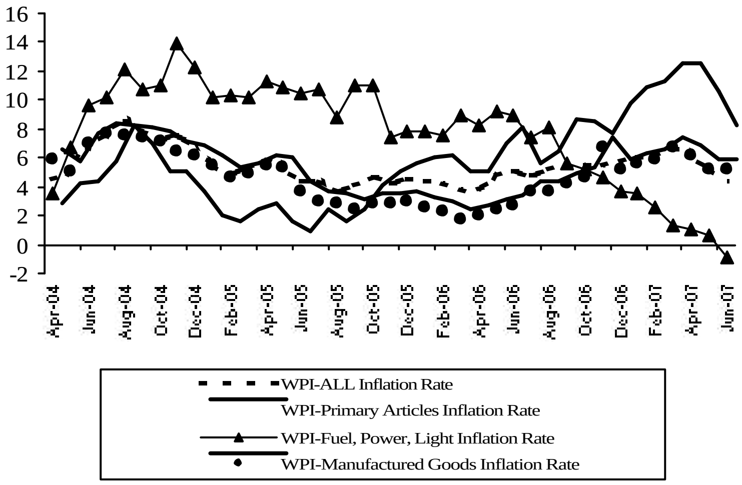
Prices

The annual Wholesale Price Index (WPI)-based inflation rate stands at 4.4 per cent at the end of June 2007. This is the first time that inflation has been below the 5 per cent mark in the current financial year and, what's more, it is also short of the RBI's target level of 5 per cent. At the outset, it seems that the monetary and fiscal measures adopted by RBI and the government, viz. revision of prime lending rate and squeezing in of credit, have paid off. However, other factors, like the appreciating Indian rupee, the high WPI base last year, and, the easing of the supply situation in case of certain primary and manufactured articles, have contributed to this trend.

In the past three months, price rise was felt the most in the case of primary articles. Inflation on account of WPI-primary was hovering above 10 per cent in the preceding three months before coming down to 7.5 per cent at the end of June. Within the WPI-primary group, the drop in inflation is mainly due to the decline in prices of food articles. In this category, the prices of moong, fish, gram, wheat, maize, fruits and vegetables have decreased. Predictions of a normal monsoon have given rise to the expectation that food prices would be cheaper in the coming months. Within the WPI-primary category, there have been increases in prices of non-food articles as well. However, that increase has not been enough to offset the decline in food prices and cause an overall fall in inflation.

Fig. P.1: WPI based Monthly Inflation Rate (%,y-o-y)



The fuel group's pressure on inflation has been rather benign for the past couple of months (Fig. P.1). It indicates negative inflation (-0.8 per cent) on a year-on-year basis at the end of June. Negative inflation in the fuel group is the result of last year's high base. The government had raised the retail prices of petrol and diesel in June 2006 and subsequently reduced them in February and March this year. Hence, the current prices of these products are ruling below last year's levels, pushing fuel group inflation into the negative zone. However, global oil prices have hardened of late and if the trend holds, the government may be forced to contemplate an upward revision in retail prices to reduce the losses suffered by the oil companies.

Inflation on account of WPI-manufacturing is on a declining trend since March. However, it is still hovering above the 5 per cent mark. International trends were responsible for the surge in prices of leather products, basic metal and alloys, beverages, tobacco and tobacco products, and, non-metallic mineral products. The role of the high economic growth (9.4 per cent in the last fiscal year) exerting pressure on prices also needs to be kept in view.

The Figure P2 shows that all components of used-based inflation, barring capital good, are on a declining trend. Demand pressure arising from robust economic growth caused capital goods inflation to cross the 8 per cent mark in June, but for intermediate goods it is below 1 per cent now. However, as metal prices have hardened recently, we may expect the WPI-Intermediate inflation rate to climb in the coming months.

Trends in CPI

Retail prices, as indicated by the Consumer Price Index of Industrial Workers (CPI-IW) and the Consumer Price Index of Agricultural Labourers (CPI-AL), are shown in Fig. P.3. At the end of May, CPI-IW stood at 1.4 percentage points above WPI-all. On the other hand, CPI-AL, even after declining in the previous three months, is higher than WPI-all by about 3 percentage points. What could be the major factor for the surge in retail prices?

In the absence of a break-up of the recent CPI numbers, we may make only tentative suggestions. The inflation in food articles, which carries the highest weight in CPI-IW, has fallen by 0.75 percentage points in the past two months. The inflation in the fuel group, with a weight of 5.39 per cent in CPI-IW, is also low during the same period. There has been a marginal rise in the prices of clothing, pan, supari and tobacco, which carries a weight of 7.8 per cent on the CPI-IW. So, the most likely reason for the continuing upsurge in retail prices could be the rising cost of housing and miscellaneous services.

