

3 Prices

The decline in inflationary pressures that began in the last months of FY05 continued into the first five months of FY06, with CPI inflation (YoY) falling from a peak of 11.1 percent in April 2005 to 7.9 percent in November 2005 (see **Figure 3.1**). Also, while the core inflation,¹ defined as non-food non-energy inflation, did not decelerate, it too is holding steady around an average rate of 7.6 percent during the first five months of FY06.² Indeed the stagnancy in core inflation, which appears to incorporate a lagged effect of the monetary tightening initiated late in FY05, and a sharp fall in food inflation (aided by improved supply and supportive government policy) have contributed to the downtrend in CPI inflation.

Interestingly, while marginal CPI and SPI inflation have both decelerated during Jul-Nov FY06, marginal WPI inflation has exhibited a steep rising trend during the same period (see **Table 3.1**).

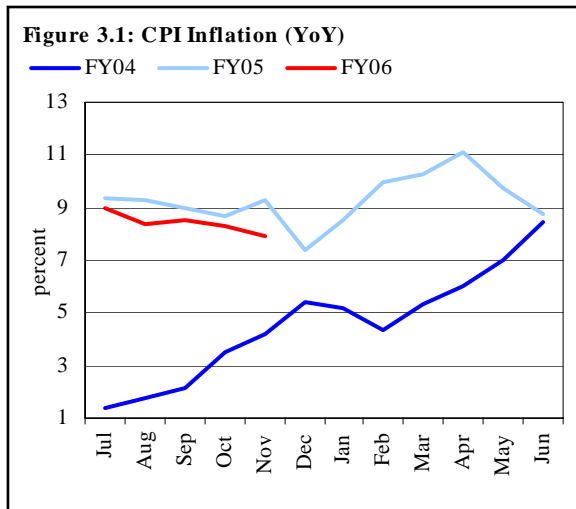


Table 3.1: Inflation Trends - (end November)

	percent			
	Marginal inflation (YoY) ¹		Annualized inflation ²	
	FY05	FY06	FY05	FY06
CPI	9.3	7.9	7.3	9.0
Food	13.6	5.8	10.8	9.6
Non-food	6.3	9.4	5.0	8.4
H.rent	11.2	10.8	7.8	11.7
WPI	5.9	10.9	8.9	8.2
Food	10.6	6.4	9.9	9.3
Non-food	2.6	14.3	8.2	7.3
SPI	11.1	5.4	11.0	8.9

1: Change in November 05 over November 04.

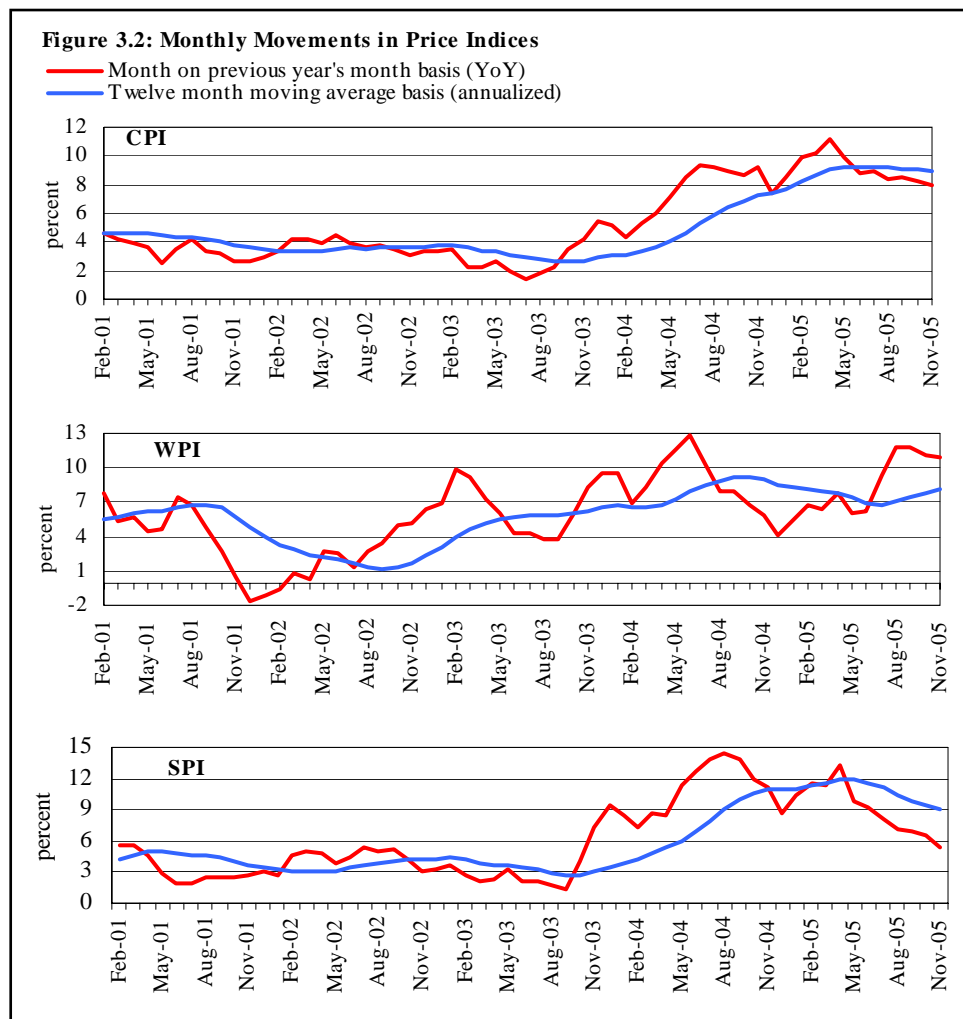
2: Change in 12-month moving averages of Nov. 05 over Nov. 04.

