Quickonomics

July 31, 2020

Food swings

Since the lockdown, wholesale and retail food prices seem to have snapped a connection, giving the central bank much to chew on ahead of its August policy meet.

Quick bites

- Divergence in wholesale and consumer price indices (WPI and CPI) for food implies: end consumers face high food prices but its benefits are not percolating to producers
- The divergence varies across food categories – wholesale prices of non-perishables such as cereals and pulses did not collapse, but those of perishables such as vegetables and eggs did
- Given food has ~40% weight in the CPI, high retail food inflation leaves a large footprint on the headline inflation which the central bank targets – but it also has to address the larger predicament of growth

What's the dichotomy about?

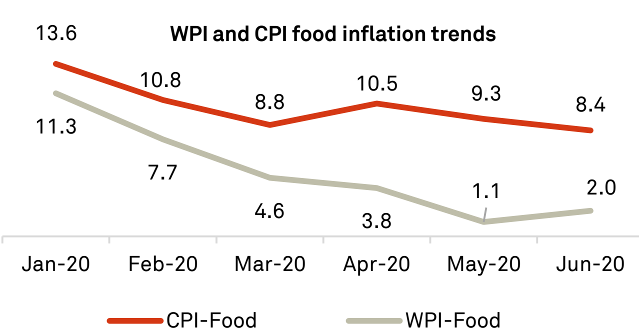
Among the myriad things the Covid-19 pandemic-led lockdown decoupled, the food inflation graph of the Indian economy was one.

In the first three months of this calendar year, both CPI and WPI food inflation were merrily travelling along a synchronous downward trajectory.

Then bam! came the pandemic and nationwide lockdown in March 2020. The WPI and CPI food inflation parted ways. The former softened from 4.6% in March to 3.8% in April – the first full month of lockdown. On the contrary, the latter firmed up from 8.8% to 10.5%. The gap between the two further widened in May.

Unlock 1.0, initiated from June, narrowed it a bit. But a wide margin persists.

Chalk and cheese



Source: National Statistical Office (NSO), Office of Economic Advisor, Government of India

What gives? One reason for the rise in retail food prices could be the supply disruptions and hindrance to movement of food items from mandis to retail markets due to lack of local transportation. It is also plausible that retailers cashed in on the situation, milking their customers.

On the other side, wholesale markets - facing temporary closures and labour shortages – were barely able to function, forcing farmers in distress sales, as farmers, who had loaded their trucks and driven to the mandis, had little choice but to sell at the available price[1].

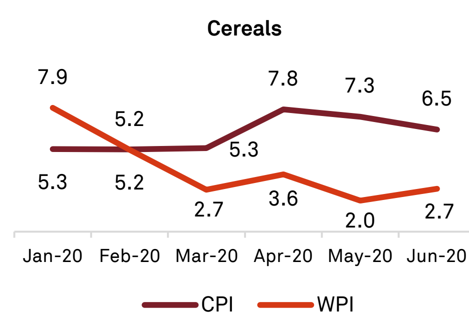
So while the end-consumer continued to pay high prices, it did not benefit the farmer, and WPI food inflation continued to fall (WPI being a good proxy for what the farmer gets).

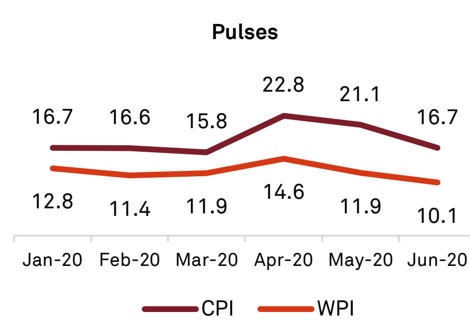
But the divergence is not uniform across items…

This has to do not only with the supply-demand dynamics of the commodity group, but also their inherent characteristics, and possibly, that people have started eating differently on account of the pandemic.

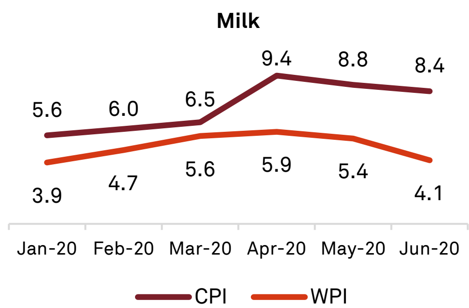
Recent WPI and CPI inflation trends across six different food categories – bunched under two broader groups - reveal some interesting heterogeneities.

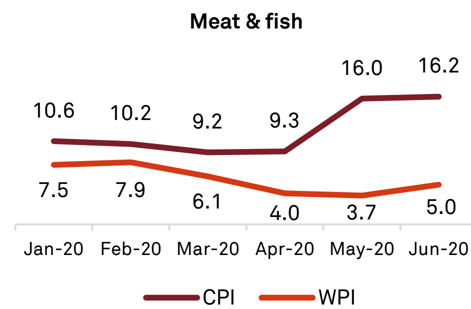
The non-perishables and the essentials inflation



