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How to read high food prices

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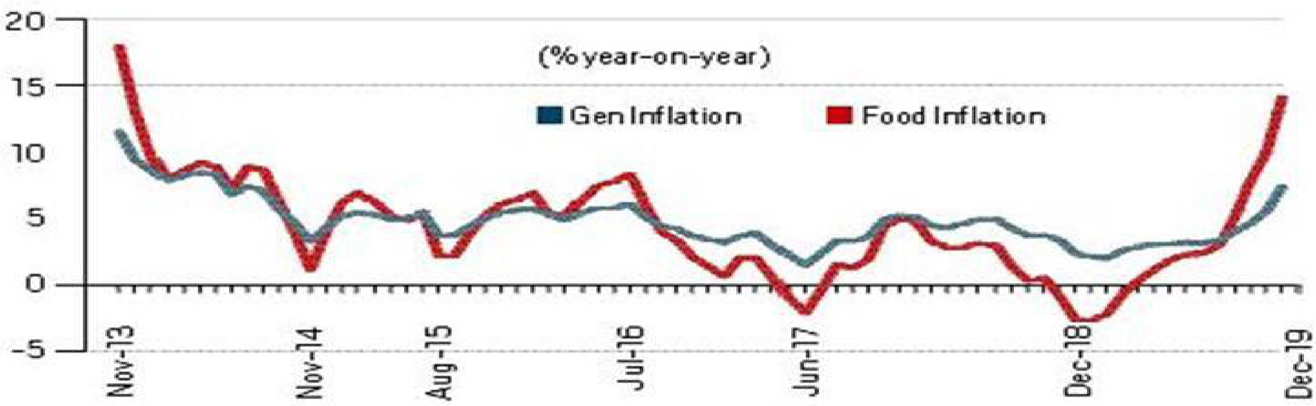
"Retail food inflation for December has touched a more than six-year high. When are prices likely to fall? And what could prevent that from happening? What steps can the government take?"

On Monday, the National Statistical Office released data that showed annual consumer price index (CPI) inflation for December at 7.35%, which was the highest since the 7.39% of July 2014, and also more than the Reserve Bank of India's (RBI) upper target limit of 6%.

But the real shocker was retail food inflation, which soared to a more than six-year high of 14.12%. Given that food items have a 45.86% weight in the overall CPI, this raises the question whether the current surge is merely transitory, or there are other factors that may come in the way of prices falling in the near future.

CONSUMER PRICE INFLATION: GENERAL VS FOOD



HOW GLOBAL FOOD PRICES HAVE MOVED

COMMODITY	UNIT	CURRENT	YEAR AGO	% CHANGE
Soyabean	US$/bushel	942.25	903.5	4.29
Corn	US$/bushel	389.5	378.5	2.91
Wheat	US$/bushel	562.25	514.25	9.33
Cocoa	US$/MT	2,583	2,341	10.34
Coffee	Cents/pound	114.55	102.75	11.48
Raw sugar	Cents/pound	14.16	12.75	11.06
Skimmed milk powder	US$/MT	3,026	2,201	37.48
Crude palm oil	US$/MT	760.73	517.63	46.96
Rice	US$/MT	450	410	9.76

How serious is the spike in food inflation? Is it more than what was expected?

The sudden and sharp increase in the consumer food price index (CPFI) inflation has caught everyone by surprise. For an extended period from September 2016 to August 2019, the year-on-year CPFI inflation consistently remained below the overall CPI inflation. But CPFI inflation went up from 2.99% in August to 5.11% in September to 7.88% in October, then to 10.01% in November and 14.12% in December. This last figure was the highest since the 17.89% for November 2013. The extent of both the earlier decline and now the rise, is much more pronounced in the case of food than general consumer inflation (see chart).

So what accounts for this sudden spike?

The main reason seems to be the uneven rains. The southwest monsoon season (June-September) this year brought little rain almost until the last week of July. The late onset of the monsoon resulted in lower and delayed sowing of the kharif crop. However, September, October, and even the first half of November saw heavy rain, which caused damage to the standing crop that was in the late maturity stage, or due for harvesting. The production disruptions during kharif, ironically from more and not less rain, are the main reason for prices rising, especially from September onward.