Source: Federal Bureau of Statistics

¹ Core inflation attempts to capture the permanent part of the headline inflation to determine the future course of inflationary pressures in the economy.

² See Inflation Monitor, October 2005 for trend in other measures of core inflation.

The divergence between WPI and CPI trends was primarily due to two factors: (1) food inflation, that has driven the rise in CPI inflation during FY05, witnessed a much stronger deceleration in CPI than in WPI during Jul-Nov FY06; and (2) the impact of the lower food inflation on WPI was offset by a sharp rise in the prices of POL (these have a much larger weight in WPI compared to the corresponding CPI weight).



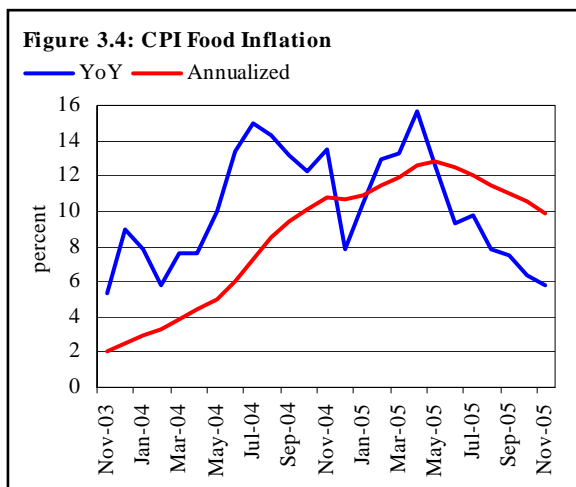
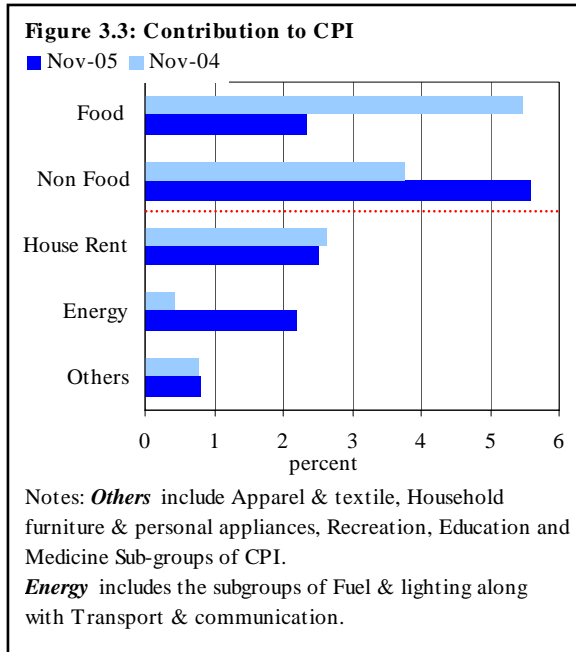
3.1 Consumer Price Index

After rising from 8.7 percent in October 2004, marginal (YoY) CPI inflation peaked in April 2005, before dropping to 7.9 percent by November 2005. While

