

November 21, 2011

# Economic Weekly



## Indian Economy

**\*CPI And WPI Inflation:** RBI primarily uses Wholesale Price Index for monetary policy decisions and not Consumer Price Index because WPI is available at a higher frequency and with lesser lag compared with CPI. While WPI and CPI both reflect price information on aggregate levels, there has been a divergence in their trends in recent years, especially since 2009. Differences in composition have been major cause for the divergence.

**\*WPI Primary Articles Inflation Eases:** WPI inflation for primary articles in the week ended November 5 stood at 10.39% on a year-on-year basis compared with 11.43% in the previous week. Primary articles inflation decelerated because of fall in prices of food articles during the week. Food inflation eased to 10.63%, compared with 11.81% in the previous week.

**\*Money Supply And Credit Growth:** Money supply and credit growth both saw different trends in the fortnight ended November 5. M3, or broad money, supply growth in the fortnight ended October 24 had fallen below RBI's FY12 target of 15.5% on a year-on-year basis, raising fears of sharp decline in economic activity. However, money supply growth recovered in the fortnight ended November 5, thereby allaying these fears. Credit growth slowed to 18.41% in the fortnight ended November from 19.28% in the previous fortnight.

**\*Forex Reserves Fall \$0.3 billion:** Foreign exchange reserves declined \$0.3 billion to \$314.4 billion in the week ended November 12, largely due to a fall in foreign currency assets.

## Global Economy

**\*Debt Crisis Claims 5th Govt In Europe:** Spain became the fifth euro-zone nation to have a new government because of the sovereign debt crisis. Earlier this year, Greece and Italy got new governments and before that Ireland and Portugal saw citizens voting out the ruling parties in elections. Spanish leader Mariano Rajoy won the majority in parliamentary elections, marking the ouster of the ruling socialists in the country.

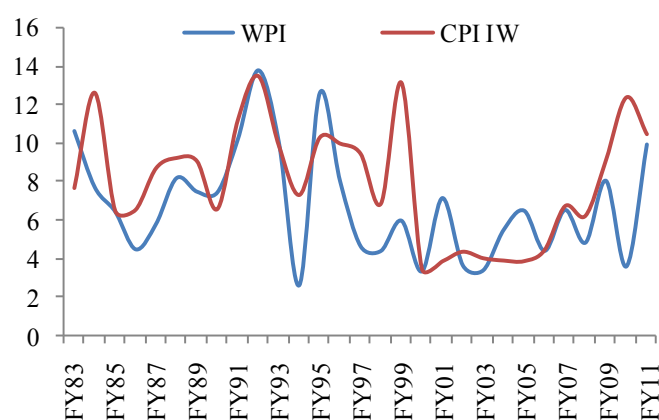
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## WPI And CPI Comparison

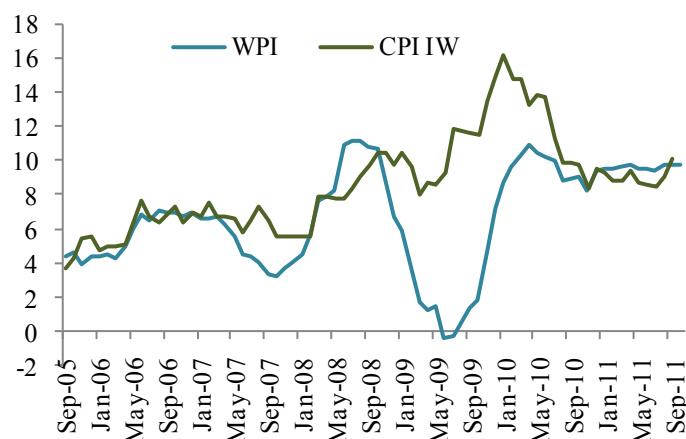
Among the several Indian inflation indices, Wholesale Price Index is primarily used by the Reserve Bank of India to take monetary policy decisions because WPI updates are available more frequently and with a lesser lag compared with the Consumer Price Index. While WPI and CPI both reflect price information on aggregate levels, there has been a divergence in their trends in recent years, especially since 2009. Differences in composition is the reason behind the divergence.