Fig. P.2: WPI based Inflation rate of use-based classification (% Change Y-o-Y)

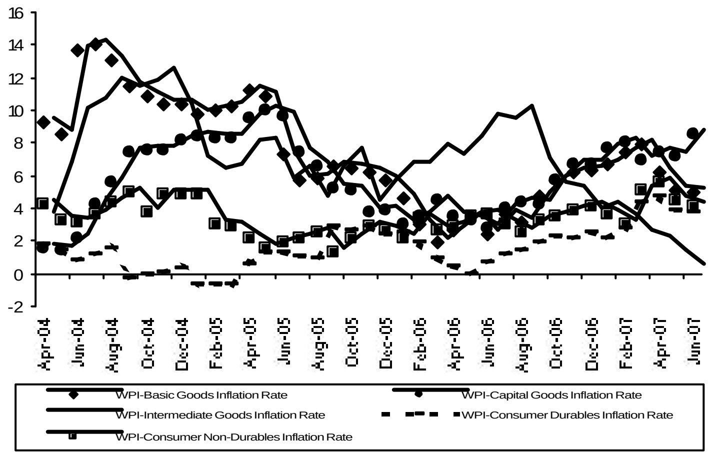
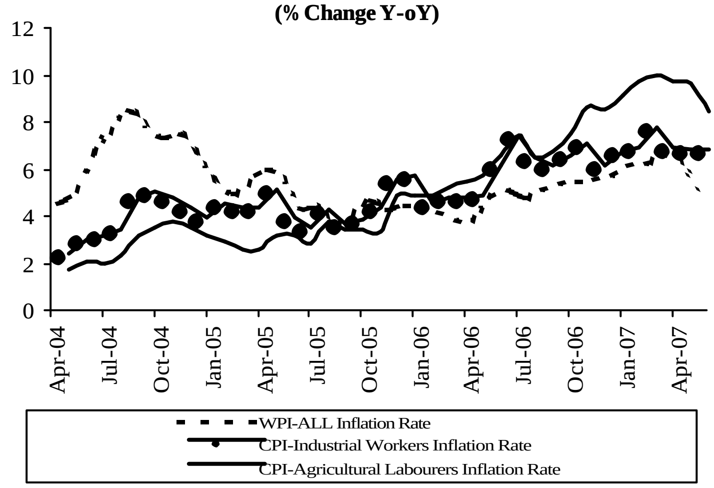


Fig. P.3: Wholesale & Retail Price Inflation (% Change Y-oY)



International price trends

Of late, oil prices have been on the rise. On July 4, 2007, oil was contracted at a high of $78.36 a barrel, the level peaked a year back almost to the day. In the past four months, crude oil prices have risen mainly on the back of geopolitical tensions and sharp draws on US gasoline stocks, which were due to extensive unplanned refinery outages and maintenance schedule delays. The current upsurge in oil prices is likely to continue as there is to let up in the disruption of the Nigerian production. No upgrades look likely in OPEC production until the cartel's September meeting. Its leaders ignored pleas from the International Energy Agency to increase current production from the present level of 30.19 million barrels per day, citing that supply continues to be 'robust'. However, given the growing demand of oil due to worldwide growth, particularly in India and China, the possibility of oil prices being pushed up by the demand-supply gap remains a possibility.

Of late, metal prices seem to have tightened. Take the case of copper, whose demand has risen six per cent year-on-year from January 2006. The rise is attributed to growth, primarily in Asia. It is now trading at $ 7,500 a tonne in the London Metal Exchange, a rise by more than $ 1,500 per tonne in the past three months. The zinc market, which was under a bullish grip in the past two months, has eased of late. Metal is trading at $3,600 a tonne in June, down from $ 3,800 in the preceding month.

On the other hand, lead is now more than 85 per cent higher than at the start of the year. The reason for this is the strong demand from China. Supply is also tight, particularly in the light of restricted exports from Australia. Most metal prices (exception being nickel and steel) have headed north due to Asian demand pressure. After being high for quite some time, steel prices have come down, though the market expectation is that the price would go up after the third quarter.

The prices of some of the primary articles have increased in recent days. International coffee prices have firmed up due to a surge in demand as well as supply cuts from Brazil, the world's leading producer. The recent worldwide boom in the bio-fuel sector has been a key factor for spiraling global grain prices. Wheat prices are also up, thanks to a tight supply situation. The ban on exports of Ukrainian wheat, lower production in the United States, Australia, and the Black Sea region have contributed to a 20 per cent increase in prices over the one month period.