

Prices and Food Management

Inflation

The annual point to point inflation rate in terms of WPI declined significantly from 6.5 per cent in 2002-03 to 4.6 per cent in 2003-04. During 2004-05, the inflation rate for the week ending June 12, 2004 stood at 5.89 per cent compared to 4.97 per cent in the corresponding period last year.

5.2 Performance of the Indian economy on the inflation front - with price stability as one of the primary objectives of the reform process initiated in the early 1990s-has been satisfactory, particularly after the mid-1990s (Table 5.1). Domestic deregulation and tariff rationalization have resulted in greater competition, greater cost-efficiency and moderation of upward pressure on prices. The double-digit annual average inflation rate of 10.6 per cent between 1991-92 and 1995-96 came down to 4.2 per cent between 2001-02 and 2003-04. The structural decline in inflation has also narrowed the differential with inflation in developed economies (Box 5.1).

Table 5.1 : Annual average inflation based on Wholesale Price Index (WPI) since 1991-92 (based on 52 week average inflation rates)

	Annual average inflation (%)			
	All Commodities	Primary	Fuel	Manufactured
1991-92 to 1995-96	10.6	11.3	11.3	10.1
1996-97 to 2000-01	5.1	5.4	13.0	3.1
2001-02 to 2003-04	4.2	3.8	6.9	3.4

5.3 The decline in inflation since the beginning of the 1990s has been most pronounced in the manufacturing sector, where the inflation rate declined from around 10 per cent in the first half of the 1990s to 3.4 per cent during 2001-02 to 2003-04. Though global slowdown, subdued demand and low capacity utilization provide some answers to this phenomenon, the bulk of the decline may be attributed to deregulation, removal of trade barriers, reduction of customs tariffs, resulting in increased competition and inducing manufacturers to cut down on costs and profit margins.

5.4 Lower annual average inflation rates for primary products point towards better supply side management. The decline in inflation in the fuel sector is noteworthy in view of the dismantling of the Administered Price Mechanism in the hydrocarbon sector in April 2002, allaying fears that such a dismantling would result in abnormal swings in petroleum product prices. The low inflation in fuel prices also reflected the preponderant public ownership of marketing companies in the petroleum sector.

5.5 In recent years, supply side factors have been more instrumental in determining the direction and magnitude of price rise, while the impact of demand side factors on inflation has been relatively weak. The occurrence of drought, decline in agricultural production, increase in global crude oil prices, supply shortages and increased international prices of imported commodities like crude oil, steel and edible oils are some of the factors that have played a crucial role in fueling inflation in the recent past. Imported inflation has therefore, a crucial role to play in setting the direction of domestic inflation.

Box 5.1 : Global Inflation

Global inflation based on the Consumer Price Index averaged 15 per cent in the 1980s and peaked to 30 per cent in the first half of the 1990s due to soaring inflation throughout the developing world. But in recent years, inflation rates in many of the developed as well as emerging economies have maintained a declining trend. Global inflation came down to 8.4 per cent for the period 1995-99 and further to 4.1 during 2000-2003. Not only has global inflation declined, it has also become more firmly anchored and is less sensitive to fluctuations in short-term inflation movements. Increased level of competitiveness and reduction in monopoly pricing power resulting from increased deregulation and globalisation could provide possible answers to this declining trend in inflation. (Table A).

In the most recent period, some economies are even experiencing an unprecedented low inflation with the need to take appropriate steps for boosting economic activity to avoid a further fall in inflation.

Even in India, increased deregulation in the domestic market and a reduction in tariffs have gradually resulted in a structural decline in inflation and the differential between the inflation rates in India vis-a-vis its trading partners has somewhat narrowed down. However, the domestic annual point to point inflation rate based on the Wholesale Price Index currently in the range of 4-5 per cent is still higher than that prevailing in many developed economies.

Table A: Global Inflation rates based on Consumer Prices (%)

	1970-79	1980-89	1990-99	2000-2003
USA	7.1	5.5	3.0	2.5
Japan	9.1	2.5	1.2	-1.8
Euro Area	-	-	-	2.3
Austria	6.1	3.8	2.1	1.9
France	8.9	7.3	1.9	1.9
Germany	4.9	2.9	2.4	1.7
Italy	12.5	11.4	4.2	2.6
Netherlands	7.1	2.8	2.3	3.5
UK	12.4	7.1	3.8	2.3
India	7.4	9.1	9.5	4.0

Source: IMF Paper on "Globalisation and Global Disinflation" by Keneth Rogoff (August 2003).