- ◆ **Measures of Inflation:** India has seven indices for measuring inflation — namely, WPI and six CPI indices. The different CPI indices are: CPI industrial workers (CPI-IW), CPI agricultural labourers (CPI-AL), CPI rural labourers (CPI-RL), CPI urban, CPI rural and, finally, a CPI combined (urban and rural). CPI urban non-manual employee (CPI-UNME) has been discontinued. In India, WPI is considered to be the headline inflation as it is available with a month's lag compared with CPI that is available with two months' lag. A new WPI series was introduced in 2010 with 2004-05 as base year to make the index more representative. A new CPI index for both rural, urban and combined indices, with a 2010 as base year, was introduced in 2011.
- ◆ **Differences Between WPI And CPI:** WPI is not a true representative of cost of living as it doesn't capture retail prices and also excludes services. It provides an indication of prices at a wholesale level (as the name suggests) but does not reflect the final prices that consumers pay. Although CPI indices are more representative of actual inflation levels faced by individuals, they suffer from several shortcomings. First, CPI baskets for rural and urban customers are different. Second, CPI inflation on a pan-India basis is available with greater lag compared with WPI, rendering CPI data almost useless for policy decisions. In coming years, the new CPI series, with 2010 base year, is likely to become important, but availability of WPI data on primary articles and fuel items on weekly basis provides a better idea of evolving inflation trends.
- ◆ **Divergence Between WPI And CPI:** Both WPI and CPI give indications of relative demand and supply in the economy. In recent years, there has been a divergence in WPI and CPI inflation levels. This has been primarily due to difference in compositions of the index. WPI has higher weighting for oil, minerals and metals while CPI has more weighting for food. CPI has food share of 46% in CPI-IW and 69% in CPI-AL. In WPI, food share is around 26%. In 2009, WPI inflation turned negative due to lower fuel and commodity prices compared with CPI inflation that remained elevated as food articles dominates the index. Also, CPI captures services costs including medical care, education and transport. Housing rent is a major category that is a huge cost for urban consumers but it is missing entirely in WPI.
- ◆ **CPI Trends:** CPI for industrial workers is used more widely as it has a wider coverage compared with CPI for farm labourers. CPI-IW gives insight into living costs of the organised sector. In the last decade, average CPI-IW inflation has been higher at 5.85% on a year-on-year basis compared with 5.33% of average WPI inflation. In last five years, the difference between the two has widened. CPI inflation stood around 9% in this period compared with 6.6% WPI inflation. After the 2008 crisis, while WPI inflation eased to 3.5% in FY10, CPI inflation rose to 12.3%. This was largely due to higher share of food items in the CPI basket. WPI inflation eased after the crisis as crude oil and commodity prices came off peaks. In FY11 and FY12 so far, higher WPI inflation because of rising food and fuel prices also elevated CPI indices to reflect higher costs of food and essential consumer items. In September, CPI-IW inflation rose to 10.6% due to pressure from food items, compared with 8.99% in August.

**Annual WPI and CPI-IW Inflation, % YoY**



**Monthly WPI and CPI IW Inflation, % YoY**



### New Consumer Price Indices

In India, different CPIs capture different segments of the economy, but not the entire population. To address this issue, new consumer price indices have been introduced for rural, urban and combined (rural+urban) price levels. However, since data only for this year have been released so far, analysis of data on a year-on-year basis is not possible. Once more data are available, the new indices would give more information on cost of living for consumers on a pan-India basis.

Composition in the new combined rural+urban index is as follows: Food, beverages and tobacco account for 49.7%, Housing (rent) for 9%, fuel for 9.5%, clothes and bedding for 4.7% and services roughly accounts for 26% of the index. In CPI-urban, rent accounts for 22% of the index and reflects sizeable cost of housing borne by urban customers.

### Percentage Composition

WPI		CPI	CPI Combined	Rural	Urban
Components	Weight %	Components	Weight %	Weight %	Weight %
Primary Articles	20.1	Food, Beverage and Tobacco	49.7	59.3	37.2
Food	14.3	Fuel	9.5	10.4	8.4
Non Food	4.3	Clothing, footwear etc	4.7	5.3	3.9
Fuel	14.9	Housing	9.8	0.0	22.5
Manufactured Products	65.0	Services	26.3	24.9	28.0