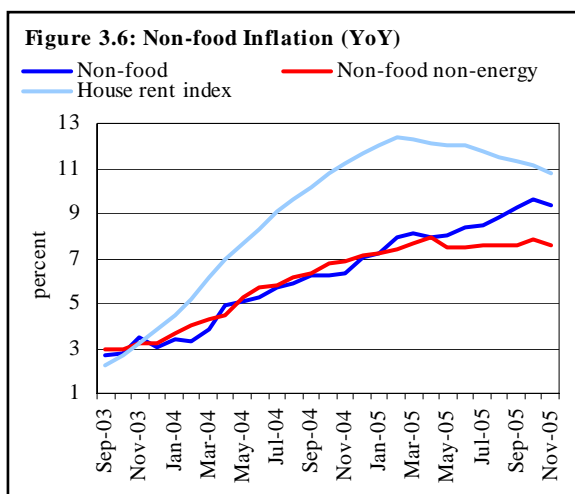
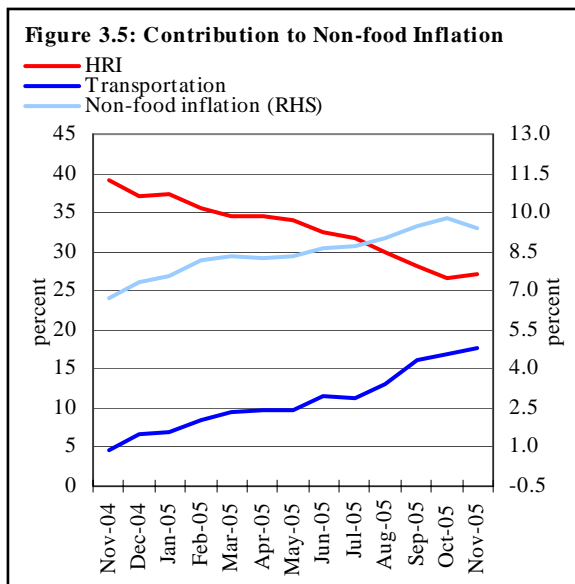
the earlier rise was dominated by rising food inflation, during the first five months of FY06 inflationary pressures were being driven principally from the CPI *non-food* group (see **Figure 3.3**), as food inflation decelerated sharply after mid-April 2005.

A major contribution to the fall in food inflation is from the downward correction in the prices of wheat and its products, alongwith the lower prices for some minor crops (see **Figure 3.4**). The fall in wheat prices reflected the improved supply on the back of the record FY05 wheat harvest compounded with other administrative measures taken by the government (including permission for duty free imports of wheat). The government also allowed imports of sugar and other essential food items, and provided sugar and wheat flour through utility stores at controlled prices.

Besides major crops, prices of the minor crops (fruits & vegetables) that were expected to show some temporary rise during the month of Ramadan, have also weakened during the Jul-Nov FY06 period, which could possibly reflecting effective price control measures by the government during Ramadan, alongwith the subdued demand in the aftermath of the October 2005 earthquake.



On the other hand, as seen throughout FY05, the CPI non-food group inflation also rose steadily during the first five months of FY06. The rise through most of FY05 was due to a persistent rise in HRI inflation. While HRI inflation has decelerated since March 2005, the impact of this has been more than offset by the sharp increases in transportation costs on the back of rising fuel prices (see **Figure 3.5** & **Figure 3.6**). Indeed, the latter has also supported increased inflationary pressures in other sub-groups³ as well during November 2005. Conscious of this broad impact, the government initially made efforts to contain the rise in domestic fuel prices until December 2004, but the consequent budgetary impact eventually forced the government to pass on a large part of the higher international prices. Even this limited increase resulted in a 22.7 percent YoY inflation in the sub-group of *transportation and communication* during November 2005.



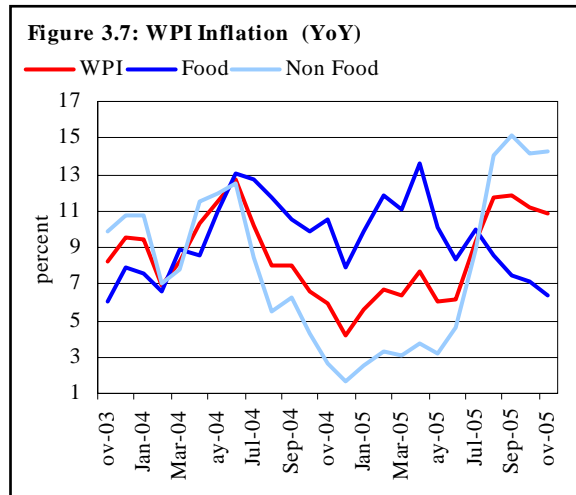
3.2 Wholesale Price Index

Despite a sharp deceleration in WPI *food* group inflation, the overall WPI YoY inflation recorded a steep rise but seems to have peaked off at 11.9 percent in

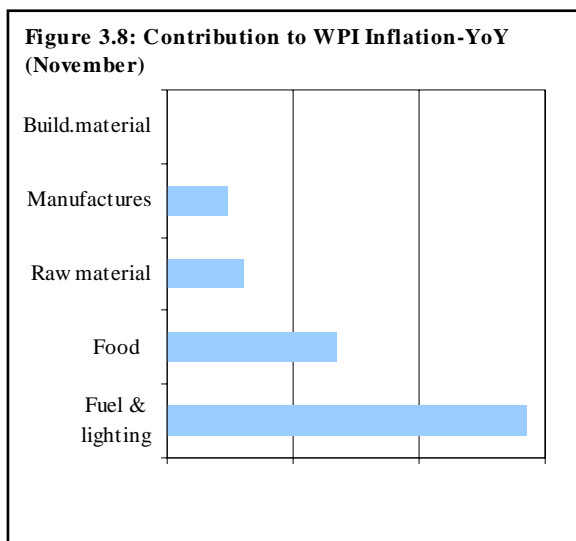
³ For example, apparel textiles & footwear, fuel & lighting and education.

