

South Asia

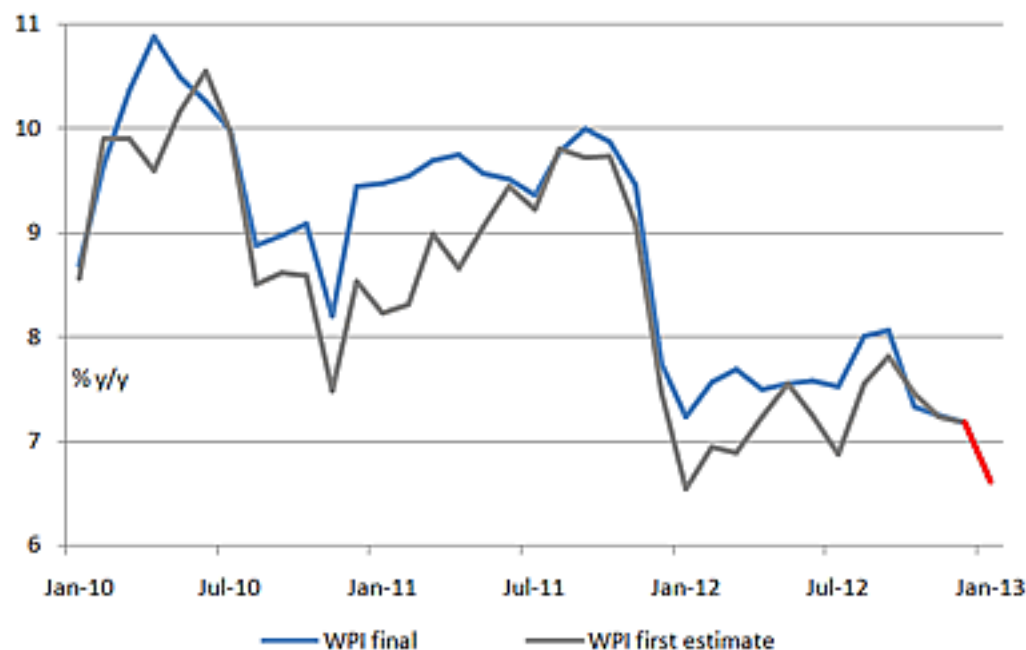
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Indian inflation eases

By Kunal Kumar Kundu

NEW DELHI - Inflation in India, as measured by the official Wholesale Price Index (WPI) surprised on the downside for January, at a 6.62% annual rate, the first sub-7% rate over the past 38 months and lower than the market expectation of 7%.

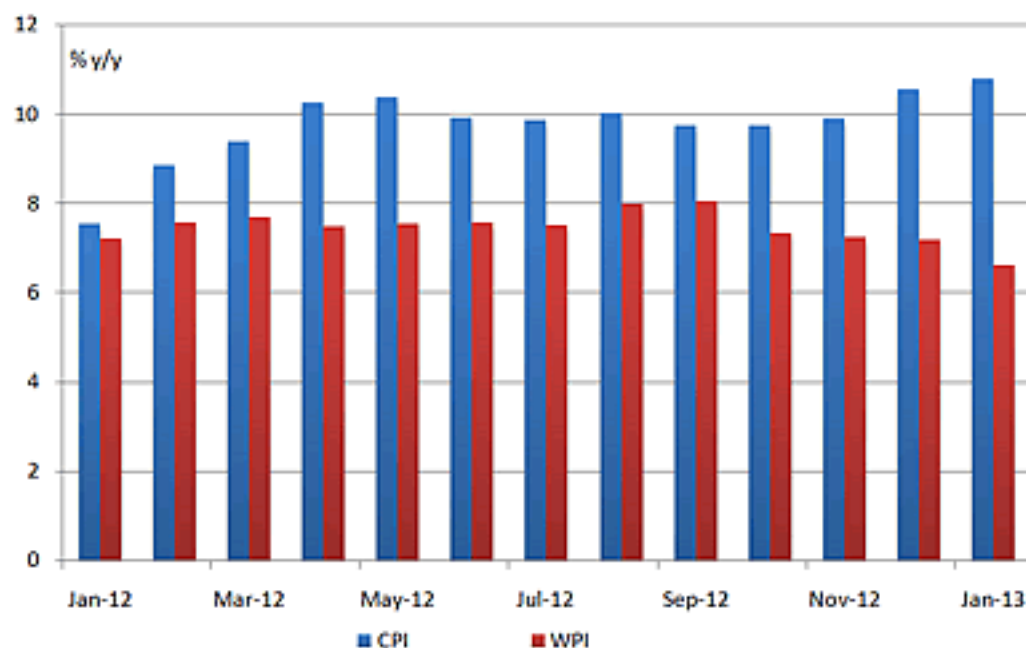
What is also heartening is that the November inflation figure remained unchanged, the second time since January 2010 that inflation data did not undergo any revision. India's inflation data, which is notorious for requiring upward revision (and by sizeable amount at that), has remained surprisingly steady since October. This does indicate that inflation is finally on an easing path.