*Source: Ministry of Statistics and Programme Implementation*

### Historical Trends in Inflation:

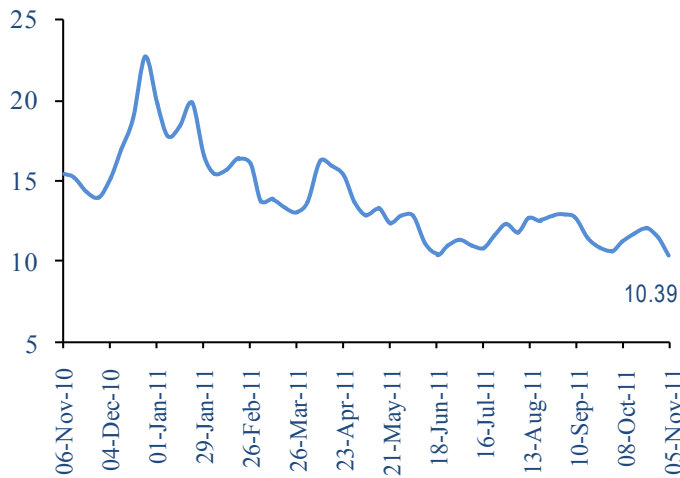
Decades (% YoY)	WPI	CPI-IW	GDP Deflator	PFCE Deflator
1971-72 to 1980-81	10.3	8.3	8.8	8.4
1981-82 to 1990-91	7.1	9	8.7	8.3
1991-92 to 2000-01	7.8	8.7	8.1	8.5
2001-02 to 2008-09	5.2	5.3	4.6	4.4
Long-term Trend	7.7	8	7.7	7.6
1971-72 to 2008-09				

*Source: RBI*

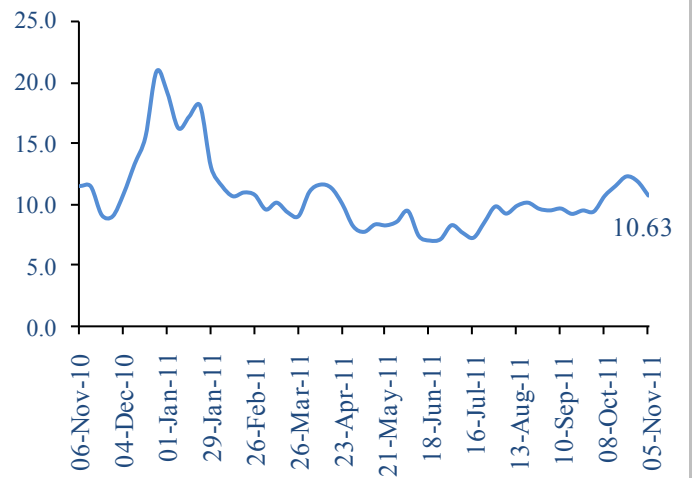
## WPI Primary Articles Inflation

Wholesale Price Index inflation for primary articles for the week ended November 5 stood at 10.39% on an year-on-year basis compared with 11.43% in the previous week. Primary articles inflation eased because of fall in prices of food articles during the week. Food inflation eased to 10.63% from a year ago, compared with 11.81% in the previous week.

