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## The Impact of Change in WPI on Future Direction of Interest Rates in India

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### ABSTRACT

To calculate inflation, the inflation-computing agency collects the prices of identified commodities. The agency can take into account wholesale prices, retail prices or factory-gate prices. As wholesale markets are few in number, it is easier to collect the prices of goods traded there. The Wholesale Price Index (WPI) takes into account the wholesale prices of over 400 commodities.

The base year for the present WPI index, which is computed by the ministry of commerce and industry, is 1993-94. The 100-point index is subdivided into three groups. The primary articles, which include food and non-food agriculture products, have a weight of 22.02% in the index. Manufactured goods have the highest weight of 63.75%. Fuel and power account for 14.23%. The government is now ready with a revised index with a new base year.

The paper is the attempt to check the impact of change in WPT on the Interest rate in the practical outlook

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## Introduction

### Objective

- To calculate WPI
- To analyze the Changes in the Base year considering the base year as 1993-94.
- To analyze the impact of change in WPI on future interest rates in India
- To analyze the Lending and Deposit rates.

### Limitations

- The commodities included in WPI for base year 1993-94 are only 435
- The interest rates are more fluctuating so, it is difficult to analyze
- The data on WPI is not provided regularly by companies
- Its geographic coverage extends only to the area of Metro Manila

### Methodology/Research Design

The objective of the present study can be accomplished by conducting a systematic market research.

### Causal Research

The basic aim of causal studies is to identify the cause and effect relationship between variables. For instance, studying the effect of prices, advertising and marketing on sales comprise causal studies. It is therefore essential for the researcher to have a thorough knowledge of the subject area of the research. The basic premise of the causal relationship is that when we do a particular thing (cause), it gives rise to another thing (effect). It is highly impossible to prove a causal relationship scientifically. Researcher develop evidence to understand causal relationships.

### Causal relationships

The causal analysis is the process of determining how one variable influences the change in other variable. As far as business research is concerned, the cause-effect relationship is less explicit

The research methodology used is Causal research as I have to find out cause and effect relationship between the two variables i.e. WPI and Interest rates.

### Collection and sources of data

#### Secondary data

Secondary data help in identifying research problem, formulation of research hypothesis and generation of new ideas which will can be later authenticated by primary research.

Secondary data can be either sourced from various departments internal to an organization or from external source, through different books, periodicals, governmental and non-governmental publications.

The wholesale price index numbers by the officer of the Economic advisor ,ministry of commerce and industry

which is weekly and covers various products such as food articles, food grains, minerals, fuel, power, textiles, chemicals, etc.

### WPI (wholesale price index)

#### Concept of WPI

The wholesale price index (WPI) is an indicator designed to measure the changes in the price levels of commodities that flow into the wholesale trade intermediaries. The index is a vital guide in economic analysis and policy formulation, and as basis for price adjustments in business contracts and projects. It is also intended to serve as an additional source of information for comparison in the international front.

#### Importance of Wholesale Price Index

Wholesale Price Index (WPI) is an important measure to monitor the movement of general level of prices in the economy. It is widely used by Government, banks, industry and business circles. In view of the importance of prices for the health of the economy, in terms of growth and distribution, the monetary policy of the RBI is often guided by the need to keeping prices within prudent limits. Similarly, the movement of WPI serves as an important determinant, in formulation of trade, fiscal and other economic policies by the Government of India.

#### Nodal Office for Compilation of WPI

The Office of the Economic Adviser in the Department of Industrial Policy and Promotion, ministry of Commerce and Industry is responsible for compiling WPI and releasing it every week. The Office published for the first time, the index number of wholesale prices, with 'base week' ended August 19, 1939=100, from the week commencing January 10, 1942. Since 1947 the index has been published regularly.

#### Need for a periodic revision in the base year of WPI

Overtime economies undergo structural changes. This is truer in the contemporary Indian context. Under the current liberalized environment, changes in the economy are taking place at a fast pace. Product and their specifications, both in terms of quality and packaging, are changing even faster. It has, therefore, become increasingly difficult to obtain the price information of selected products for a fixed number of quotations over a longer period of time. Also, a number of products, which were very important in terms of the market share at one point of time, become obsolete in a short span of time and their places get occupied by altogether different items.

#### Highlights of the Report of the last Working Group

The last Working Group to revisit the base year issues of WPI series was constituted on June 18, 1993 under the Chairmanship of Prof. Y.K. Alagh, the then Vice Chancellor, Jawaharlal Nehru University. Consequent to Prof. Alagh

taking over as Minister of State (Independent Charge), Government of India, Prof. S.R. Hashim took over the Chairmanship of the Working Group from September, 1996.

The Group submitted its Report to the Minister of Commerce & Industry on November 5, 1999. It recommended 1993-94 as the revised base year with a new basket of commodities and revised weighting diagram for new series.

In addition, the Group made the following important recommendations:

- (i) Strengthening of wholesale price collection mechanism,
- (ii) Development of Business Service Price Index Numbers as also Stage of Processing framework for WPI.

