



Inflation In India

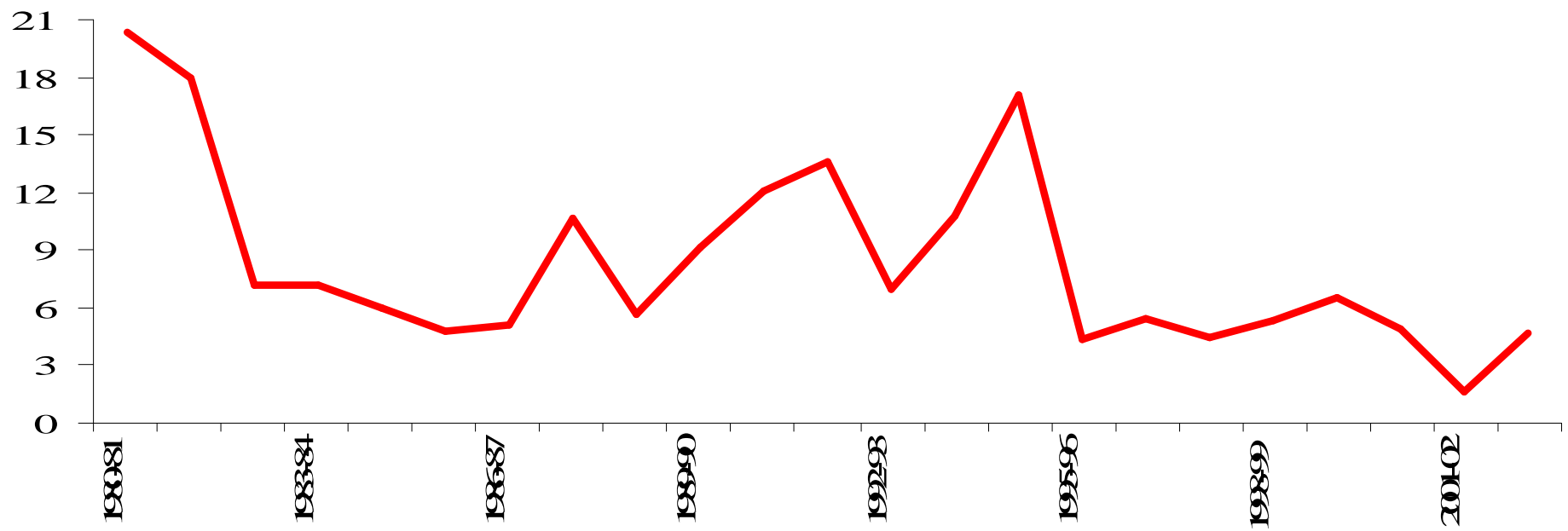
- Inflation is measured by the Wholesale Price Index (WPI) and Consumer Price Index (CPI)
- WPI is the measure of headline inflation in India
- WPI preferred to CPI
 - wider commodity coverage
 - available on weekly basis
 - computed at all-India basis



Trends in WPI

- Average for 1980s : 7.5 (point-to-point)
- Average for 1990s : 6.3 (point-to-point)
(excluding crisis years)
- Secular decline in inflation began in 1996-97 :
Average 1996-97 to 2002-03 4.7 per cent

