

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 54month 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 <u>wholesale</u> 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 $\underline{traders}._{\n}$
- Consumer Price Index (CPI) tracks changes in prices levels at the shop end. \n
- It is thus reflective of the inflation experienced at the level of consumers. \n
- The two indices differ in the manner in which weightages are assigned. \slashn
- \bullet This applies to food, fuel and manufactured items as well as their subsegments. $$\n$
- E.g. weightage of food in CPI is far higher (46%) than in WPI (24%). $\slash n$
- Also, WPI does not capture changes in the prices of services but CPI does. $\slash n$

What are the driving factors for WPI rise?

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• Rising <u>crude oil</u> prices has persistently driven inflation.

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 \bullet Inflation in the $\underline{fuel} \ \underline{and} \ \underline{power}$ 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. \n
- The inflation in politically sensitive duo of potatoes and onions is a notable cause.

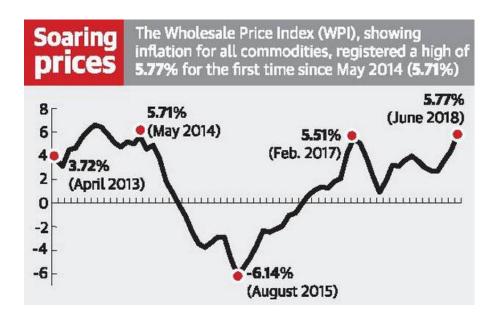
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- <u>Manufactured products</u> (largest weight in the WPI) are also on an inflationary trend. \n
- \bullet WPI rise is also to be seen from the perspective of an <u>unfavourable base effect.</u>

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- It is the effect of the previous year taken as the base for calculation. $\space{\space{1.5}n}$
- This is because the WPI inflation in June 2017 was just 0.9%. $\ensuremath{\sc vn}$

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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. $\ensuremath{\sc vn}$
- Economy However, price changes at the producer level usually get transmitted to the consumers.
- But this could come with a time lag or may not be to the full extent of the impact at the producer level. $\gamman{\cases} n$
- So, the apprehensions with a higher WPI may not be valid at all times. $\slash n$
- 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. $\slash n$
- Retail There is a concern of a cascading effect of WPI increase on the CPI. \n
- This remains even after discounting for the base effect. \slashn
- 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. \n
- 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. \n
- \bullet But substantial gains can be achieved if inflation is kept below the threshold. \n

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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.
- 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. $\space{\space{1.5}\spac$

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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.
- 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

