The Curious Case of Inflation Combat

RBI is being forced to treat a malaise over which it has limited control

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In the last 15 months or so, the Reserve Bank of India (RBI) has relentlessly pursued the goal of inflation control as the number appears to be quite intransigent despite all the positive developments in agriculture. The results have not been encouraging so far and the impact has been limited.

How do we tackle inflation then? The answer could actually be staring in front of us that we have not taken into account. To understand more, let us look at the composition of inflation in terms of what are the sectors that influence inflation. Broadly speaking, primary products have a weight of 20%, fuel products 15% and manufactured goods 65%. Inflation has been relatively high in all the sectors by the pre-2009 standards and each of them is guided by a different government body that has influence over prices.

Let us look at primary products. Here the ministry of agriculture (MoA) has maintained that FY11 has been one of the best for agriculture. Yet prices have been rising and all the assurances of good monsoon, robust kharif and an ecstatic rabi harvest has not helped bring down prices. This is partly due to the fact that the ministry has been instrumental in increasing the minimum support prices (MSP) of all farm products. In the last 2 years, it has been increased by between 10% and 30%, which means that there is an inherent tendency for prices to go up as market benchmarks are increased. Last week, the MSPs were raised once again by the Cabinet Committee on Economic Affairs (CCEA) across pulses, cereals, oilseeds and fibres. This means that there is an inherent upward bias in the market even though the government physically only deals in procurement of wheat and rice. By counter-intuitive reasoning, it may be concluded that MSPs have driven inflation since the government maintains that the high MSPs have helped to shift crop patterns and increase output. Here we are not passing a value judgement on whether it is justified or not.

Now let us look at the fuel prices that are increasing by around 13%. Higher crude oil prices make state-run oil marketing companies unviable and there is this constant call to align petro-product prices with those in the market (including by economists). The ministry of petroleum (MoP) decides on the pricing policy. Motor spirit prices directly feed into inflation with a weight of around 1%, while diesel comes with a direct weight of close to 5% and an indirect influence of 0.75-1% on prices. Although it makes economic sense to increase prices, it also adds to inflation.

Then there is the ministry of finance (MoF), which has its opinion on the subsidy bill on food and oil. To ensure that the Fiscal Responsibility and Budget Management (FRBM) targets are adhered to, it is reluctant to increase its expenditure and hence deficit, and is exerting pressure on the MoP to increase fuel prices. Curiously, the government can enhance its expenditure without the fear of being caught in the RBI's web of increasing interest rates as it gets its funds through the regular auctions, which come in at an average rate of around 8.4-8.5%.

The last sector, manufacturing, is the one which generates core inflation (non-food and fuel). If manufactured food products and textiles are excluded (as they are agro-based), then this group accounts for 45% of inflation and core inflation would be only 5% in April 2011. In fact, since April 2010, this entire group has shown an increase of between 5% and 6.5% consistently until April 2011 with limited volatility. This is where RBI policy can work.

But for this to happen we need to answer some questions. First, is consumption supported by bank finance increasing demand of houses (mortgages) or automobiles or consumer durable goods? Is investment by industry growing rapidly? Is industry holding on to large inventories? If the answer is yes, then interest rate hikes will lower demand by increasing cost of credit. But if the answer is a shoulder shrug then we may be barking up the wrong tree by raising rates.

The point that emerges is that we have a situation where different arms of the government are speaking different languages and expecting RBI to tackle inflation. So we have a case of food and fuel prices increasing on which RBI has no control-after all, no one borrows money to eat food. The poor anyway continue to starve as they are not credit worthy. Therefore, RBI may be forced to treat a malaise over which it really has limited control.

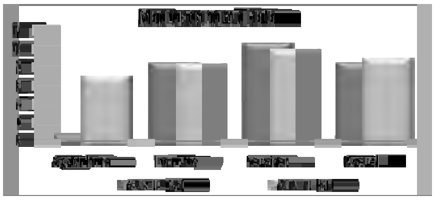
What is the solution? The MoA, CCEA, MoF, MoP and RBI should all sit together and discuss the inflation strategy. Currently we have every authority looking closely at its own jurisdiction and taking decisions to ensure that their houses are clean, while RBI has the tough job of finding solutions to inflation. We certainly must have all these 'arms' talk to each other continuously with a macro eye. This will ensure that we have a singular approach to inflation and eschew this seemingly chaotic situation where RBI is on one side and the others are pulling the strings in the other direction.

