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Indian stocks face power shortage

By Kunal Kumar Kundu

BANGALORE - The Indian government recently came out with a new index for measuring inflation - dubbed the WPI Index - a change worth some study in the light of the Reserve Bank of India's (RBI's) decision on Thursday to raise repo and reverse repo interest rates.

The aim for revamping the index was to ensure that it would be the true representative of India's changing consumption pattern and thereby much more relevant than its predecessor. The coverage of the new series has been rationalized by incorporating important new items, dropping unimportant items and amalgamating items with those to which they are akin.

Based on the recommendations of a working group headed by Planning Commission member Abhijit Sen, the new series has a base year of 2004-05 as compared to the base year of 1993-94 that was applicable earlier.

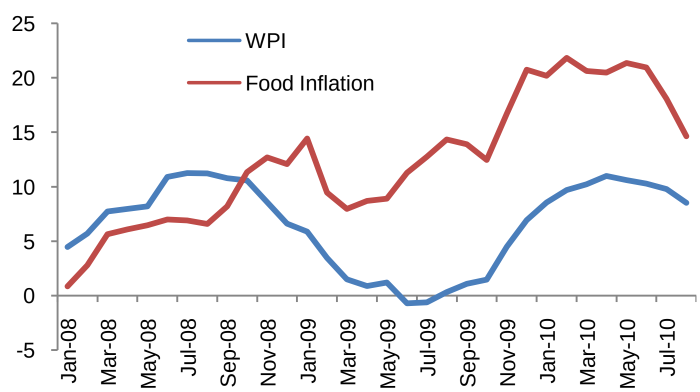
Available information indicates that some of the important items included in the new series are mineral water, refrigerators, computers, microwave ovens, communication equipment, TVs, VCDs, washing machines and auto parts. The new index even captures the Indian fetish for gold jewelry.

In totality, a basket of around 676 items (compared with 435 items in its previous avatar) has been put together. The associated weights are aimed at reflecting the present structure of the economy.

A closer look at the data reveals that there is a lower weightage given to food articles (down from 15.4 to 14.34), while commodities are given more weightage. This might lend some volatility to the index value.

While the new index is much more representative of the changing consumption patterns of Indians, it brought more cheers when the first set of data was released. It showed sharply lower inflation for August. The rate of inflation under the new series dipped substantially, to 8.51% from 9.78% in July.

In this case, it is important to realize that the decline in inflation is more because of the base effect than anything else. As the data reveal, the nominal index value remained unchanged at 140.3, the same as was recorded in July.



Source: Office of the Economic Advisor, Government of India

More worrying is the still elevated level of food price inflation. Under the new series, the food price inflation stands at 14.64% as of August 2010. Although it is down from 18.09% in July, it is much higher than the 10.29% recorded in July as per the old series. Clearly food price inflation continues to be a major bugbear for India. Add to that another bout of erratic monsoon and it is clear that food price inflation will be like a hot potato to our policymakers and politicians.

Recently, Indian Finance Minister Pranab Mukherjee stated that, “Inflationary pressure is still there because food prices have gone up, erratic monsoon and certain other things.” This does indicate that fact that inflation remains a serious concern for the government.

Not surprisingly RBI took note of the stickiness in prices and high food inflation. Although RBI has already lifted key policy rates by 100 basis points in four installments this year, there was a belief in the market that it might take a breather following a poor 5.7 % industrial growth in June sharply lower 13.2% growth in exports in July. However, a rebound in industrial growth to 13.8 % in July brought back the spectre of inflation to the fore. Another concern, of course, was to come out of the negative real interest rate regime. Hence they decided to hike the repo rate by 25 basis points while the reverse repo rate was hiked by 50 basis points during its credit policy announcement today.

Clearly, inflation continues to remain a dominant concern and the high food inflation is feeding onto the headline inflation number.

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His other articles are available at http://kunalsthoughts.weebly.com