

<http://blogs.wsj.com/indiarealtime/2012/12/14/inflation-what-lies-beneath/>

The Wall Street Journal

**INDIA REALTIME**  
The daily pulse of the world's largest democracy

December 14, 2012, 5:25 PM

## Inflation: What Lies Beneath

By Kunal Kumar Kundu



*Associated Press*

*The steep fall in the price of manufactured products is reflective of a severe slowdown in the Indian economy, with demand contraction taking a toll on manufacturing activity, says Kunal Kumar Kundu. Shown, a manufacturing unit in Haryana, Dec. 12.*

India released the November wholesale price index, its main inflation barometer, Friday.

The data might appear to be very encouraging as the official gauge of inflation eased to an annual rate of 7.24%, below market expectations and down from 7.45% in October. This number is the lowest since January.

However, there's a catch here. The November number is the first estimate and, in all probability, the number will be revised upward if history is any guide. Inflation numbers are revised with a two-month lag. The sub-8% September inflation rate (the first estimate of was 7.81%) has been bumped up to 8.07%.

What's worrying is that inflation remains outside the Reserve Bank of India's comfort zone despite being based in a high base effect from the previous year.

In fact, India has never experienced such a period of sustained high inflation – an indication that inflation in India is more structural than cyclical. The average annual inflation rate for the past three years is as high as 8.90% (which will likely go even higher once the October and the November data undergoes revisions.)

Not surprisingly, during a recent panel discussion in the Indira Gandhi Institute for Development Research, the RBI's governor, D. Subbarao, hinted that the RBI might be ready to rethink its inflation target of between 4% and 5%, a rate that seems far-fetched at this point in time.

Going by the first estimate Friday, food inflation has picked up again, reaching 8.5% compared with November 2011. Food grain continues to be the biggest contributor to food inflation, accounting for more than half of it. This is despite the changing pattern of consumption for an average Indian. Although high- protein items like egg, meat and fish now account for an increasing share of consumer spending, food-grain prices are still rising at a fast pace because for two reasons.

First, drought-like conditions are having a negative impact on food-grain production. Second, there has been aggressive food-grain procurement by the government as it looks to implement the food security bill.

Lower production and higher procurement has led to shortages in the market, thereby allowing black marketers a relatively free hand, which drives up prices.

On a positive note, core inflation (as measured by inflation in manufactured products less manufactured-food inflation) has been falling and, at an annual rate of 4.5%, is at its lowest since March 2010.

While this is likely to provide some comfort to the RBI, the steep fall in the price of manufactured products is reflective of a severe slowdown in the Indian economy, with demand contraction taking a toll on manufacturing activity.

Core inflation may, however, have bottomed out as the impact of a rise in the price of diesel starts to feed into the data. Also, retail inflation (as measured by the Consumer Price Index) has moved up in November to 9.9%, thereby clearly indicating that price pressures continue to mount.

Also, given the propensity of wholesale inflation numbers to be revised upward with unerring regularity, the central bank would probably like to wait for a few more data points to be certain that inflation is easing before making its first rate cut move.

I stick to my expectation of a 0.50 percentage point cut in interest rates only during the first quarter of 2013.



Kunal Kumar Kundu is senior economist at RGE India, based in New Delhi. The views expressed are his own.