Prices

The overall inflation rate stands at 4.1 per cent at the end of March 2006 (Fig P.1). The increase in the year-on-year inflation rate was mainly on account of rise in energy products, according to the data released by the Ministry of Commerce and Industry. The unusually high and volatile oil price, which has been the focal point of discussion for quite some time, seems to be continuing in the first quarter of the financial year 2006-07. Among the fuel, power, light and lubricants group index, apart from oil, the upsurge in prices of furnace oil, bitumen, and electricity seems to be the current trend.

Among the primary articles' group, prices of food items, condiments and spices showed increasing trend. On the other hand, prices of barley and gram showed decreasing trend. In the non-food articles' group, prices of soybeans, castor seed, groundnut seed and cottonseed went up.

Fig P.2 shows the use-based component of inflation. The graph shows that the inflation rate on account of basic and capital goods is decreasing at the end of March 2006. The tight supply situation, both on the domestic as well as international fronts, is the principal factor for this behaviour. However, the intermediate goods prices have been increasing in recent months. The inflation is now 7.5 per cent at the end of March 2006. Two factors are responsible for this upsurge. One, the tight supply situation in the international market, the other, increase in the landed cost of major non-ferrous metals including copper, nickel, zinc and lead metal by 5 per cent, despite the 2.5 per cent basic customs

Fig P.1: Monthly Inflation Rate (% Change, Y-o-Y)

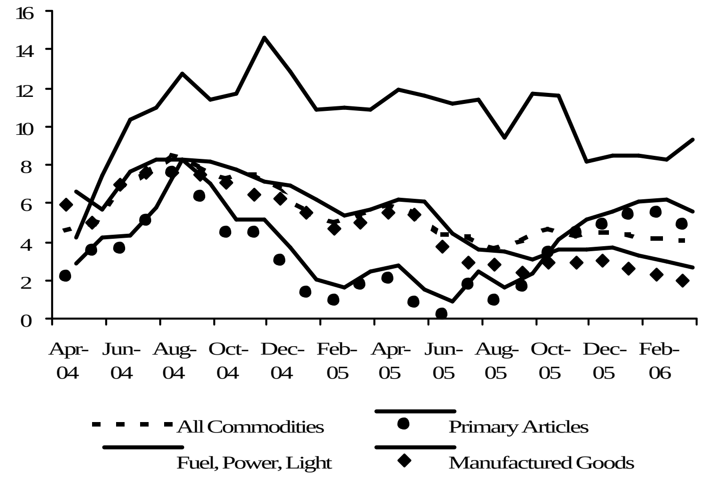
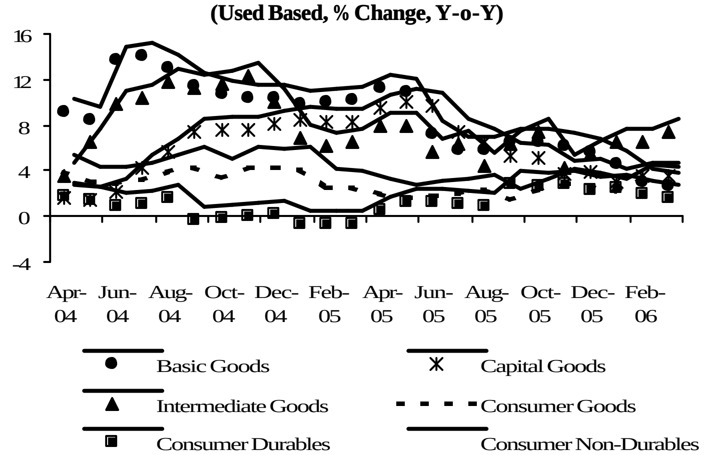


Fig P.2: Monthly Inflation Rate (Used Based, % Change, Y-o-Y)



duty cut proposed in the Union Budget of 2006-07. The Finance Minister, Mr P Chidambaram, has proposed a 2.5 per cent reduction in the basic customs duty to 7.5 per cent from 10 per cent. He has also proposed additional 4 per cent countervailing duty on all imports, apart from the normal rate of 16.32 per cent. According to industry sources, the net effect of 4 per cent in the cost of raw materials will now be 6 per cent, which is bound to go up.

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.

The core inflation has now declined below 5 per cent at the end of February 2006 (Fig P.3). It is now about one percentage points above the WPI-based inflation. This indicates that inflation has been high in the category of non-administered items. This may be a point of worry in the coming months.