September 2005, declining in the subsequent two months. As a result, WPI inflation stood at 10.9 percent YoY during November 2005 compared to the 5.9 percent YoY recorded in the corresponding month of 2004 (see **Figure 3.7**).

Although WPI food inflation (YoY) was recorded at 6.4 percent during November 2005, its trend has been declining since April 2005 due to a fall in the prices of key staples such as wheat, pulses, sugar, tomato, onion and potato, resulting from improved supply situation. Prices of vegetable ghee and cooking oil also witnessed deceleration due to the declining price of palm oil in the international market.



In fact, **Figure 3.8** reveals that it was mainly a rise in fuel prices that drove the WPI inflation higher during the initial months of FY06. In particular, furnace oil prices increased by a massive 66.3 percent during Jul-Nov FY06 over the same period last year. Similarly prices of kerosene oil, diesel, and gas also witnessed significant increases during the same period. This resulted in sharp increase in *fuel & lighting* sub-group of WPI, leading WPI non-food inflation YoY to 14.3 percent in November 2005, against the 2.6 percent YoY inflation recorded during November 2004.



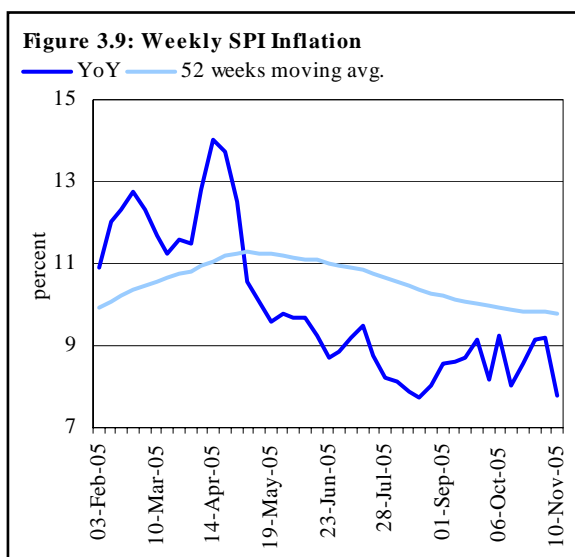
Another contribution to the rise in WPI *non-food* inflation was by the 15.1 percent YoY rise in the *raw material* index of WPI. This sharp rise in the *raw material*

index, on the one hand is due to a low-base effect⁴ and on the other, it is attributable to the rise in price of cotton (amid reports that the FY06 crop is likely to be well below target). The latter also had a downstream impact, as the consequent rise on prices of yarn and readymade garments has reversed the downtrend in the WPI *manufactures* sub-index, June 2005 onwards.

Finally, the *building material* sub-index witnessed a moderate inflation of 0.3 percent YoY in November 2005 compared to a sharp increase of 22.7 percent YoY in the corresponding month of last year. This could largely be attributed to the persistent deceleration in sub-indices of iron bars & sheets since March 2005, reflecting the impact of reduced import duty on iron & steel as well as the fall in prices in international market.

3.3 Sensitive Price Indicator

The sensitive price indicator (SPI) records the changes in prices of basic essential commodities (mostly kitchen items and some non-food items e.g. petrol and diesel). During November 2005, weekly SPI inflation YoY decelerated further after recording abrupt fluctuations during the first quarter of FY06 (see **Figure 3.9**). Monthly SPI (YoY) witnessed 5.4 percent increase during November as compared to the 11.1 percent YoY rise recorded during the same month last year. The deceleration in SPI inflation could greatly be attributed to the downward correction in prices of wheat and its products in recent months. In addition, the prices of some of the important minor crops, including tomato and onions, also declined during the last few months.



⁴ *Raw material* sub-index witnessed a fall of 24.8 percent during November 2004, thus suppress its base for November 2005.

3.4 Income Group-wise Inflation

As a result of the weakening inflationary pressures in the CPI *food* inflation, the higher income group has been recording relatively high inflation as compared to the other income groups during the initial four months of FY06. Year on year inflation for the higher income group (above Rs 12,000 per month) was witnessed at about 9 percent during November 2005, while the remaining income groups (below Rs 12,000 per month) recorded below 8 percent inflation during the same month.