

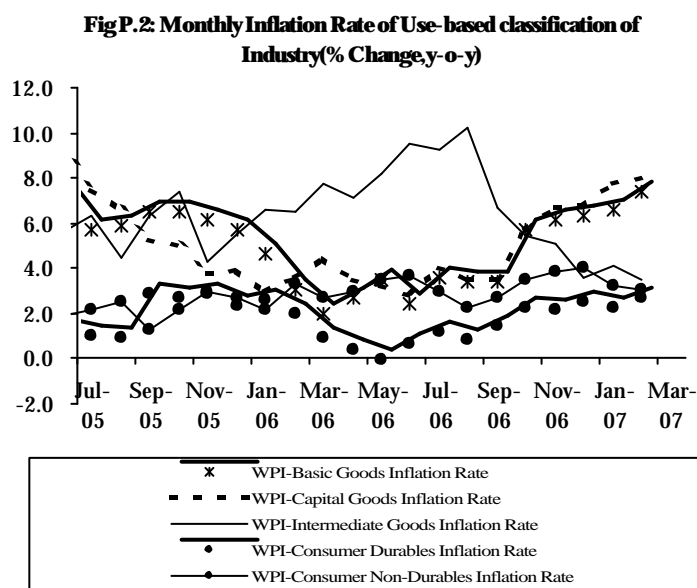
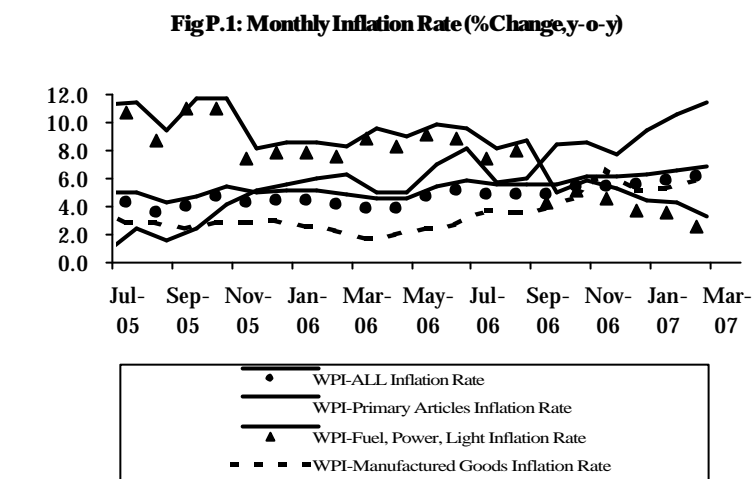
# Prices

The overall inflation rate stood at 6.2 per cent at the end of February 2007 (Fig P.1). The increase in the year-on-year inflation rate was mainly on account of the rise in prices of manufactured products and primary articles. Fuel prices, the chief driving force behind last year's inflation, fell somewhat this year. The price index of the Fuel group showed a lower inflation of 2.6 per cent in February 2007, compared with a rise of 5.1 per cent in February 2006. The effect of the cut in domestic prices of petrol and diesel by Rs 2 and Re 1 per litre respectively on November 29, 2006 was observed on the fuel group's price index in February 2007.

Among the Primary Articles group, the prices of food items, condiments and spices showed an increasing trend due to supply side constraints in the domestic market. In the Non-Food Articles' group, oilseed prices rose in the domestic market in consequence to lower stocks of mustard and rapeseed with the National Agricultural Co-operative Marketing Federation of India (NAFED).

The point to be noted is that the surge of the price index of Primary Articles, particularly Food, is not enduring and would be checked once supplies normalise.

Fig P.2 shows the price changes in the industrial products based on Use-based classification. The graph shows that the inflation rate on account of basic and capital goods increased at the end of February 2007. The higher prices of non-



metallic mineral products, basic metal alloys and metal products are the major contributors to inflation of basic goods.

On the other hand, costlier electrical and non-electrical machinery pushed up the capital goods index. However, the intermediate goods prices have been decreasing in recent months. Inflation hovered at around 4 per cent at the end of February 2007. This fall in the prices of intermediate goods is due to the fall in the prices of the Fuel group.

Consumer goods inflation, both non-durable as well as durable, is still low. The high inventory, increased competition and the wide spectrum of suppliers, both from within and outside India, prevented producers from raising consumer prices.