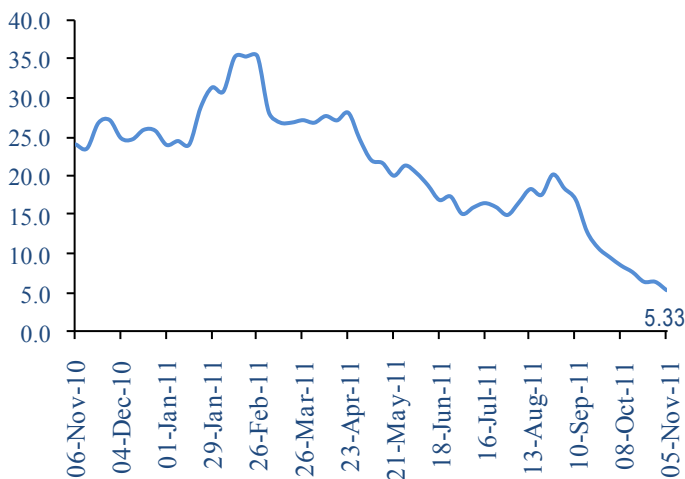
**Primary Articles Inflation, % YoY**



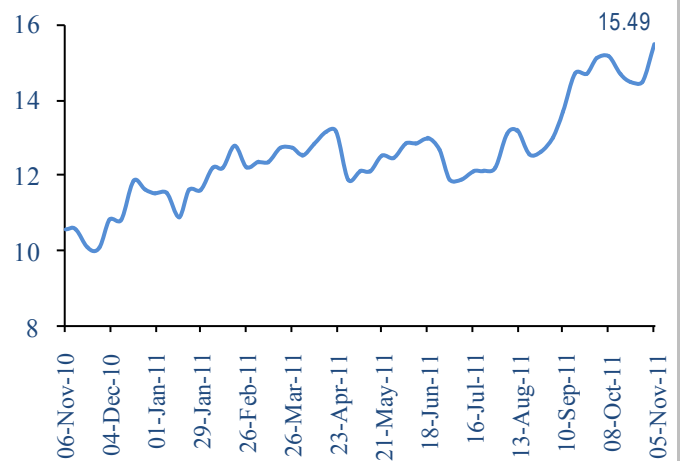
**Food Inflation, % YoY**



**Non Food Inflation, % YoY**



**Fuel Inflation, % YoY**



## Weekly Trends In Primary Articles Inflation

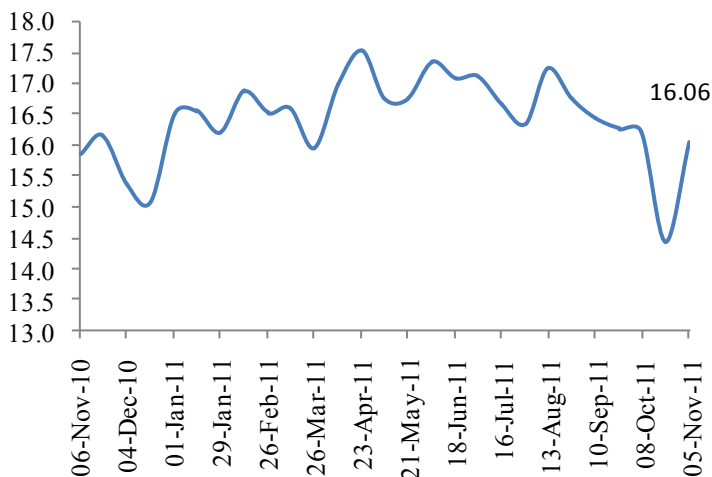
- ◆ Food inflation in the week ended November 5 stood at 10.63% on a year-on-year basis compared with 11.81% in the previous week. Food inflation slowed during the week due to food prices easing 0.93% from the week before. Food prices fell due to lower prices of fish-marine, poultry chicken and fruits and vegetables.
- ◆ Non-food articles' inflation stood at 5.33% on a year-on-year basis compared with 6.41% in the previous week, due to fall in non-food article prices. Non-food articles index fell 0.90% from previous week due to fall in prices of oilseeds.
- ◆ Minerals inflation remained unchanged at 18.52% from previous week, as there was no change in the index.
- ◆ Fuel inflation stood higher at 15.49% on a year-on-year basis in the week ended November 5, compared with 14.50% in the previous week, as there was a rise in fuel prices during the week. Fuel index grew sharply 1% during the week due to higher prices of aviation turbine fuel, naphtha, furnace fuel and petrol during the week.

<b>WPI Sub groups</b>	<b>Index</b>	<b>% YoY</b>	<b>% YoY</b>	<b>% WoW</b>	<b>% WoW</b>
	Nov 5, 2011	Nov 5, 2011	Oct 29, 2011	Nov 5, 2011	Oct 29, 2011
<b>Primary articles</b>	<b>204.7</b>	<b>10.39</b>	11.43	-0.83	0.15
<b>Food Articles</b>	<b>199.8</b>	<b>10.63</b>	11.81	-0.94	-0.25
<b>Non Food Articles</b>	<b>175.9</b>	<b>5.33</b>	6.41	-0.90	0.17
<b>Minerals</b>	<b>309.2</b>	<b>18.02</b>	18.02	0.00	0.00
<b>Fuel</b>	<b>171.5</b>	<b>15.49</b>	14.5	1.00	0.00

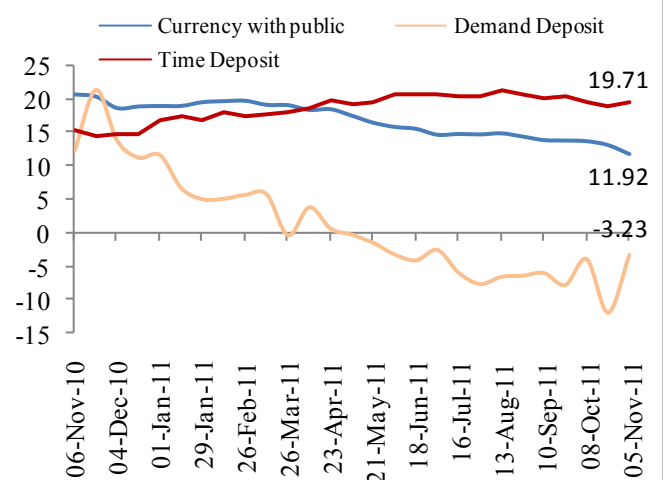
## Money Supply Rises, Credit Growth Eases

