

ASSOCHAM

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STUDY

“Inflation concerns for the Indian economy”

June 2009

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Commodity bubble would spark inflation to average near 5 per cent in FY 2009-10: Assocham

Defying the current downward trend in headline inflation, the continuing spike in commodity prices globally facilitated by poor monsoon and the fruits of fiscal and monetary measures is likely to trigger inflation to average near 5 per cent in FY 2009-10, according to an Assocham Eco Pulse Study.

The AEP Study titled **“Inflation concerns for the Indian economy”** stated, the surge in international commodity markets led by energy (crude oil, natural gas and coal), metals (copper, aluminium and iron ore) and food (cereal and meat) is likely to push the domestic prices up once the heavy fiscal and monetary measures taken as the crisis response starts to firm up the economic activity.

The Study also cautioned that if the monsoon fails to revive, the consequences could be far-reaching. With no new crop arrivals expected until September and a prolonged delay of monsoon arrival, the supply of agricultural commodities would taper off leading to food prices shooting up. Despite the WPI based inflation turning negative, the overall food article inflation is still holding strong at more than 8 per cent.

“If it was the imported inflation phenomenon which took the WPI based inflation to average 8.5 per cent in last fiscal, a rebound in commodity prices aggravated by poor monsoon would lead WPI inflation to average near 5 per cent this fiscal” said Shri D. S. Rawat, Secretary General, Assocham.

The spiraling crude oil prices have more than doubled from a low of USD 33.87 per barrel in mid-December to nearly USD 70 per barrel. Considering that India imports more than 75 per cent of its crude oil requirement, the sharp

pick up in the crude oil prices would fuel inflation at a rapid pace if the retail fuel prices are aligned to the international prices following the oil price deregulation.

A prominent rebound in global commodity markets may have severe implications on the Indian economy. Among the major commodities, crude oil prices have jumped nearly 30 per cent over the past month to seven-month high. In the metals category, tin prices are up 40 per cent since March whereas agriculture commodities like corn, soybean and wheat futures have touched their eight-month highs.

Heavy fiscal stimulus totaling close to 4 per cent of GDP and monetary measures to ease money supply would commensurate into a fresh lease of demand that would give a push to the general price level in the economy, added the AEP Study.

A trend of upward revision in the WPI since the beginning of the fiscal is also likely to give strength to the headline inflation. The WPI based annual inflation for the week ended April 4 was revised to 0.83 percent from 0.18 percent. Similarly, it was revised to 0.96 percent from 0.26 per cent for the week ended April 11, and to 1.62 percent from 0.57 per cent for the week ended April 18, 2009.

The AEP Study also lamented that the negative WPI inflation phenomenon is likely to continue for 10 – 12 weeks due to high base of the index as crude oil prices peaked at USD 147 per barrel in July last year. The inflation will pick up as the base effect subsides and commodity prices increase substantially during the second half of the fiscal.

High degree of comprehension about the global economic recovery is driving up the commodity markets; however some segments of the market are ignoring the fundamentals. The crude prices are moving up despite the International Energy Agency (IEA) forecasts that in 2009 the fuel demand will decline by 2.47 million barrels per day, whereas food prices are increasing despite strong supplies in some agricultural markets, found the Assocham Study.

As per the IMF primary commodity price index, the commodity prices have taken a sharp rebound. After an enormous decline witnessed during the second half of 2008, the commodity prices have firmed up continuously in 2009. The index for all primary commodities has moved up from a figure of 98.0 in December 2008 to 114.3 in May 2009.

The spurt in commodity prices is seen to be more significant in energy, metals and food category. In the energy segment, consisting of petroleum, natural gas and coal, the index scaled higher due to the major turnaround in crude oil prices whereas in the non fuel category, food prices jumped considerably. Among the industrial inputs, the prices in metal category comprising mainly of aluminium, copper, iron ore, tin, etc has risen substantially.

ANNEXURE:
IMF Indices of Primary Commodity Prices, 2008-2009

 (2005=100, in terms of US dollars) ^{1/}

Month	All Primary Commodities ^{2/}	Non-Fuel				Industrial Inputs		Energy ^{4/}		Petroleum ^{5/}
			Edibles	Food	Beverages		Agricultural Raw Materials ^{3/}	Metals		
(weights)	(100.00)	(36.90)	(18.50)	(16.70)	(1.80)	(18.40)	(7.70)	(10.70)	(63.10)	(53.60)
2008										
Jul-08	219.0	168.8	177.2	178.3	167.2	160.3	122.0	188.0	248.4	248.4
Aug-08	195.2	158.1	164.9	164.8	165.6	151.2	118.2	175.0	217.0	214.7
Sep-08	175.7	149.3	154.5	154.0	159.0	144.1	116.4	164.1	191.2	186.1
Oct-08	139.2	126.4	130.4	129.8	135.2	122.4	109.9	131.5	146.6	136.2
Nov-08	114.9	116.8	123.0	122.4	128.3	110.6	102.9	116.1	113.7	101.3
Dec-08	98.0	108.9	120.9	119.6	132.5	96.8	87.6	103.4	91.7	77.8
2009										
Jan-09	101.8	113.9	129.4	127.9	143.0	98.3	89.8	104.5	94.8	82.3
Feb-09	97.3	111.1	126.5	124.6	143.6	95.5	87.6	101.3	89.2	78.3
Mar-09	100.1	110.9	127.0	125.8	137.6	94.7	81.7	104.1	93.7	88.0
Apr-09	104.2	117.2	132.8	131.9	141.2	101.4	85.7	112.8	96.5	94.2
May-09	114.3	123.0	140.1	139.5	145.9	105.7	89.1	117.7	109.2	108.9

1/ Weights based on 2002-2004 average world export earnings.

2/ Non-Fuel Primary Commodities and Energy Index.

3/ Includes forestry products.

4/ Includes petroleum, natural gas and coal.

5/ Average Petroleum Spot Price (APSP). Average of U.K. Brent, Dubai, and West Texas Intermediate, equally weighted.