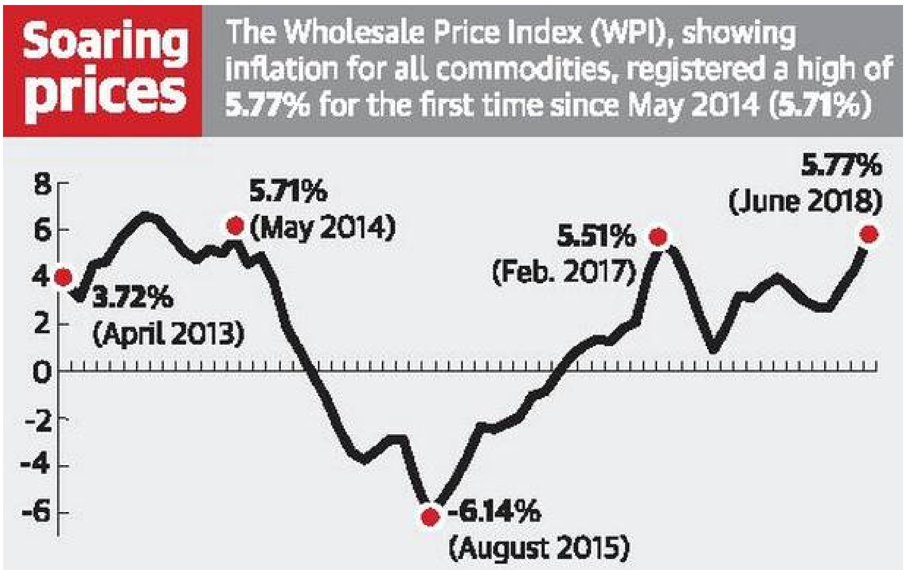

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Is WPI rise a concern?

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- **Policy** - In 2014, RBI had adopted CPI as its key measure of inflation from the earlier WPI.
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- India thus shifted to CPI as the benchmark for deciding policy rates (e.g. repo rate).
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- Accordingly, RBI has a target to keep consumer-level inflation at 4% (+/- 2%).
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- Any rise in CPI inflation beyond this comfort zone pressurises RBI to hike interest rates.
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- So WPI rise might not appear relevant from a policy perspective.
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- **Economy** - However, price changes at the producer level usually get transmitted to the consumers.
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- But this could come with a time lag or may not be to the full extent of the impact at the producer level.
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- So, the apprehensions with a higher WPI may not be valid at all times.
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- Nevertheless, a steady rise in WPI is certainly an indicator of an overall inflationary pressure.
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- It reflects the unbalanced conditions within the broader economy.
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- **Retail** - There is a concern of a cascading effect of WPI increase on the CPI.
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- This remains even after discounting for the base effect.
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- Evidently, the retail inflation (CPI) had risen to a 5-month high of 5% in June, 2018.
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How does it affect growth?

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- Inflation-growth relationship is “significantly negative” if inflation is above a threshold value.
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- It is “insignificant or significantly positive” if inflation is below the threshold value.
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- Simply, inflation to a certain extent is favourable to the economy, above which it becomes harmful.
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- But generally, the threshold values in developing countries are relatively higher.
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- In India's case, roughly 4 to 5.5% inflation is said to be the range, above which it retards GDP growth rate.
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- But substantial gains can be achieved if inflation is kept below the threshold.
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How does the future look?

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- Government has recently decided to increase the minimum support price for kharif crops.
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- A possible inflationary pressure due to this exists already.
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- On the other hand, inflationary trend has reinforced the expectations of a repo rate hike.
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- As, rate hike would be a measure of controlling the inflationary trend.
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- However, IMF in a recent update has said the Indian economy will grow slower than estimated earlier.
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- It has also cut India’s growth projection for 2018-19 by 10 basis points to 7.3%.
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- The pressure on growth due to the added impacts of inflation and faster interest rate hikes is the reason.
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- Thus, balancing between inflation and growth prospects would be a challenging task for the policy makers in the near future.

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Source: The Hindu, Indian Express

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