- ◆ Money supply and credit growth saw divergent trends in the fortnight ended November 5. M3, or broad money, supply growth in the fortnight ended October 24 had fallen below RBI's FY12 target of 15.5% on a year-on-year basis, raising fears of a sharp decline in economic activity. However, money supply growth recovered in the fortnight ended November 5, allaying fears.
- ◆ M3 growth in fortnight ended November 5 stood at 16.06% on a year-on-year basis, compared with 14.44% in the previous fortnight. Money supply growth improved as demand and time deposits growth increased during the fortnight.
- ◆ Growth of currency with public declined to 11.92% on a year-on-year basis from 13.26% in previous fortnight. Demand deposits shrank 3.85%, much less compared with 11.86% in the previous fortnight. Time deposit growth rose to 19.71% on a year-on-year basis from 18.94%.
- ◆ Credit growth in fortnight ended November 5 stood at 18.41% on a year-on-year basis, compared with 19.28% in the previous fortnight. Credit growth slowed due to decline in non-food credit growth during the fortnight to 18.02% on a year-on-year basis from 18.92% in the previous fortnight and food credit to 44.12% from 45.97% before.

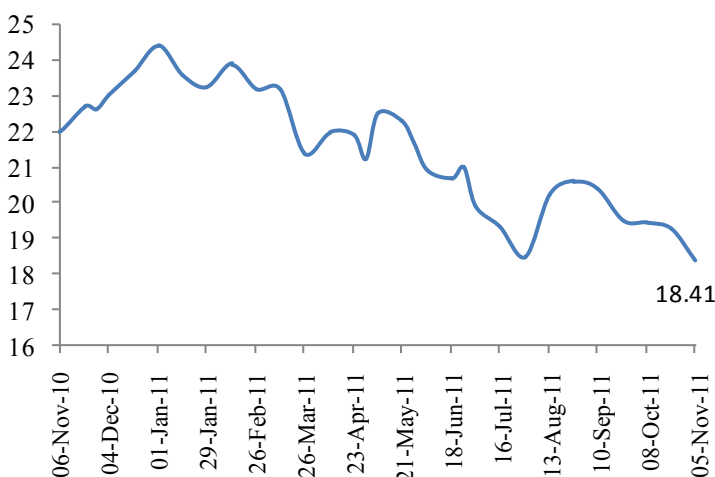
### Money Supply, % YoY



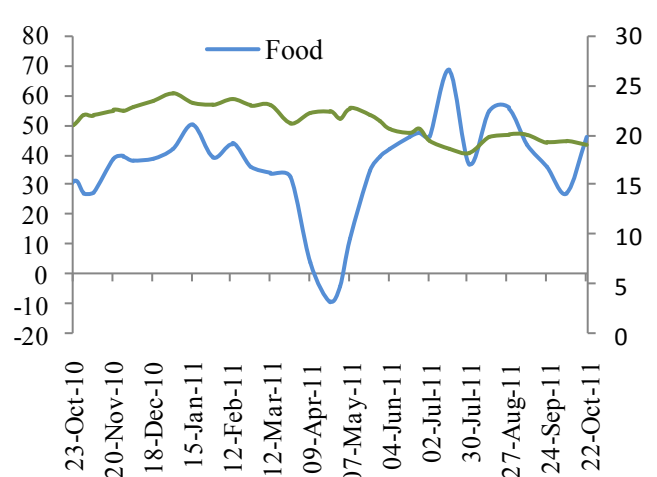
### Currency And Time Deposits Growth, % YoY