Is this then temporary and once-for-all?

The same heavy and unseasonal rain that wreaked havoc on the kharif (monsoon) crop has helped recharge groundwater aquifers, and filled the major irrigation reservoirs to near full capacity. This is proving beneficial to the rabi (winter-spring) crop. Government data show farmers have sown 8% more area during the current rabi season. That, together with vastly improved soil moisture conditions and a normal winter, should hopefully translate into a bumper harvest, offsetting any kharif losses.

An illustrative example could be onions. The Agriculture Ministry has estimated the total production in 2019-20 for kharif/late-kharif at 54.73 lakh tonnes (lt), which is nearly 22% below the corresponding level of 69.91 lt last year. However, transplanting during the rabi season — which accounts for over two-thirds of India's onion production — has been about 19.5% more than in 2018-19 due to a combination of better water availability and higher prices received by farmers. This crop will start hitting the market towards March-end, which should go some way in easing prices.

The same would apply to many other vegetables, which incidentally have reported the highest year-on-year CPI inflation of 60.5% for December.

Will prices of all foods fall similarly in the next couple of months?

The likelihood is more for vegetables, which are mostly seasonal and short-duration crops. Farmers generally respond to the high prices in one season by expanding production in the following one. The situation could, however, be trickier in crops where supply cannot be ramped up in the immediate run. The best example here is milk, where farmers experienced low price realisations for much of 2015 to 2018.

Many of them gradually reduced herd sizes or diverted more fodder and feed to animals yielding milk. The undernourished calves have grown to be less productive milkers, just as the pregnant females that have undergone delayed calvings. Better prices now — dairies in Maharashtra are now procuring cow milk at Rs 31-32 per litre, compared to Rs 21-22 a year ago — may make farmers invest in more animals and also feed them better. But the results will take time to show. It is not unlikely that the prices of milk will go up further in the next few months, particularly in the "lean" summer months, when production by buffaloes and cows falls in the natural course.

Is there anything else that could keep food prices high even after March?

The thing to watch is global prices. The 2000s were a decade of high agri-commodity prices. Between 2003 and 2011, the world food price index (base year: 2002-04 = 100) of the UN's Food and Agriculture Organisation (FAO) soared from an annual average of 97.7 to 229.9. It then crashed to 161.5 by 2016. That major reason for benign food prices, including in India, has started showing signs of reversal. The FAO's benchmark index in 2019 was 12.5% higher than in the previous year. This is also reflected in a hardening trend in the international prices of individual food commodities (see table).

What can the government do?

Food inflation is not bad news for farmers who have suffered from low crop prices and the end of the global commodity boom after 2014. A price recovery would give a boost to rural incomes, which is beneficial for consumption and overall economic growth in the current circumstances. But neither the government nor the RBI can afford to ignore food inflation that will hurt consumers and make further cuts in interest rate impossible.

There is pressure now to open up — or allow more imports of — commodities such as pulses, milk powder, and edible oils. The government will ultimately have to take a considered decision that balances the interests of both producers and consumers.

Expected Questions (Prelims Exams)

1. Consider the following statements:

1. Industrial Production Index is released by Central Statistics Office.
2 Mostly wholesale price index is used as an inflation indicator in India.
3. The Consumer Price Index is released on a quarterly basis.

Which of the above statements is/are correct?

(a) 1 and 2 (b) 1 and 3

(c) 2 and 3 (d) 1, 2 and 3

Note: Answer of Prelims Expected Question given on 14 Jan., is 1 (b)

Expected Questions (Mains Exams)

Q. "The high inflation data in the recently released annual consumer price index has depicted a major reason for the weakening of the Indian economy." Analysing the datas in the context of present form of Indian economy discuss the measures that could be taken by the Indian government. **(250 words)**

Note: - The question of the main examination given for practice is designed keeping in mind the upcoming UPSC main examination. Therefore, to get an answer to this question, you can take the help of this source as well as other sources related to this topic.