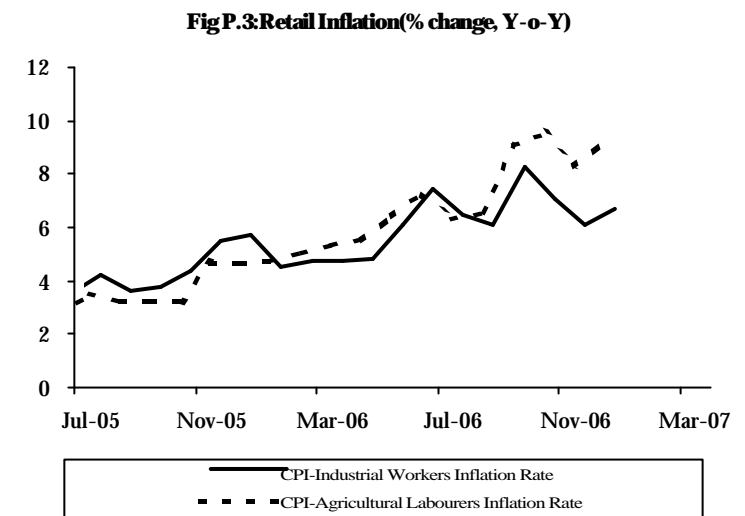
### Trends in CPI

Retail prices, as indicated by the Consumer Price Index of Industrial Workers (CPI-IW) and Consumer Price Index of Agricultural Labourers (CPI-AL), are shown in Fig P.3. The graph shows that the CPI of agricultural labourers (CPI-AG) has risen at a higher rate compared to that of CPI of industrial labourers during the period December 2006-February 2007. The CPI of both agriculture and industrial workers are, in the large part, influenced by the prices of primary articles. The higher rise in this group has put pressure on the consumption basket of the workers.

### International Trends

The high sugar prices during 2005-06 prompted substantial increase in global production in 2006-07 and an associated rise in stocks as consumption grew by less than output. In 2007-08, production is expected to increase further and again exceed consumption, with the result that prices are forecast to fall by 17 per cent.

It is expected that the strong growth trend in palm oil consumption would continue in 2007-08 due to higher demand in China and India. Hence, it is obvious that the prices of crude palm oil



would go up for the coming year. On the other hand, the global price of soybean oil witnessed a sharp rise in 2006-07. So, it could be expected that the price of soybean oil would follow palm oil price movement, as they are close substitutes to each other.

The lower Kenyan output, along with lack of global stock, made tea prices higher for the previous year. That helped the Indian tea industry to achieve record tea exports in 2006. But, at the end of 2006-07, the Indian tea industry recorded a 3.9 per cent fall in production. So, the global price of tea would be expected to surge in the coming year.

Global cotton prices have firmed up. The Washington-based International Cotton Advisory Committee (ICAC) has projected the Cotlook A-Index to average 57 cents a pound for 2006-07 based on supply-demand fundamentals. In its latest report, ICAC has said that world cotton plantings could increase by 1 per cent next year (2007-08) as growers are encouraged by the prospect of getting higher prices. Assuming normal weather conditions, world cotton output is forecast to remain stable at 25.3 million tons. Consumption, on the other hand, would continue to rise

and that too mostly in China, India, Pakistan, and Bangladesh.

The global demand for base metals, mainly copper, tin, and zinc, has been growing due to higher demand in China. But the mining industry has not been able to meet this excess global demand. Market survey reports indicate that base metal prices would go up in 2007-08. On the other hand, the risk of inflation increases the attractiveness of gold as a defence against the erosion of money. Resultantly, the price of gold has been moving up in the international market.

On the oil front, global production failed to increase over the past year owing to what now looks like a permanent loss of over 300,000 barrels per day in the Gulf of Mexico and a production shut-in in Nigeria. Given the limited excess production capacity of the present time, there exists the possibility of additional supply disruptions from places such as Iran and Nigeria, which would again translate into higher current prices for crude oil. As prospects for continued global economic growth appear strong, we could expect oil prices to surge again.

### **Budget impact**

Budget 2007-08 has removed the 4 per cent additional Customs duty on all edible oils - crude as well as refined. It also reduced the Customs duty on crude sunflower oil from 65 per cent to 50 per cent, and on refined sunflower oil from 75 per cent to 60 per cent. As a result, edible oil would be more affordable in the domestic market.

The budget proposed to lower Customs duty on most organic and inorganic chemicals, including vitamins and their derivatives, to 7.5 per cent. Customs duty on chemical products such as dyes and pigments, fertilisers, rubber chemicals and tanning chemicals, was also slashed to 7.5 per cent. This reduction would have a general negative impact on the chemicals and chemical products industry as foreign competition would increase.

All coking-coal imports, irrespective of their ash content, have been fully exempted from Customs duty in Budget 2007-08. This would primarily benefit the steel companies importing significant quantities of coal to blend with high-ash content domestic coal. Steel prices would be expected to inch up from the current levels because of a healthy demand scenario.

Budget 2007-08 came with some duty cut measures for oil marketing companies. Excise duty on petrol and diesel has been cut to 6 per cent from 8 per cent, maintaining the specific portion at Rs 13 and Rs 3.25 per litre respectively. This reduction in Customs duty is expected to make good for the losses incurred by the public sector marketing companies. It would also help private oil companies reduce their prices.