### Credit Growth, % YoY



### Food & Non Food Credit Growth, % YoY



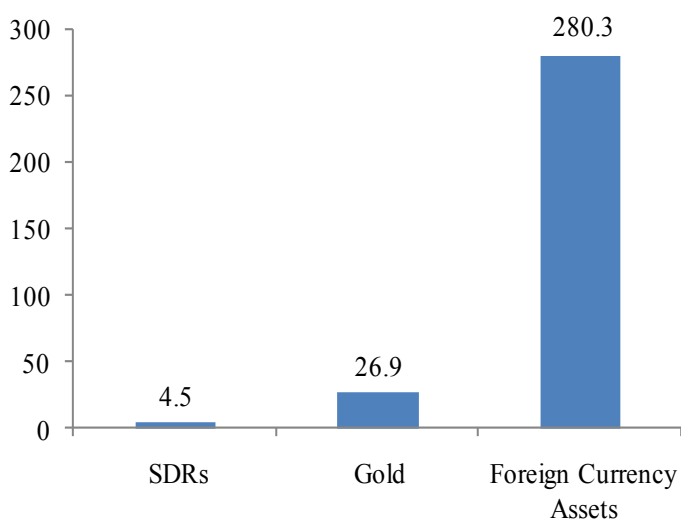
## Forex Reserves Fall \$0.3 Billion

Foreign exchange reserves declined by \$0.3 billion to \$314.3 billion in the week ended November 12, largely due to a fall in foreign currency assets. Total foreign exchange reserves comprise foreign currency assets, special drawing rights and central bank's position in gold, all of which are measured in US dollars.

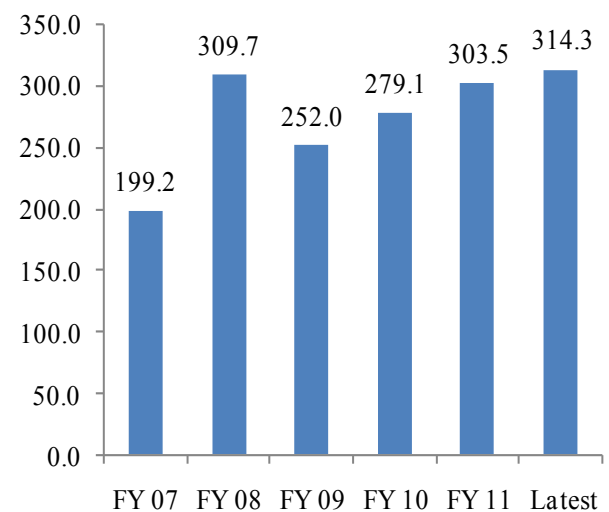
- ◆ In the week ended November 12, foreign currency assets fell by \$0.3 billion to \$280.3 billion. Revaluation changes may have resulted in the fall.
- ◆ Position in gold, reserve position with International Monetary Fund, special drawing rights (SDRs) remained largely unchanged during the week.

US\$ bn	Forex Reserves	SDRs	Reserve Position in IMF	Gold	Foreign Currency Assets
22-Oct-11	318.4	4.5	2.6	28.7	282.5
29-Oct-11	320.4	4.6	2.6	28.7	284.4
5-Nov-11	314.7	4.6	2.6	26.9	280.6
12-Nov-11	314.3	4.5	2.6	26.9	280.3

**Forex Reserves Components (in \$ billion)**



**Forex Reserves Annual Trends (in \$ billion)**



## Eurozone Debt Crisis Claims Its Fifth Government

Spain became the fifth euro-zone nation to have a new government because of the sovereign debt crisis. Earlier this year, Greece and Italy got new governments and before that Ireland and Portugal saw citizens voting out ruling parties in elections. Spanish leader Mariano Rajouy won the majority in parliamentary elections, marking the ouster of ruling socialists in the country.

- ◆ **Crisis Claims One More Euro Government:** Earlier this month, Greece Prime Minister George Papandreou and Italian Prime Minister Mario Monti formed new governments after the debt crisis led to the fall of previous governments in their respective countries. As the crisis continues in Europe, citizens in Spain voted out the ruling party. The unfolding of events in Europe points to general dissatisfaction of euro citizens with handling of the crisis by their respective government.
  - ◆ **German Will:** German influence has been a key factor that held back the European Central Bank from engaging in bailouts, which has led to a change of guard in five nations. However, the new governments are expected to instill confidence as these nations work their way through reforms. The new Spanish government has absolute majority in parliament and is expected to enact speedy reforms.
  - ◆ **Italy On Reform Path:** Mario Monti, the new PM of Italy, has formed his government and is expected to complete reforms that are required to meet bailout conditions. Monti is expected to lead Italy until the new elections are announced. The new technocratic government has many economists and officials, who are needed to enforce austerity measures.
  - ◆ **ECB Needs To Act:** ECB, the central bank for the euro-zone, needs to act to calm markets. However, its bond-buying programme has been so far restricted due to German opposition. Since it is the lender of last resort, it should step up bond-buying to help yields decline. This would also help markets to find more assurance and order.
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