Chart : Inflation Rate - 1980-81 to 2002-03





Composition of WPI

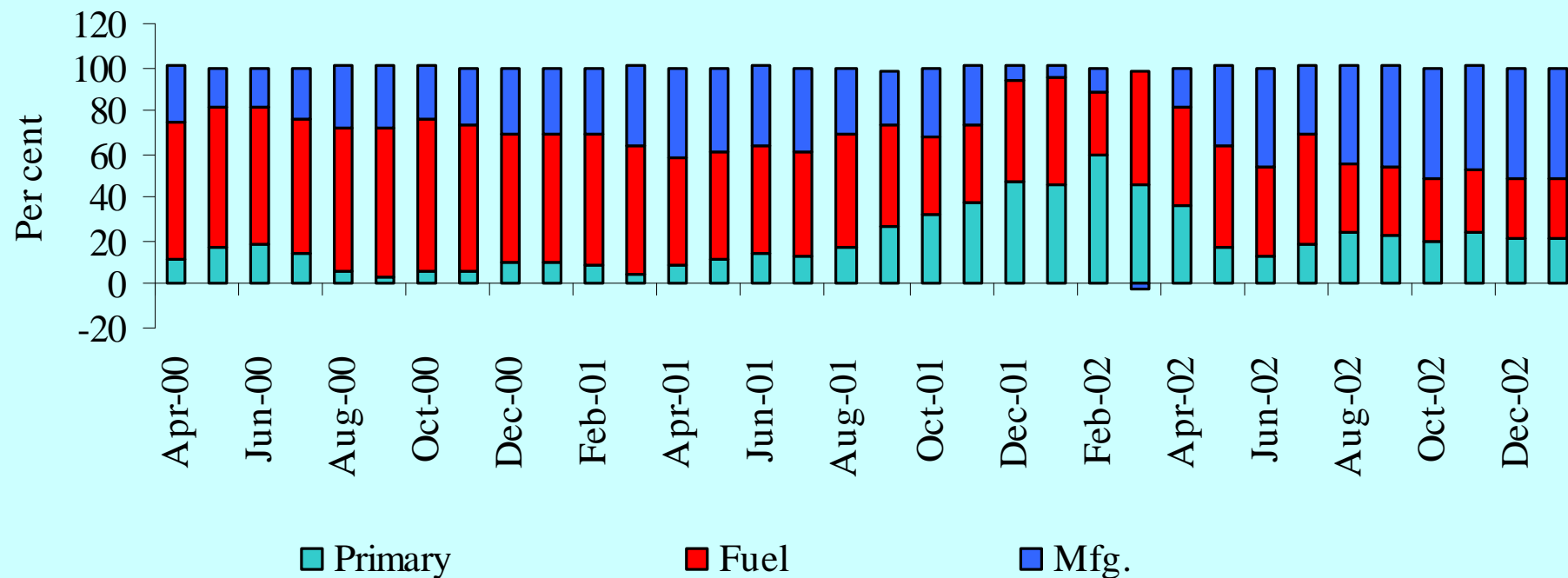
Wholesale Price Index
(weight =100)

Primary Articles (wt= 22.0)
Cereals, Pulses, Fruits &
vegetables, milk, oilseeds,
egg, fish, oilseeds, spices, fibres, etc

Fuel Power, Light & Lubricants (wt.= 14.2)
Mineral Oil
Electricity
Coal Mining

Manufactured Products (wt.63.8)
Sugar, edible oils
textiles, chemicals, iron & steel
machinery, transport equipment, etc

Chart : Major Group's Weighted Contributions to WPI





Trends in Fiscal Deficit

- Gross fiscal Deficit

1980s : 6.8 % of GDP

1992-93 to 2001-02 : 5.7 % of GDP

(ten years excluding crisis years)