Fig P.3: Monthly WPI based and Core Inflation
(% Change, Y-o-Y)

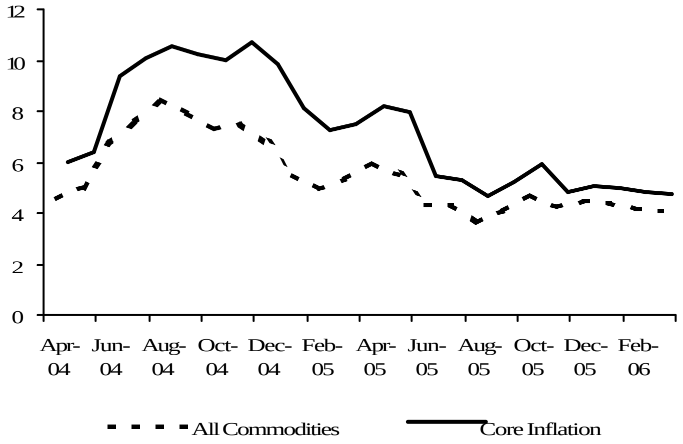
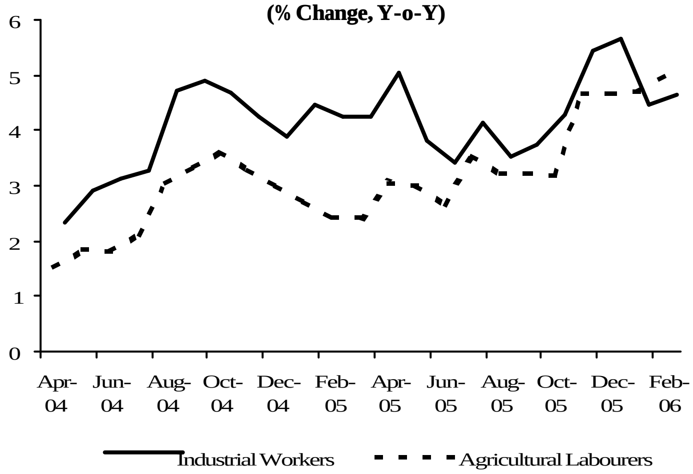


Fig P.4: Retail Inflation
(% Change, Y-o-Y)



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.4. The inflation rate on account of CPI-IW has been on the rise for the last three months. This seems to hover between 4.5-5 per cent. The increase was due to the rise in prices of rice, wheat, wheat atta, pulses, onion, vegetables and fruits. The CSO has come out with new series of CPI-IW and CPI-AL with 2001 as base year. The new series also seem to suggest hardening in retail prices.

International Trends

This year's early prediction that the commodities' rally of late 2005 would continue till the second quarter of 2006, seems to have come true. The population growth and rapid industrialisation by the developing and the CIS countries have ushered in a huge and growing middle class, which is competing for every additional barrel of crude oil sold in the international markets, and for every kilogram of wheat, sugar, rubber or gold.

The global cotton prices have firmed up. The Washington-based International Cotton Advisory Committee (ICAC) has projected Cotlook A-Index to average 65 cents a pound for 2005-06, based on supply-demand fundamentals. In its latest report, ICAC has said that following higher prices, world cotton planting could increase by 3 per cent next year (2006-07). Assuming normal weather conditions, world cotton output could expand marginally to 25.4 million tonnes. The consumption, on the other hand, would continue to rise, mostly in Asia — China, India, Pakistan, and Bangladesh.

It is expected that the prices of crude palm oil would go up due to weak Malaysian output, but in the global market strong US soybean output would keep the average level of vegetable oil prices in check. The pivotal role of India as a large importer with ability to switch from palm to soft oils would affect world markets via its preferential tariffs for soybean oil.

After quite some time, it has been good for the tea industry. This year, Kenyan output may drop by 80-85 million kg due to drought. On the other hand, there are not much carryover stocks globally to make up this shortage. As a result, tea prices have firmed up. India is one of the countries, which is expected to gain from this situation.

The mining industry has not been able to keep pace with the scorching demand witnessed in recent years. The Asian economies, mainly China, have contributed to this bull-run. There is now emerging consensus that some metal markets will have surplus this year, mainly copper, lead and tin, while others may stay in deficit (aluminium, nickel, and zinc). Recent quotations indicate that the world will have to live with higher prices for aluminium, nickel and zinc.

On the oil front, persistent downstream bottlenecks could strengthen pressure on prices in the coming months. The price of OPEC basket of eleven crudes stood at $62.13/ barrel on April 6, 2006, compared with $61.08 the previous day. According to OPEC, world crude oil prices would remain volatile, due to geopolitical factors and associated concerns regarding future supply disruptions, as well as downstream bottlenecks, exacerbated by more stringent US fuel quality standards. These factors are reflected in the increased activity observed in the futures market and the pattern of disconnect between prices and commercial stock levels, that has become apparent since 2004. Despite the present supply/demand outlook and in view of the prevailing geopolitical concerns, the OPEC, in its latest meeting has decided to maintain the current production ceiling of 28.0 million barrels per day for the time-being. Thus, we can expect that the upward rally in oil prices would continue.

World crude oil prices will remain volatile