India's imported food inflation

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This article is related to General Studies-Paper-III (Indian Economy)

Indian Express

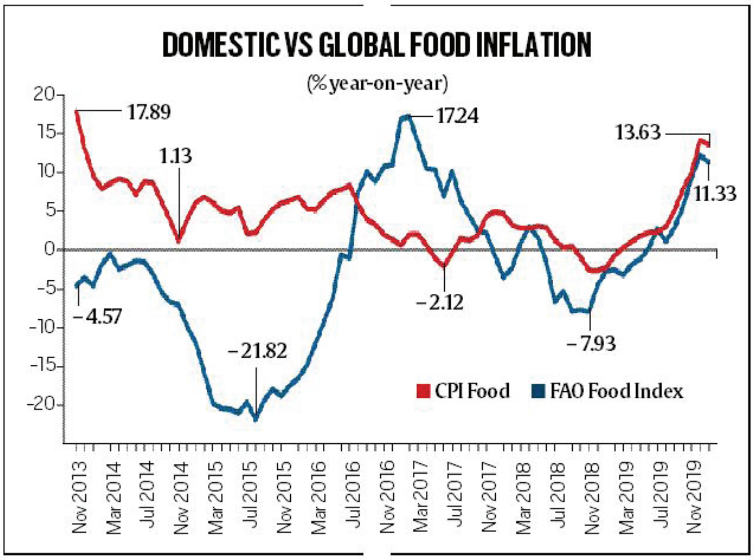
19 Feb., 2020

"After a period of divergence, domestic and global food prices are rising in tandem. Coronavirus, global crude prices, and an expected bumper rabi harvest could determine the scenario in the coming months."

Is food inflation in India influenced by global price movements? On the face of it, that seems to be the case.

The return of food inflation

The United Nations Food and Agriculture Organisation's (FAO's) food price index — which is a measure of the change in international prices of a basket of major food commodities with reference to a base period (2002-04 = 100) — touched 182.5 points in January 2020, the highest since the 185.8 level of December 2014.



Also, the year-on-year inflation rate based on this index has risen steadily from 1.13% in August 2019 to 2.86% in September, 5.58% in October, 9.33% in November, 12.22% in December, and now, 11.33% for January 2020.

This sharp surge in global food prices is reflected in trends in India as well. Annual consumer food price index (CFPI) inflation stood at just 2.99% in August 2019, before climbing to 5.11%, 7.89%, 10.01%, 14.19% and 13.63% in the succeeding five months.

The year-on-year inflation in the wholesale price index for "food articles" began rising somewhat earlier — reaching 7.8% in August 2019 from 2.41% in January last year. Subsequently, it increased to 9.8% in October, 11.08% in November, 13.24% in December, and 11.51% in January 2020.

Retail and wholesale food inflation rates for December 2019 were the highest since November 2013 and December 2013 respectively. Simply put, since October or so, food inflation has made a comeback, both in India and globally.

Local and 'foreign' factors

While the recent rise in domestic food prices has been blamed largely on "local" factors — poor rainfall during the first half (June-July) of the monsoon season and too much of it thereafter till about mid-November, leading to both reduced/delayed kharif sowings and damage to the standing crop at maturity/harvesting stage — some of it is also "imported".

According to the Department of Consumer Affairs, retail prices of packed palm and soyabean oil in Delhi rose from Rs 79 and Rs 100 per kg on January 31, 2019 to Rs 108 and Rs 122 respectively on January 31, 2020. This increase of 22%-37% was almost matched by the 34.37% rise in the FAO's global vegetable oil price index between January 2019 and January 2020. Since India imports two-thirds of its edible oil requirement, higher international prices would have been automatically transmitted to the domestic market.

On the other hand, the increase in the retail prices of onion in Delhi from Rs 22 per kg on January 31, 2019 to Rs 50 on January 31, 2020, was purely due to the failure of the domestic kharif crop. While global prices can be transmitted to the domestic market too through exports — traders would sell abroad if realisations are better relative to the local market — the government has foreclosed that possibility by banning/restricting onion shipments since September 2019.

The period of divergence

The chart above shows that the domestic CFPI and FAO food price index inflation rates started moving in tandem only from around March 2018, while exhibiting significant divergence in the period prior to that.

The FAO index peaked at 240.1 in February 2011, but remained at 200-plus levels until July 2014. Global prices crashed after that, and stayed low up to early 2016, with the FAO index dipping to 149.3 in February 2016. Domestic food inflation, too, eased from 17.89% in November 2013 to fall below 7% by early 2016, as lower global commodity prices reduced the demand for Indian farm exports, even as they made imports cheaper.

However, the actual fall in domestic inflation — to the sub-5% range — took place after September 2016. And that, in turn, had more to do with domestic factors, especially demonetisation, than global prices — between August 2016 and October 2017, the FAO index inflation, in fact, exceeded the corresponding CPFI rate.

Now, when both international and domestic food prices are showing signs of renewed hardening, the question is: How sustainable is this trend? There are at least three bearish factors currently at play.

The first is, of course, the novel coronavirus epidemic that has reduced Chinese buying of everything from palm oil and soyabean to milk powder and meat. Palm oil prices in Malaysia have plunged from 2,922 ringgit ($719) to 2,725 ringgit ($658) over the last one month.

The second is crude oil. Brent crude prices had touched $70 per barrel after the January 3 United States airstrike that killed Iran's top military commander, but have dropped since, closing at $57.67/barrel on Tuesday.

The third is the prospect of a bumper rabi (winter-spring) crop in India. The kharif harvest turned out to be not so good because of excess and unseasonal rain. That same rain, though, has helped boost rabi acreage by 9.5% compared to last year. The arrival of this crop in the mandis from March should cool down prices, especially of vegetables and pulses, which showed the highest year-on-year retail inflation of 50.19% and 16.71% in January.

Against these bearish factors are the relatively "bullish" factors.

Global palm oil ending stocks this year are projected to be the lowest since 2009-10, while sugar is also expected to move significantly into deficit. Supply tightness is being seen both globally and in India, even in milk. Like Malaysian palm oil prices, which rose from an average of 2,037 ringgit to 3,014 ringgit between January 2019 and January 2020, skimmed milk powder rates at New Zealand's global dairy trade auctions had also moved up from $2,201 to $3,036 per tonne during this period — before the novel coronavirus struck.

It would be interesting to see what happens once the virus has run its course. If Brent crude too, were to rally again — making it attractive for sugarcane and corn to be diverted for ethanol production and also palm oil towards biodiesel — there could be uncertainty ahead.

Expected Questions (Prelims Exams)

Q. Consider the following statements:

1. Low prices of global commodities have reduced the demand for Indian agricultural exports.

2. India imports two-thirds of the edible oil requirement.

3. Global prices can be transmitted to the domestic market through exports.

Which of the above statements are correct?

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

(c) 2 and 3 (d) All of the above

Note: Answer of Prelims Expected Question given on 18 Feb., is 1 (c)

Expected Questions (Mains Exams)

What does imported inflation mean? How does this affect the development and consumption patterns of the economy? Discuss. (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.