- Net RBI Credit to Government

1980s : 2.1 % of GDP

1992-93 to 2001-02 : 0.4 % of GDP



GFD and Inflation

Chart A: Inflation Rate and GFD - 1980-81 to 1989-90

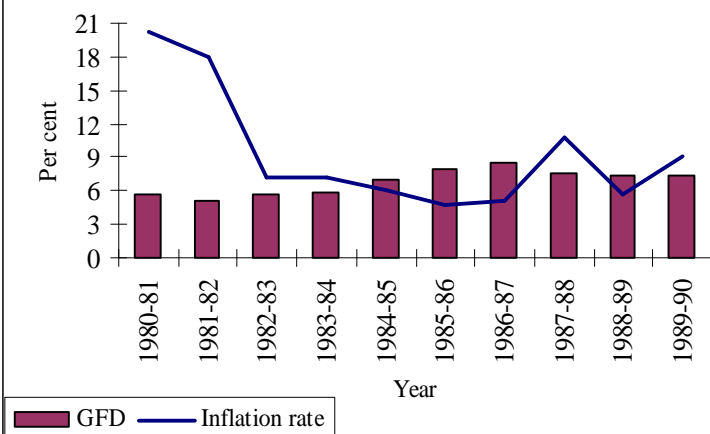


Chart C: Inflation Rate and GFD - 1990-91 to 1994-95

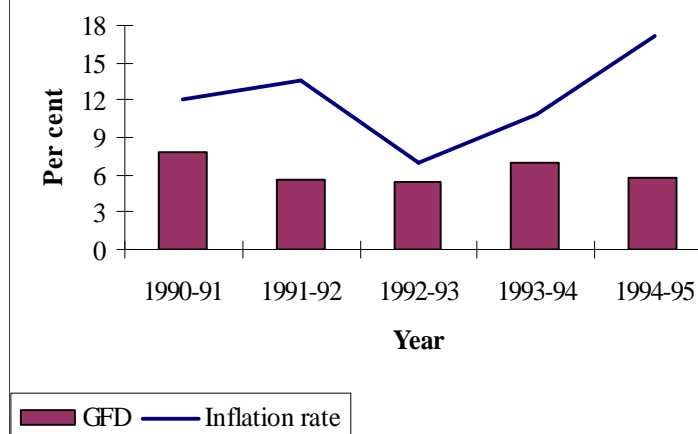


Chart B: Inflation Rate and GFD - 1990-91 to 1999-2000

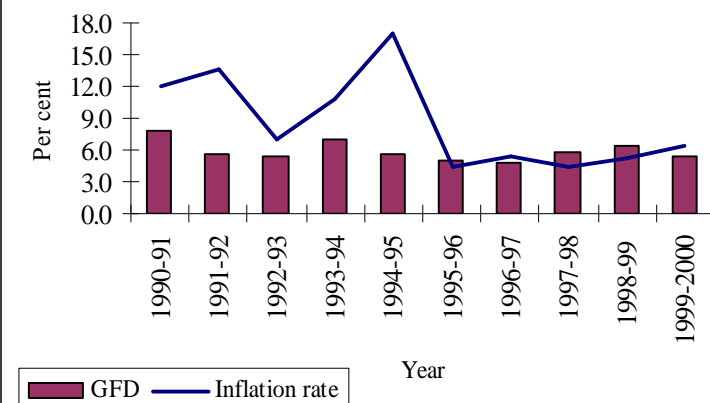
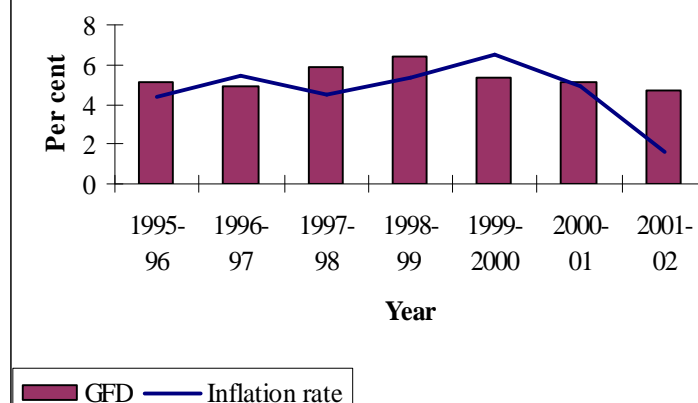


Chart D: Inflation Rate and GFD - 1995-96 to 2001-02





Reasons for Sustained Maintenance of Price Stability in the 1990s

- Structural changes in the global economy
- Productivity gains
- Favourable supply shocks
- Institutional reforms in monetary policy



Inflation viewed from supply-side

- Even though fiscal deficit is high
 - High food stocks
 - High forex reserves (sterilised intervention)
- Fuel Inflation
 - Upto end of 1990s Administered Prices
 - Even after deregulation, low pass-through of import prices



Demand Side- Monetary Management

- Monetary Policy objectives : Price stability and Growth
- Money Demand Function reasonably stable
- $M_3 = f(1.6 \text{ GDP}, 1.0 \text{ Price})$
- Reserve Money is the operating target
- In 1990s Compositional Shift in Reserve Money
 - NFEA is predominant component of RM
 - Net RBI Credit to Government down



Demand Side- Monetary Management

(Contd..)

- Monetary Policy operational framework has changed
- Automatic monetisation of fiscal deficit that prevailed upto mid-1990s terminated
- Net RBI credit to Government moderated greatly
- Government debt sold in market at market-related rates
- RBI modulates liquidity through LAF
- Moving towards Fiscal Responsibility and Budget Management Bill (FRBMB) which envisages withdrawal of RBI from primary subscription of Government paper



Monetised Deficit and Inflation Rate

