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THE PUZZLE OF INFLATION GOING UP DESPITE LOW DEMAND IN INDIA

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Inflation & Monetary Policy

The government’s inordinately large food stockpiles have resulted in an artificial market scarcity

On 7 January, the ministry of statistics released India’s advance estimates of national income for 2019-20, pegging the economy’s growth rate this financial year at 5%. Based on data available for the first two quarters, this seems an overestimate. Most indicators suggest that actual growth may be lower than 5%. This is bad news, especially since there is no hope of an economic revival in the near future. What is likely to create further problems is rising inflation.

The consumer price index (CPI) rose 7.35% in December, hitting the highest since 2014 and crossing the threshold limit set by the Reserve Bank of India. Price pressures were high in both rural and urban areas, driven by food prices. Food price inflation surged to 14%, led by vegetables (60%), pulses (15%), meat and fish (9.6%), and eggs (8.8%). A similar picture emerged from the wholesale price index (WPI) data. While overall inflation, at 2.6%, is not very high, inflation in food articles at 13.2% is close to the CPI rate. The culprit again is food inflation, driven by vegetables (70%), cereals (7.7%), pulses (13.1%), and egg, meat and fish (6.2%).

At the same time, core inflation has stayed low, ruling out any possibility of a demand recovery. The question then is, why is inflation rising? Most commentators have highlighted the rise in onion prices, which did contribute to vegetable inflation. However, data also shows a sharp rise in inflation in almost all vegetables along with cereals (mainly wheat and coarse cereals), pulses and personal care items. Clearly, the inflation story is not just an onion story, and is far more widespread and serious. However, attributing this to seasonal factors would be missing the forest for the trees. Untimely rains, drought in some regions and crop losses due to local factors did contribute to supply shocks, but this is not enough to explain the sharp rise in overall inflation, or even food inflation, given the small weight of these crops in the consumption basket. Onions, for example, have a weight of only 0.64% in the CPI and 0.16% in the WPI.

Further, the worry is not restricted to vegetable prices—which may stabilize in due course if driven by seasonal factors—but also cereals and pulses, whose inflation rates have seen a consistent rise in the past six months. They together have a weight larger than vegetables, and the rise in their prices is unlikely to be a result of seasonal factors. Some of it may be due to the transmission of global food prices, which have shown a rising trend in the last half year. But a bulk of the blame lies with government policy. In pulses, untimely imports flooded the markets and contributed to lower price realization last year, further leading to lower production this year. Within cereals, wholesale wheat prices have risen 8% this year while retail prices gained 6.3%, the highest in five years.

But why are wheat prices rising if wheat production has been at record levels? Government policy has created an artificial scarcity in the market. In the run-up to the general elections, the government procured 34 million tonnes of wheat in 2019, on top of the 36 million tonnes procured in 2018. These are the highest procurement levels since 2012-13. But it failed to distribute the wheat through the public distribution system, so there just wasn’t enough to go around. As of January, total stocks with Food Corporation of India (FCI) stand at 75 million tonnes, 33 million tonnes of it wheat, and the rest, rice. This implies that almost all the wheat that the FCI procured before the polls is still with it. This is almost a third of the country’s total wheat production. For the record, the buffer norms for FCI prescribe 21.4 million tonnes of stock at the start of each year. The resultant artificial scarcity has not only pushed up wheat prices, but also led to higher demand for coarse grains and fodder, almost all of which have seen double-digit inflation. Fodder prices have risen 14% in the last six months, driving up input costs for non-vegetarian items, which are now seeing high inflation.

Given high government stockpiles, it is unlikely that food inflation will fall soon. This poses problems in reviving the economy. The poor have to bear the brunt of government apathy. With food accounting for two-thirds of their household budgets, higher prices will worsen demand for non-food goods, in addition to proving a serious setback for nutrition security. At a time when consumption expenditure data shows rising poverty along with declining wages, climbing inflation will only lead to increased vulnerability, while making an economic recovery harder.

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