ASSOCHAM Eco Pulse Study

Impact of Inflation on the power projects

July 2008

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Rising prices of key input materials may hurt 11th Plan targets for Power sector

To achieve the power generation targets laid in the 11th Plan, Government may have to revise the investment in power projects in view of 25 per cent rise in prices of key input materials including cement, steel, aluminium, copper and zinc over last two years, an Assocham Eco Pulse (AEP) Study has stated.

With WPI based inflation rate hovering close to 12 per cent and expected to be in double digits for quite some time, the proposed power projects in India could take a hit from increased cost of inputs and a recent down-turn in the core infrastructure industrial productivity, according to an AEP study on "Impact of Inflation on the power projects".

"Planning Commission has estimated the fund requirement of Rs. 4,10,897 crore for the likely capacity addition of 68,869 MW during the 11th plan. However, considering the recent trends in inflation, this amount is now seen as substantially low. Therefore, there should be an upward revision for the funds to be invested in the power sector to ensure that 11th Five Year plan targets are met", said Mr. Sajjan Jindal, President, Assocham.

The key input requirement includes Cement, Steel, Aluminium, Copper and Zinc. The weighted cost of these key input materials for the power sector in the 11th plan has seen an increase of 25 per cent over the last two years.

Steel and Cement being the most vital inputs for the planned capacity addition with a total requirement of 45.88 million tonnes, constituting almost 95 per cent of the total key input requirements, the rise in their prices may largely impact the costs of the power projects under construction. Between the period June 2006 to June 2008, the WPI for Cement and Iron & Steel has increased by 30.63 per cent and 11.73 per cent respectively.

Impacting the project cost significantly, the WPI for Aluminium, Copper and Zinc has also risen tremendously over the last two years. The prices for Aluminium and Zinc have increased by 17.75 per cent and 45.82 per cent respectively while the WPI for Copper has almost doubled. It has gone up by 99.08 per cent over last two years.

TOTAL REQUIREMENT & INFLATION IN VARIOUS INPUTS FOR CAPACITY ADDITION PLANNED DURING 11TH PLAN (2007-2012)

Input	11th Plan requirement (in million tonnes)	Proportion to total input requirement	% change in WPI (June 2006-08)
Cement	30.63	63.23	30.63
Steel	15.25	31.48	11.73
Aluminium	1.6	3.30	17.76
Copper	0.81	1.67	99.08
Zinc	0.15	0.31	45.82
Total	48.44	100	

Data Source: Planning Commission and CSO

The project cost of the power plants might also see a big upsurge because of rapidly rising fuel costs in the recent times. The Wholesale Price Index (WPI) for Fuel, power, light and lubricant with 14.23 per cent weight in WPI, consisting of key inputs for power generation like coal, gas and oil, grew much faster than the over-all WPI. The over-all WPI growth for the first six months of 2008 stood at 9.41 per cent while the WPI for Fuel, power, light and lubricant registered a staggering sharp rise of 12.53 per cent.

The declining growth rate of the six core infrastructure industries with a combined weight of 26.7 per cent in the index of industrial production (IIP) could also pose problems for the power projects. The core infrastructure industries providing major inputs for the power plants like cement, finished steel, coal, electricity have witnessed major slow-down in the growth rate for the first five months of 2008.

The growth rate of index for six core infrastructure industries has gone down considerably; the five monthly average growth rate for the six core infrastructure industries for 2008 is recorded at below 6 per cent level (5.92) while for the corresponding period in 2007 it was above 8 per cent (8.02). This significant downturn in the industrial activity may also hamper the pace of power projects in India. On one hand it would dampen the supply of these key inputs for power projects and on another it may put further inflationary pressure on the prices of these inputs. The penultimate effect will be further escalation in cost of the power projects.