The Report of the Working Group was placed before the Technical Advisory Committee on Statistics of Prices & Cost of Living (TAC on SPCL) in Central Statistical Organisation (CSO). The TAC in its meeting held on December 12, 1999 broadly accepted the Report. Thereafter, the Report of the Working Group was finally considered by the Committee of Secretaries (COS) in its meeting held on February 10, 2000 which in brief directed that: Year 1993-94 may be accepted as the base year for the new series of Wholesale Price Index with the revised commodity basket; Instead of a separate Standing Committee as recommended by the

Working Group, a Sub-Group of the Technical Advisory Committee should be set up, inter alia, to advise on strengthening of the data collection system within a timeframe of three months. It would also take steps for development of Business Service Price Index (BSPI) within six months; Action may be initiated to construct a Stage of Processing Index to reflect inflation in a better way after a thorough study of the prevalent practices in other countries.

In pursuance of the above directions, the following actions were initiated:

New Series of WPI with base year 1993-94=100 released with effect from 1.4.2000.

The Department of Industrial Policy and Promotion in the commerce and industry ministry acts as the nodal agency for compiling and disseminating the WPI data

#### **The wholesale price as defined for WPI:**

The concept of wholesale price adopted in practice represents the quoted price of bulk transaction generally at primary stage. The price pertaining to bulk transaction of agricultural commodities may be farm harvest prices, or prices at the village mandi /market of the Agricultural Marketing Produce Committee/ procurement prices, support prices. For manufactured goods the wholesale prices are administered prices, ex- factory gate/ ex-mill, ex-mine level. Ex- factory prices exclude rebate if any,

other taxes and levies are excluded though excise duty is currently included.

#### **Wholesale price and producer price:**

The wholesale price as defined above differs from producer (output) prices as the latter excludes all kind of taxes and transport charges. In 1993 SNA, Producer (output) price is defined as the amount receivable by the producer from the purchaser for a unit of a good or service produced as output minus VAT or similar deductible tax, invoiced to the purchaser. It excludes any transport charges invoiced separately. It excludes any transport charges invoiced separately by the producer. However, the producer (input) prices include retail or wholesale margins

Like most of the price indices, WPI is based on Laspeyres formula for reason of practical convenience. Therefore, once the concept of wholesale price is defined and the base year is finalized, the exercise of index compilation involves finalization of item basket, allocation of weights (W) at item, groups/ sub-groups level. Simultaneously, the exercise to collect base prices (Po), current prices (P1), finalization of item specifications, price data sources, and data collection machinery is undertaken.

The price data covers the wholesale prices of commodities from two levels of bulk distribution, i.e., the wholesaler-to-retailer and the wholesaler-to-producer (end-user).

WPI is also compiled by many states covering state level wholesale transactions. Presently WPI series compiled are — Assam (base 1993-94), Bihar (1991-92), Haryana (1980-81), Karnataka (1981-82), Punjab (1979-82), U.P.(1970-71) and West Bengal (1980-81). Most of the state series are cover agricultural commodities only

Wholesale price has divergent connotations adopted by the different departments using them. There is no uniform definition for agricultural and non- agricultural commodities as all the wholesale prices can not be collected from the established markets.

#### **Agricultural commodities:**

There are three types of wholesale markets viz., primary, secondary and terminal in the agricultural sector. The price movements and price levels in all three vary. Price movement in the terminal market may tend to converge toward the retail prices. Option to collect the wholesale prices for these three different stages of wholesale transactions exists for agricultural commodities though the primary market is prepared.

Ministry of Agriculture has defined wholesale price as the rate at which relatively large transaction of purchase, usually for further sale, is effected.

As there is a little scope of emergence of new commodities in the agriculture, the selection of new items in the basket is done on the basis of increased importance

in wholesale markets. Varieties, which have declined in importance, need to be dropped in the revised series. Final inclusion or exclusion of an item in the basket is based on the process of consultation with the various departments. The exercise of adding /deleting commodities, specifications and markets is completed once the consultation process is over. In the existing WPI series, items, their specifications and markets have been finalized in consultation of with the Directorate of E&S (M/O Agriculture), National Horticulture Board, Spices Board, Tea board, Coffee Board and Rubber Board, Silk Board, Directorate Of Tobacco, Cotton Corporation of India etc.

Various state agencies concerned with the collection of wholesale prices of agricultural commodities are following the concept of Ministry of Agriculture. However, there are certain variation with regard to inclusion or exclusion of incidental charges, duties and taxes. For e.g., in Andhra Pradesh, the wholesale prices include incidental charges such as weightment charges, cost of bags and sales tax.

In Gujarat, the wholesale prices are inclusive of packing charges and taxes. In Punjab and Tamil Nadu, the wholesale prices are inclusive of incidentals. In Haryana, the wholesale prices for agriculture commodities exclude taxes but include arat, weightment and the lorry charges, whereas, non-agricultural products include sales tax, etc.

