

INTRODUCING THE PRODUCER PRICE INDEX FOR SRI LANKA

WHAT IS A PRICE INDEX?

A price index is a measure of the proportionate, or percentage, changes in a set of prices over time. Each month, prices are collected for a group of well-defined and clearly described products. These prices collected during a specific point in the month are compared with prices at another point in the past. One well-known example of a price index is a Consumer Price Index (CPI); however, there exists another important price index – the Producer Price Index (PPI).

WHAT IS THE PRODUCER PRICE INDEX?

The PPI measures the average change over time in the prices received by domestic producers of goods and services. The PPI is very important to Sri Lanka for a variety of reasons. Up to the present, the Department of Census and Statistics (DCS) has published only one price index – the CPI. A CPI measures changes over time in the prices paid by consumers for a representative set of goods and services. The introduction of the PPI in Sri Lanka provides a more complete picture of price movement and trends for policy-makers and private sector decision-makers.

WHY IS THE PRODUCER PRICE INDEX IMPORTANT?

The PPI is an important economic indicator for Sri Lanka. Uses of the PPI include:

- A) **Indicator of inflationary trends** – Sri Lanka's monthly PPI with detailed industry data will serve as a leading indicator of price change in the economy.
- B) **Deflator of economic series** – The PPI will be used to deflate gross domestic product (GDP) estimates to create a series in constant terms. Other important economic data series can also use the PPI to remove the effect of prices changes to produce estimates of real change over time.
- C) **Productivity analysis** – The PPI can be used to deflate the nominal value added of an industry into a real value added. These industry measures of real value added are then divided by labor input to the industry to form estimates of industry labor productivity or are divided by an index of industry primary input usage to form estimate of industry total factor productivity. Productivity increases act as a primary driver of a

higher standard of living, so it is of some interest to try to determine which industries are the main drivers of productivity improvements.

- D) **Contract escalation** – The PPI can be used as an escalator to index long-term contracts for goods and services. In this case, the PPI can be used to adjust the value of the monetary amounts stipulated in the goods and services based on the increase or decrease in the level of a specific index. The main purpose of the indexation is to take the inflationary risk out of the contract. The PPI provides an independent measure of the change in prices of the good(s) or service(s) being considered. Indexation is common to long-term contracts, where even relatively small levels of inflation can have a substantial effect on the real value of the revenue flows.
- E) **Current cost accounting** – The PPI can be used for current cost accounting by businesses. Current cost accounting is a method of accounting for the use of assets in which the cost of using the assets in production is calculated at the current price of those assets rather than by using the historic cost (the price at which the asset was originally purchased). In current cost accounting, the price index used should not be a general price index but should be specific to the asset being used. Thus the PPI can be used to estimate the current value of a business' capital assets.
- F) **Business analysis** – the PPI enables business owners to make a comparison of trends in their own business with those of the industry group.
- G) **Policy-making** – The PPI is used as an important tool during the design and formulation of policies and analysis of inflation by the Central Bank of Sri Lanka and other governmental ministries; such as the Ministry of Finance.

FOR MORE DETAILED INFORMATION ON THE PPI :

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