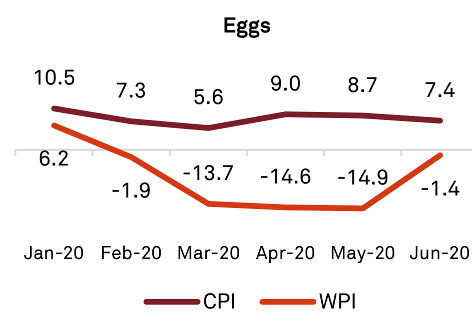


[1] *True more for horticulture products than cereals*





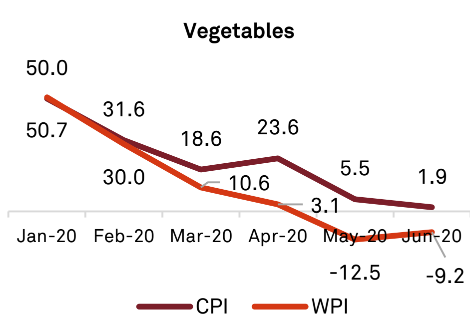
Source: NSO, Office of Economic Advisor, CRISIL



Source: NSO, Office of Economic Advisor, CRISIL

- **Cereals and pulses:** While overall WPI inflation fell in April, it actually rose for cereals and pulses. Perhaps, something to do with the fact that these are non-perishable commodities and that mandi arrivals reduced when the lockdown began. Pulses inflation was running higher because of short supply even before the lockdown. CPI inflation spiked in April on the back of panic buying. But pressure on prices have since eased somewhat on account of expectation of bumper food grain production this year
- **Milk:** Milk is an essential household consumption item. CPI milk inflation rose because of supply disruption amid robust household demand. WPI inflation, on the other hand, has trended down as milk production has increased compared with last fiscal on account of better water and fodder availability. Also, the fact that excess produce can be converted into skimmed milk powder (SMP) means that the supply at the producer end remains unaffected.

The perishables and non-essentials inflation



Source: NSO, Office of Economic Advisor, CRISIL

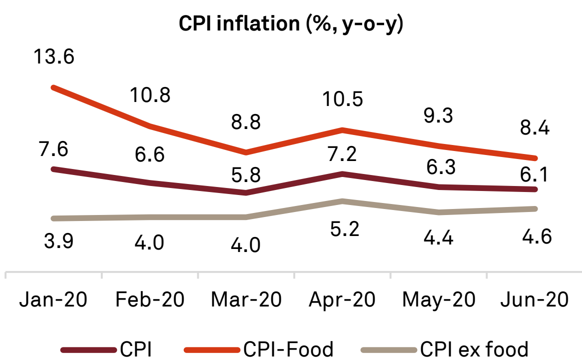
- **Vegetables:** To be sure, their perishability renders their prices vulnerable, but a large part of the drop in WPI vegetable inflation is also attributed to a sharp correction from unusually high onion prices last fiscal. Tomato prices too plunged through this April and May. The duo represent roughly one-quarter of the vegetable group. That said, many other vegetables too saw prices fall during the lockdown. Retail vegetable inflation, after initially rising in April, has since softened as supply chains have improved.
- **Eggs:** Initial fears that eggs may carry the coronavirus led to a sharp decline in demand, reflected in double digit decline in its WPI inflation in March through April and May. A bottoming out and rise since June suggests this misconception might have got cleared. But the lack of supply to the retail markets, likely due to disruption in transportation and/or manpower, kept CPI inflation up.
- **Meat and fish:** This is one category where CPI inflation continues to trend up, even after the easing of lockdown since June. CPI inflation has not only shot up the most vis-à-vis other categories, it is at an all-time high. This is even as WPI inflation for this category fell in April and has subsequently remained soft. The highly perishable nature of this category and supply shortage could ex-

plain this. The WPI break-up of this category[2] suggests that wholesale prices of two key meat constituents (mutton and beef) surged during the lockdown months of April and May. This could partly explain the rise in retail inflation of the overall meat and fish category.

How does this feed into the next course of monetary policy action?

The decline in WPI food inflation is not good for farmers' incomes. And rising CPI food inflation erodes consumer purchasing power and harms headline CPI inflation, given its high weight[3] in CPI. This becomes a cause of concern for our inflation targeting[4] central bank. Bad enough, CPI inflation ex-food is still ~4% (see chart below).

High food inflation has bloated headline inflation



Source: NSO, CRISIL

But given the pandemic-induced slack in the economy, the central bank may still need to reduce interest rates further[5]. While the CPI food inflation, and thereby, headline CPI inflation have softened somewhat in the past two months, the latter still remains above the 2-6% target band. Recent news suggest some vegetable prices, chiefly that of tomato and potatoes have again flared up. Surprisingly, rural food inflation has already been higher than urban since March. Now, rising Covid-19 cases in rural areas could lead to supply disruptions there as well, in turn, further pushing up retail inflation.

To boot, all this is happening at a time when core inflation too has firmed up. The rise in core, though, is not due to demand pressures but other idiosyncrasies such as rise in gold, and transport and communication prices. Rise in petrol and diesel inflation also has second round effects on transportation cost for goods.

Yet, all things considered, we believe that growth concerns would still outweigh those on inflation and expect the Reserve Bank of India to cut repo rate by 25 basis points in its August policy.

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[2]It is not available for the CPI category
[3]Food and food & beverages have 39.1% and 45.9% weight in CPI respectively; In WPI, weight of food is 15.3%
[4]Current medium term inflation target is 4% with a +/- 2% band around it
[5]Starting March 2020, MPC has already cut repo rate by 115 bps so far

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