Understanding Inflation

In June, Wholesale Price Index (WPI) inflation rose to its highest level in 54 months and Consumer price index (CPI)-based inflation rose, reaching 5%—a five-month high.

The impact

- The rise in WPI inflation shows the pressure on prices in the economy, and any changes in prices at the producer level get transmitted to consumers, mostly with a lag - indicating a further rise in retail inflation.
- Given the recent trends, the sharper-than-expected increase in the WPI inflation may prompt a repo rate hike at the next meeting by the RBI's Monetary Policy Committee.

CPI vs. WPI

- Wholesale inflation, measured by WPI, tracks year-on-year inflation at the producer level and CPI, on the other hand, captures changes in prices levels at the consumer level.
- Both baskets measure inflationary trends (the movement of price signals) within the broader economy, the two indices differ in which weightages are assigned to food, fuel and manufactured items.
- The weightage of food in CPI is far higher (46%) than in WPI (24%).
- WPI does not capture changes in the prices of services, which CPI does.
- In April 2014, the RBI had adopted the CPI as its key measure of inflation. Prior to this, the central bank had given more weightage to the WPI as the key measure of inflation for all policy purposes.

Warning Signs

- The revised inflation projection of 4.8%-4.9% issued by the RBI in its June review could be breached in the first half of FY'19 due to rising crude oil prices, according to projections by India Ratings and Research (Ind-Ra).
- Recently, the IMF trimmed India's growth projection for 2018-19 by 10 basis points and for 2019-20, by 30 basis points.

Inflation and Growth

- It has been concluded by economists that the threshold values of inflation in developing countries are higher than in developed countries.
- Many economists find the inflation-growth relationship as being "significantly negative" if inflation is above the threshold value (i.e. if inflation increases beyond the limit, growth would be on decreasing trend), and "insignificant or significantly positive" if it is below the threshold value (i.e. if the inflation is within the limit, growth might be unchanged or on increasing trend).
- In the Indian context, the empirical analysis is based on WPI inflation data, using the data for the period 1996-97 to 2010-11, concluded that threshold for India falls in the 4% to 5.5% inflation range, above which inflation retards growth rate of GDP, and below the threshold level, there is a "statistically significant positive relationship" between inflation rate and growth.