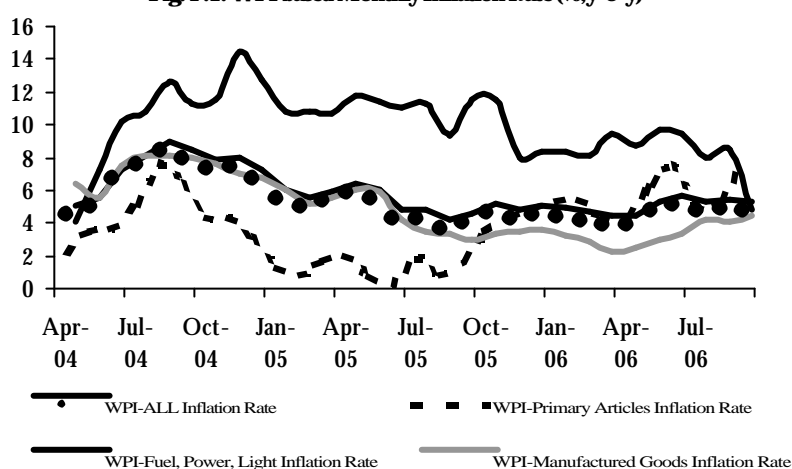


# Prices

The annual wholesale price index-based inflation stands at 4.8 per cent at the end of September 2006. The spurt in the year-on-year inflation rate was mainly due to an increase in food, mineral and manufactured product prices. On a disaggregated basis, the Primary Articles' group index was up by 2.5 percentage points over the August figure due to increase in prices of food, non-food and minerals. The good news is that the inflation on account of energy related WPI has now subsided and stands at 4.3 per cent at the end of September 2006. The Manufactured Products group index, though rising, is still below 4 per cent mark.

Among the Primary Articles' group, the chief contributors to inflation are urad, gram, moong, condiments and spices, wheat, masur, milk and fish-inland. The cardamom prices are on an upswing since August 2006. The ensuing festival season coupled with reports of a possible decline in the production this year by 30 - 35 per cent has been the driver for this up trend. As the inventories are down, and there is increased border trade with Pakistan, we can expect that the high prices would continue in the coming months. Clove production in the country continues to remain far below the requirement, making India a net importer of this commodity. A sharp fall in the world production of the commodity has pushed up its prices in the international market and we can expect that domestic clove price would remain high till end of year, when the

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



tightness in the global market would recede. Among the Non-Food Articles' group index, domestic spot rubber prices are bullish since September 2006 due to sustained recovery in international markets.

Among the manufactured products' group, the easing of Malaysian palm oil prices have started impacting local prices. Local refiners have dropped the price of refined palm oil by Rs 2-8 per 10 kg. Though the country has nearly completed its festive buying, the fall in international prices is expected to impact sentiment in the domestic market.

Recently the domestic match-making units, a largely labour intensive sector, are grappling with the problem of non-availability and increasing prices of matchwood splints, a key input for production of safety matches. The growers are diverting land to other crops due to more remunerative prices. According to the

industry circles, if this problem is not addressed quickly, the crisis could be sharp for the match industry in India.

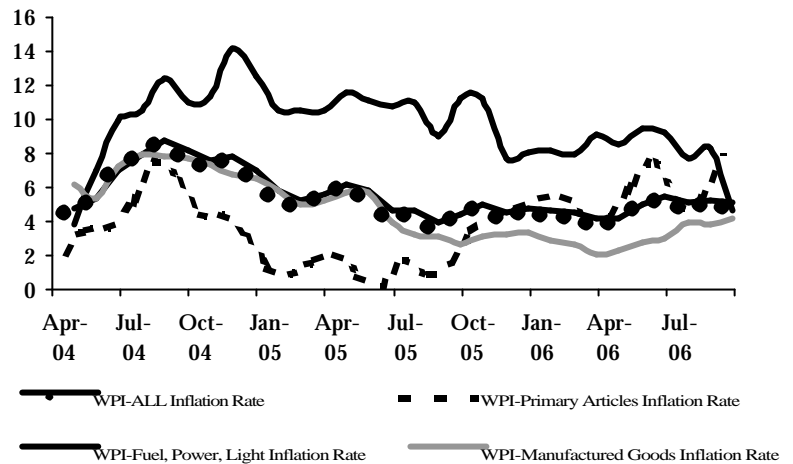
With the softening of international crude prices to less than US \$ 60 barrel, oil marketing companies have started making marginal profit of Rs 1.50 per litre in retail sale of petrol and almost breaking even on diesel sales. However, the consumer may have to wait before any price revision is considered, as the government wants to watch the trend, since the companies continue to bleed on sale of subsidised kerosene and cooking gas. Making the Government stand clear on the pricing issue, the Finance Minister, Mr P. Chidambaram indicated that softening of crude oil prices did not imply that domestic prices of oil products would correspondingly get lowered since the entire burden was not passed on to the consumers.

Fig P.2 shows the use-based component of inflation rates. As this figure shows, there has not been any significant change in the different components of use-based indices in the last couple of months, barring intermediate goods. After reaching 10 percent mark at the end of August 2006, the inflation on account of intermediates has now fallen to 6.7 per cent at the end of September 2006. However given the high metal prices and the tight supply situation, it is unlikely to fall any further. The marginal increase in the inflation on account of consumer durable goods is due to the festive season, and we can expect this to price index come down in the coming months.

