



# World Economic Situation and Prospects

## Weekly Highlight

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### India's continuing struggle to contain inflation

While global inflation remains subdued and some developed economies even face deflationary pressures, India continues to struggle with high and persistent inflation. This adversely affects business investment and household consumption, and complicates monetary policy at a time when the domestic economy is very weak. Inflation, as measured by the consumer price index (CPI) and the wholesale price index (WPI), moderated slightly in the first half of 2013, but accelerated again in recent months. In November, year-on-year CPI inflation stood at 11.2 per cent, the highest level in more than two years. Wholesale price inflation, which continues to be used as a benchmark by the Reserve Bank of India, soared to a 14-month high of 7.5 per cent in November, up from 4.6 per cent in May.

This latest surge in inflation was, once again, driven primarily by sharp increases in food prices, notably for vegetables. On average, vegetable prices in the WPI were about 95 per cent higher in November than a year ago, with the prices of onions and tomatoes rising by 190 per cent and 178 per cent, respectively. Food articles (excluding prepared meals, beverages and tobacco) have a weight of 42.7 per cent in the CPI, compared to only 14.3 per cent in the WPI—a main reason for the significant difference in the two measures.

India's high and volatile food price inflation partly reflects recurring supply disruptions, but is also related to more structural

issues, such as the move away from cereals and towards more vitamin- and protein-rich foods as people's incomes are rising, and the lack of adequate storage and transportation facilities. Some recent studies have identified rapidly rising farm wages as an additional source of food inflation. The surge in food prices, which occurred simultaneously with a rebound in fuel inflation to double-digit levels, stands in contrast to low upward pressures on the prices of manufactured products. Faced with sluggish domestic demand, firms in the manufacturing sector are unable to pass on the full increases in input prices to output prices. In November, WPI inflation in manufactured products stood at only 2.6 per cent year on year.

This inflationary picture presents a dilemma for India's monetary policymakers, which have repeatedly vowed to bring inflation down, but may not have the necessary tools to do so. The main effect of tighter monetary conditions could be to add further downward pressure on demand and prices in the manufacturing sector. Lowering food and fuel price inflation on a sustained basis, by contrast, likely requires a more comprehensive approach and a broader set of economic policies, including increased efforts to address the current supply-demand imbalances in the agricultural and energy sectors.

Figure

WPI Inflation of selected categories, January 2011–November 2013

