Syllabus subtopic: Indian Economy and issues relating to planning, mobilization of resources, growth, development and employment.

Prelims focus: Terms like inflation, stagflation, IIP and CPI

Mains focus: the impact of recent slowdown on various sectors of the economy and govt’s efforts to check it

News: Industrial activity contracted for the third consecutive month in October by 3.8%, driven by a fall in activity across sectors.

Inflation and Contraction data

Retail inflation had surged to a 40-month high of 5.54% in November, driven by rising food inflation.

The Index of Industrial Production (IIP) had contracted by 4.3% in September and 1.1% in August.

Within the IIP, the mining sector shrunk by 8% in October compared with a contraction of 8.5% in the previous month. The manufacturing sector contracted for the third consecutive month in October, by 2.1%, compared with a contraction of 3.9% in September.

Growth in the Consumer Price Index (CPI) accelerated in November for the fourth consecutive month. It stood at 4.62% in October.

Impact

This combination of contraction in industrial activity and rising inflation has led experts to fear that India is entering a phase of stagflation (a situation in which there is persistent high inflation combined with stagnant or declining demand).

The momentum of IIP remaining in the negative zone has continued while CPI inflation, led by food and vegetable inflation, has crossed 5.5%. This is developing into a classic situation of stagflation.

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What is meant by the term Inflation?

- Inflation is a quantitative measure of the rate at which the average price level of a
basket of selected goods and services in an economy increases over a period of time.

- It is **the constant rise** in the **general level of prices** where a unit of currency buys less than it did in prior periods. Often expressed as a percentage, inflation indicates a decrease in the purchasing power of a nation’s currency.

**Types of Inflation Indices**

Depending upon the selected set of goods and services used, multiple types of inflation values are calculated and tracked as inflation indexes. Most commonly used inflation indexes are the Consumer Price Index (CPI) and the Wholesale Price Index (WPI).

**The Consumer Price Index (CPI)**

- The CPI is a measure that examines the **weighted average of prices of a basket of goods and services which are of primary consumer needs**. They include transportation, food, and medical care.
- CPI is **calculated by** taking price changes for each item in the predetermined basket of goods and averaging them based on their **relative weight** in the whole basket. The prices in consideration are the retail prices of each item, as available for purchase by the individual citizens.
- Changes in the CPI are used to assess price changes associated with the cost of living, making it one of the most frequently used statistics for identifying periods of inflation or deflation.

**The Wholesale Price Index (WPI)**

- The WPI is another popular measure of inflation, which **measures and tracks the changes in the price of goods in the stages before the retail level**.
- While WPI items vary from one country to other, they mostly include items at the producer or wholesale level. For example, it includes cotton prices for raw cotton, cotton yarn, cotton gray goods, and cotton clothing.
- Although many countries and organizations use WPI, many other countries, including the U.S., use a similar variant called the producer price index (PPI).

**The Producer Price Index**

- The producer price index is a **family of indexes that measures the average change in selling prices received by domestic producers of goods and services over time**.
- The PPI measures price changes from the perspective of the seller and differs from the CPI which measures price changes from the perspective of the buyer.

**Note:** In all such variants, it is possible that the rise in the price of one component (say oil)
cancels out the price decline in another (say wheat) to a certain extent. Overall, each index represents the average weighted cost of inflation for the given constituents which may apply at the overall economy, sector or commodity level.

About Index of Industrial Production (IIP)

- It is an index that shows the performance of different industrial sectors of the Indian economy.

The IIP is estimated and published on a monthly basis by the Central Statistical Organisation (CSO). As an all India index, it gives general level of industrial activity in the economy.

Importance of Index of Industrial Production

The IIP is used by public agencies including the Government agencies/ departments including that in the Ministry of Finance, the Reserve Bank of India etc. for policy purposes. The all-India IIP data is used for estimation of Gross Value Added of Manufacturing sector on quarterly basis.

Similarly, the data is also used extensively by analysts, financial intermediaries and private companies for various purposes.

Following are the main changes brought in the new series of IIP:

- Base year has been updated to 2011-12 by upgrading the item basket and weighting structure.
- National Industrial Classification (NIC) 2008 has been adopted in the new series of IIP.
- Number of item groups has increased from 399 to 407 out of which 149 are new/ emerging items.
- Electricity generation from renewable energy sources has been included under the ‘Electricity’ sector.
- Weights are rationalised to appropriately to reflect the actual value addition of each sector incorporating effects of subsidies.
- New use-based classification has been adopted with following categorisation: (i) Primary goods, (ii) Capital goods, (iii) Infrastructure/ construction goods, (iv) Intermediate goods, (v) Consumer durables, and (vi) Consumer non-durables.
- A review mechanism has been introduced through a Technical Review Committee.

Note: In the new base year (i.e. 2011-12), the 407 item groups are divided under three sectors i.e. Mining (1 item group), Manufacturing (405 item groups) and Electricity (1 item) with weights of 14.37%, 77.63% and 7.99% respectively.