#### **Non-agricultural commodities:**

For non-agricultural commodities, which are predominantly manufacturing items, the problem arises, as there are no established sources in markets. This is true of mining and fuel items also. The issue of ex-factory vis-à-vis wholesale prices for non-agriculture items have been discussed by the successive Working Groups set up for the revision of WPI and all have reached the conclusion that in practice, it is not feasible to collect wholesale prices for most of the manufacturing items. It has also been observed that the margin of wholesalers in case of non-agricultural commodities remains unchanged for over a long period of time. As a result, it is felt that the trends in the index compiled on the basis of ex-factory prices would not be much different from the index if compiled on the basis of wholesale prices if it were feasible to get these prices. The last Working Group has recommended collecting wholesale prices from the markets as far as possible, because the economy is moving towards globalization and open trade with inputs increasing in the commodities set.

#### **Mining Items:**

For deciding on the inclusion and exclusion of mineral items, their grades, market centers etc. suggestions of Indian Bureau of Mines are taken into account. Specifications of coal, coke and lignite have been decided

in consultation with the Department of Coal. Likewise for selection of petroleum products the Ministry of Petroleum is consulted and for electricity suggestions are taken from Central Electricity Authority.

**Manufactured Products:** Selection of items from manufacturing sector, as a whole, is the most tedious and time taking process. To ensure complete coverage, selected items have to represent not only the organized manufacturing sector but also vast informal sector.

#### **Characteristics of WPI**

Following are the few characteristics of Wholesale Price Index

- WPI uses a sample set of 435 commodities
- The price from wholesale market is taken for the calculation
- Currently the Base year for the WPI is 1993-94
- WPI is available for every week
- It has a time lag of two weeks, which means WPI of the week two weeks back will be available now
- It gives yearly inflation rate. Its the increase in prices since one year back from the given week.

#### **Use of WPI**

1. The main use of WPI is to calculate inflation  
The percentage rate of change of WPI over a period of time, normally a year.

Inflation rate of a country is the rate at which prices of goods and services increase in its economy. It is an indication of the rise in the general level of prices over time. Since it's practically impossible to find out the average change in prices of all the goods and services traded in an economy (which would give comprehensive inflation rate) due to the sheer number of goods and services present, a sample set or a basket of goods and services is used to get an indicative figure of the change in prices, which we call the inflation rate.

2. WPI mainly used by different manufacturing industries to determine there product prices.

#### **Limitations**

1. The commodities included in WPI are only 435
2. The data on WPI is not provided regularly by companies
3. Its geographic coverage extends only to the area of Metro Manila
4. An implicit disadvantage of Laspeyre's formula, the methodology used for compiling the WPI, is that the indices with fixed weighting diagram fail to capture the dynamic changes in product mix and structure of the economy over time.

#### **Relationship between interest rates and Inflation**

It is typically a positive relation. In other words, both tend to move either up or down together. However, the caveat is that interest rates will always follow inflation rates or,

put simply, when inflation goes up, interest rates go up and when inflation comes down, interest rates tend to fall. The reason behind this relationship is fairly simple as also complex. Inflation tends to happen when an economy is 'overheating' much like what is happening in India now. Of course, inflation also happens when central banks print a lot of money or when macroeconomic policies go bad. However, in this case, let's assume that the central bank and government are largely following 'correct' policies. This assumption is necessary because the relation between inflation and interest rates becomes clearer.

Money is the engine of any economy. Let's start from the time when money is cheap or in other words, there is a low interest rate. This is also called 'loose money policy'. Because of this cheap money, people borrow to start businesses, invest and so on; the price they pay for the money is interest. Over time, a virtuous cycle gets created where this money generates more money and people tend to become richer.

India is the best case where this has happened in the last few years. Interest rates were low in India and people and companies have borrowed liberally for a variety of things. People bought houses, cars, TV sets and so on and companies built factories, etc. When this happens, economies will typically go through what is known as a boom phase with GDP, incomes, and profits rising rapidly. All this increases the demand for goods and we all know that prices of goods depend on demand and supply. Over time, demand builds and slowly outstrips supply as is happening in India now. When that happens, prices of goods tend to go up and that results in inflation because most of these goods are usually part of a basket that constitutes the Wholesale Price Index.

To 'cool' the economy, central banks will raise interest rates. The intention here is to slow demand and, in effect,

decelerate the economy. However, this is a tightrope act because interest rates must be raised just enough to cool the economy but not send it into a recession. When interest rates are increased, money becomes costlier and that is known as 'tight money policy'.

#### **Conclusion and /or recommendations**

✓ When liquidity in the system increases the demand for commodities will increase and as demand increases the supply goes on decreasing so, the prices of the commodities will increase. And WPI will also increase in same manner.

✓ To overcome the liquidity the government decreases its lending rates as well as Deposit rates. And the CRR will increase So that the WPI is controlled

✓ Change in the Base year does not have any impact on interest rates, but there can be change in WPI, as base year changes only the Index number changes, actually there will be no changes in the prices of the commodities.

✓ The exchange rates will also affect the fluctuation in WPI

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