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## **Kunal Kumar Kundu: Cornered by inflation**

What is it about onions and elections in India? Difficult to say, except that shooting onion prices can play a decisive role in influencing electoral outcomes.

But then, don't skyrocketing onion prices defy the [normal monsoon](#) logic? As mentioned earlier, a normal monsoon is a mere statistical trend and such estimates may not mean much in the real sense. Some regions in the country may experience drought while some others may experience flood, and yet, we might end up with a normal monsoon. The fact is, we had onion prices shooting up, tomato prices shooting up, and ditto for salt prices. And now the country is staring at the prospect of a substantial loss of rice production. The problem is, any hint of a production shortfall leads to a disproportionate rise in prices, given the inefficient ways of managing food [economy](#) by the government, and rampant hoarding by the traders.

Ever since the India Meteorological Department (IMD) first talked about normal monsoon in India, virtually every analyst has been talking about easing food price inflation - come September. Now that the [IMD](#) reiterated normal monsoon during the second half of the year (essentially buttressing their view of normal monsoon for the whole year), the expectations of easing prices have shifted to December since the September easing failed to materialise.

Hope is a significant input in Indian policymakers' revenue estimation, which helps justify schemes that can otherwise be fiscally challenging. Now, hope it is that many are clinging on to, as everybody desperately wants food prices to ease. That, however, appears to be a long shot, at least for the next few months.

India's [food inflation](#) for October came in at 18.2 per cent and headline wholesale price index (WPI) printed 7 per cent. What is more worrying is that the final inflation figure for August was revised up to 7 per cent (by a whopping 0.95 per cent) from the preliminary estimate of 6.1 per cent, and the underlying data suggest even the final inflation figure for September will cross 7 per cent, as compared to the first estimate of 6.5 per cent. At the retail level, consumer price index inflation continues to be in double-digits.

The pace of inflation in India is one of the highest in the developing world (and not just in emerging Asia), propped up by inordinately high levels of food inflation that has been sustained for an unprecedented long period of time. In fact, over the past 60 months, India's food inflation averaged more than 12 per cent annualised rate per month. And, during this period, on only six occasions was food inflation less than 8 per cent annualised rate. The fact that even base effect is failing to slow down inflation points to the fact that food inflation in India has assumed serious structural proportions. This behaviour of food prices in India is a manifestation of some debatable policy choices and is often the result of a clear mismatch between actual and desired policy outcomes.

Not surprisingly, food subsidy has been on the rise in India. Food subsidies currently account for more than one-third of the total subsidies, and push the [fiscal deficit](#) wider. And, now that the food security Bill has been announced, India's overall food subsidies will increase once the bill has been fully implemented, thereby exerting even more pressure on the fiscal deficit. The fact is, over the years, various national political parties doled out huge subsidies for food, energy and other necessities, thereby distorting these markets and engendering multiple economic problems for the country - high fiscal deficit being one such debilitating consequence. And with the government refusing to take any meaningful action in view of the forthcoming general elections, there's no fiscal space left to prop up the sagging economy.

Unfortunately, this is leading to a clamour for the Reserve Bank of India (RBI) to reverse the fortune of the economy by easing its monetary policy stance. The general view is that since inflation is structural in nature and monetary policy measures being virtually ineffective in impacting it, the RBI should refocus on growth. There is, however, a fallacy in this argument. Apart from potential headwinds for inflation (rupee depreciation being one of them), a high and sustained level of food inflation is feeding into core inflation through wage price spiral, thereby raising inflationary expectation. The fact remains that inflation is the worst form of taxation for the poor, more so food inflation.

Not surprisingly, there is very little monetary policy room for manoeuvre for India's central bank. In fact, I expect the RBI to raise rates one more time next month. In the face of high inflation, not doing so would put further pressure on the rupee since it would discourage savers in the face of falling savings rate.

Unless inflation moderates, which it eventually would - likely from next financial year - tight monetary policy is important to prevent the rupee from rapid depreciation, though at current levels the rupee does seem to be overvalued given that actual inflation is higher than what [WPI](#) suggests, apart from falling levels of productivity.

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Views are those of the author*