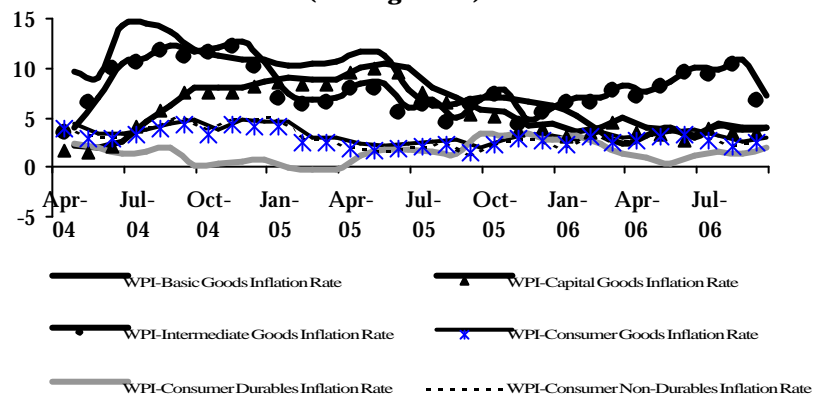
With the implementation of the new drug policy from October, 2006, the government has made a significant progress towards transparency in the pharmaceutical sector. From the consumer is point of view, the policy has following benefits:

- (a) elimination of unhealthy practices presently prevailing in the market by the capping of wholesale and retail

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



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



trade margins on generic drugs;

- (b) increasing consumer awareness about the medicines by introducing the dual-language labelling of medicines in English and Hindi;
- (c) transparency in pricing of medicines by printing on the pack details of MRP (maximum retail price), inclusive of all taxes, with no additional charges

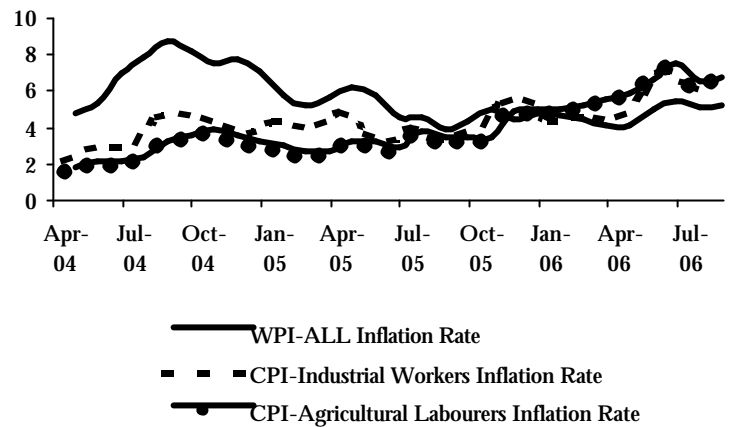
The government is extremely upbeat regarding the impact of the new policy on the prices of medicines. According to Mr Ram Vilas Paswan, Minister for Chem-

icals and Fertilisers, the prices of more than half of all drugs will come down by around 50 per cent with the introduction of fixed margins on generic drugs for wholesalers and retailers. However, there are certain caveats to it. The implication of new policy will be felt only after about a month till the old stock exhausts. However, since the usual practice among all retail medical practitioners is to prescribe branded drugs for various reasons, the move may not in effect cut general treatment cost for the common patient. While the industry has expressed their resentment in various forums regarding capping of margins, their arguments are not very convincing. Except for the fact that why the margins for only medicines? Following industry-Ministry discussions, it has now been agreed that wholesale margins would be capped at 15 per cent and retailer margin would be 35 per cent in the generic-generic and branded-generic space. While the expectation in the official circles is that medicine prices would crash by up to 90 per cent in some cases, industry people of the opinion that there would be marginal price revisions in the generic segment, but nothing as dramatic as projected by the Centre.

### 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. At the end of August 2006, inflation rate based on CPI-IW stands at 1 percentage points above WPI. On the other hand, CPI-AL inflation even after declining consecutively in the previous two months is higher than WPI by about 2 percentage points. The principal components of this increase have been the surge in the prices of wheat, atta, etc. Though the government have resorted to large-scale imports of wheat to arrest the price rise and

Fig. P.4: Wholesale & Retail Price Inflation (% Change Y-oY)



replenish buffer stocks, it seems that the impact of the same is yet to be substantially felt on retail prices.

### International Trends

The oil prices have declined a little below US \$ 60 per barrel in October after hovering over US \$ 70 per barrel for quite some time. The trends from future markets trading suggests that oil prices may go up in future months in view of tight spare capacity in global markets against the background of buoyant GDP growth, rising geopolitical tensions in the middle East and risk to production in some other large producers, notably Nigeria.

The international prices of non-fuel commodities are on a rise in recent months. These prices-particularly for metals-have risen sharply in recent years. According to latest World Economic Outlook of IMF, the price increases have largely been driven by strong demand, particularly from China, as well as supply bottlenecks. The speculative activity does not seem to have been a significant driver leading commodity price movements in recent times. The optimistic view is that the metals prices would come down over the medium term as

new production comes on stream to meet rising demand.

The food and beverages prices are also on the upswing in recent months, albeit on a lower scale. The only respite is in the prices of agricultural raw materials, the worst of which seems to be over.

### **Prognosis**

The WPI shows inflation at 4.8 per cent at the end of September 2006. The consumer price indices are much

higher with inflation at 5.9 per cent for the CPI-IW and 6.5 per cent for the CPI AL for the month of August. Though crude prices have tumbled and stabilised around US \$ 60 a barrel, the RBI suggests that the crude at US \$60 a barrel can fuel inflationary pressures. Based on a multiplicative model consisting of four components of time series-trend, seasonal, cyclical and random. We expect that the WPI inflation rate during the year will be around 5.5 per cent.