Source: Office of the Economic Adviser

Lending credence to the belief is the fact that manufacturing inflation has fallen below 5% while core inflation is down to a mere 4.12%. Despite galloping non-core inflation, benign core inflation is an indication that India's manufacturers lack pricing power as domestic demand continues to remain weak. Not surprisingly, industrial production is showing signs of deceleration.

Unfortunately, easing wholesale inflation is not percolating down to retail inflation. India's Consumer Price Index is actually steepening and the difference between the two measures is the highest ever recorded, thereby posing an additional headache to the Reserve Bank of India.



Source: Economic Adviser, MOSPI

The bigger concern is the continued rise in food inflation. At 11.9%, this is now at its highest since January 2009. Food articles (which account for over 14% of the total inflation basket) contributed more to inflation than non-food manufacturing, which has as much as a 55% weighting in the basket.

Apart from the usual structural factors (such as high procurement prices of food grain by the government, virtual transfer income in the form of employment guarantee schemes) that affect food inflation in India, this year's inflation has also been impacted by falling food grain production due to the prevalence of drought-like conditions in some parts of the country.

As per the second advance estimate of food grain production released last week by the agriculture ministry, India's food grain production is set to decline by 3.5% in the 2012-13 crop year, with food grain output estimated to touch 250 million tonnes, compared with the previous year's peak of 259 tonnes.

Not surprisingly, average food grain inflation over the past six months was more than 16%. In a situation of stress, food inflation perks up because of sheer inefficiency in India's central food grain procurement organization, the Food Corporation of India (FCI). Every year, the government procures food grains fairly aggressively, which reduces the supply available in the market when the monsoon fails. On top of this, time and again the FCI has proved to be a failure in its ability to move food grains from a surplus region to deficit regions, thereby allowing black marketers to flourish.

Food inflation faces further headwinds next year as the government (in light of the forthcoming general elections) aggressively pursues the introduction of a food security act, which would result in much higher procurement of food grain. This would also mean higher procurement prices.

The government's effort to cut down on oil subsidy through a phased increase in diesel and kerosene prices and a limit to the number of subsidized cylinders of cooking gas per household would also be inflationary. As per the Petroleum Planning & Analysis Cell, as of the start of this month, the state-owned oil marketing companies incur a loss of 9.22 rupees (17 US cents) per liter of diesel sold by them. Since this is planned to be phased out over the next year-and-a-half by increasing prices every month, the pressure on inflation will stay, more so because diesel has the highest weighting (4.67%) in the power and fuel segment.

The Reserve Bank of India will also be concerned about the current account deficit (CAD), whose increase is being further exacerbated by the rising price of crude oil. As of February 13, the basket of Indian crude oil jumped to US\$115.18 per barrel from \$109.95 a fortnight ago.

Not surprisingly, although India's exports (in US dollar terms) registered a slight increase in the month of January after having recorded successive months of contraction, imports increased at a far higher rate, resulting in the trade deficit rising to \$20 billion from \$17.7 billion in December 2012. The rising CAD will put additional pressure on the Indian rupee, which will further fuel inflation.

Overall, while the headline inflation number will provide some level of comfort to the RBI, the central bank will also be mindful of the impending pipeline pressure on prices. Nevertheless, the RBI might still opt for a rate cut during its March meeting and by no more than 25 basis points (100 basis points equal percentage point) as concern regarding plummeting growth will outweigh inflationary concerns.

Thus, while the RBI will end up cutting the interest rate by 50 basis points during the first three months of 2013, I believe that it will remain cautious during the remainder of the year and will likely opt for at most another 50 basis points cut over the next nine months.

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