

Inflation

GDP Deflators

1.30 The implicit deflator for GDP MP and its demand components is the most comprehensive measure of inflation on an annual basis. Overall inflation, as measured by the aggregate deflator for GDP MP, is projected to decline from 5.6 per cent in 2006-07 to 4.1 per cent in 2007-08. Thus the inflation rate is projected to be identical to that in 2005-06. The counterpart of the consumer price index (CPI), the most commonly used inflation rate for monetary purposes, is the deflator for private final consumption expenditures (PFCE). Inflation, according to the PFCE deflator jumped from 3 per cent in 2005-06 to 5.1 per cent in 2006-07 and is projected to be 5.5 per cent in 2007-08. The projected decline in the overall inflation is therefore due to the deceleration in investment goods prices from 5.5 per cent growth in 2006-07 to 4.3 per cent growth in 2007-08. This should have a positive effect on investment.

Prices

1.31 Inflation as measured by the Wholesale Price Index (WPI) rose from 4.4 per cent in 2005-06 to 5.4 per cent in 2006-07 and is expected to return to around the 2005-06 rate for the full year 2007-08, based on the 10 months completed. The composition will, however, be different, with a much higher primary goods inflation, mainly because of primary non-food prices and a lower fuel price inflation because of low pass through of global oil prices. The latest flare up in prices started from a trough of around 4 per cent in February-March 2006 and (except for a short respite in July) continued to accelerate till it peaked in March 2007. Since then there is a declining trend till December 2007. Annual headline inflation was 4.1 per cent on February 2, 2008. On February 15, 2008, a hike in fuel prices was announced, which as per preliminary estimates is expected to add 19 basis points to the inflation rate.

1.32 The increase in the prices of primary articles and mineral oils in June 2006 substantially

contributed to this firming up. It started moderating from June 2007 onwards because of a number of reasons: These included a rollback in the increase in the prices of petrol and diesel at end November 2006 and mid-February 2007 to the pre-June 2006 levels, improved availability of primary articles, and fiscal and monetary measures. The year-on-year rate of inflation declined to less than 4 per cent in mid-August 2007 after a gap of 67 weeks. The overall inflation has remained below 4 per cent since then for 23 consecutive weeks, before inching up to 4.1 per cent in the last two weeks. Primary articles which had contributed to substantial increase in the inflation in 2006-07 and in the first five months of the current year were also the major contributors to the deceleration in the rate of inflation. The inflation of primary articles declined from 12.2 per cent on April 7, 2007, to 3.8 per cent on January 19, 2008, the lowest level since early November 2005. There was also deceleration in the prices of manufactured products from over 6 per cent in April 2007 to less than 4.5 per cent in the last 17 weeks (up to February 2, 2008).

1.33 The group "fuel and power" has, however, witnessed an increase in inflation in recent months. An increase in the prices of coal and domestic pass through of international price increase in crude oil to petroleum products, other than petrol and diesel, contributed to this firming up of inflation. At a disaggregated level, on January 19, 2008, the prices of 132 "manufactured products" with a weight of 29.7 per cent, 10 items of "fuel and power" with a weight of 10.1 per cent and 41 "primary articles" with a weight of 6.8 per cent were the same or lower than a year ago. The combined weight of these 183 commodities was 46.6 per cent. These commodities substantially contributed to moderation in the inflation in the current year.

1.34 The close monitoring of prices and appropriate policy interventions initiated in the last year and a half helped in maintaining price stability and reducing the impact of increase in global prices on domestic consumers.