

# 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.

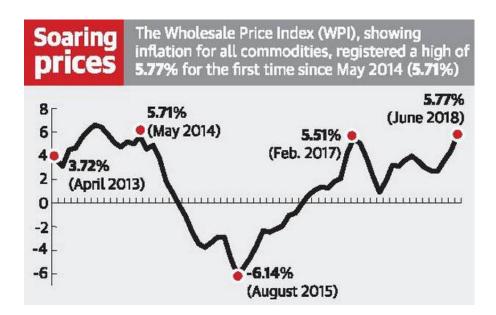
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- <u>Manufactured products</u> (largest weight in the WPI) are also on an inflationary trend.  $\n$
- $\bullet$  WPI rise is also to be seen from the perspective of an <u>unfavourable base effect.</u>

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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