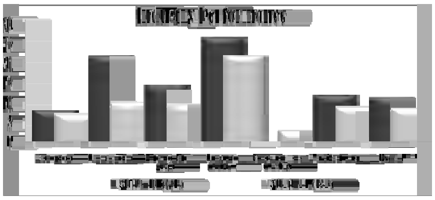
Source: www.financialexpress.com

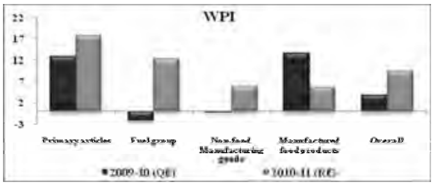
Current Economic Scenario - May 2011

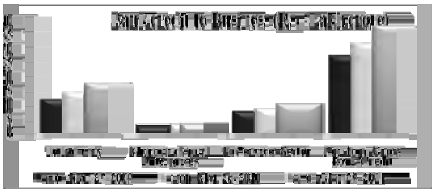
	2009-10 (QE)	2010-11 (RE)	Q1 : 2010-11	Q2 : 2010-11	Q3 : 2010-11	Q4 : 2010-11
I. Macroeconomic		Growth rate (Year on Year) in percent				
Agriculture	0.4	6.6	2.4	5.4	9.9	7.5
Industry	8.0	7.9	10.2	8.4	7.1	6.1
Services	10.1	9.4	10.7	9.9	8.4	8.7
Overall	8.0	8.5	9.3	8.9	8.3	7.8
II. Industry Performance						
Basic goods	7.2	6.3	6.9	4.7	7.7	6.0
Capital goods	20.9	9.3	36.3	21.3	8.5	-8.0
Intermediate goods	13.6	8.8	10.5	10.8	6.8	7.4
Consumer durables	25.5	20.9	27.4	20.1	18.2	19.7
Consumer non-durables	0.4	2.2	2.6	1.5	-2.1	6.5
Manufacturing	11.0	8.1	12.8	9.9	6.0	5.0
Overall	10.5	7.8	12.0	9.1	6.1	5.0
III. Prices (WPI)						
Primary articles	12.7	17.7	20.7	17.7	17.0	15.4
Fuel group	-2.1	12.3	14.0	12.3	10.9	11.9
Non-food Manufacturing goods	-0.3	6.0	5.8	5.2	5.7	6.5
Manufactured food products	13.5	5.6	7.4	5.2	2.1	0.6
Overall	3.8	9.5	10.6	9.3	8.9	8.9
IV. Bank Credit to Business (Rs. 'Lakh Crore)			**as on Mar27, 2009**	**as on Mar26, 2010**	**as on Mar25, 2011**	
To Industry			10.5	13.1	16.2	
Micro and Small Enterprises			1.7	2.1	2.3	
To Services Sector			6.5	7.3	9.0	
Non-food Gross Bank Credit			*26.0*	*30.4*	*36.7*	
V. EXTERNAL (USD Billion)	**2009-10 (PR)**	**2010-11 (P)**	**Q1 : 2010-11 (PR)**	**Q2 : 2010-11 (PR)**	**Q3 : 2010-11 (P)**	**Q4 : 2010-11 (P)**
5.1 Exports (Merchandise)	182.2	N.A	55.3	51.8	66.0	N.A
5.2 Exports (Invisible)	161.2	N.A	43.5	47.1	54.1	N.A
5.3 Imports (Merchandise)	300.6	N.A	88.0	89.6	97.6	N.A
5.4 Imports (Invisible)	82.3	N.A	23.2	26.0	32.2	N.A
5.5 Exports (as % of Imports)	89.7	N.A	88.8	85.6	92.5	N.A

QE: *Quick Estimate;* RE: *Revised;* PR: *Partially Revised;* P: *Provisional*









Key Macroeconomic Developments

- Agriculture and allied sector made a strong growth statement. The revision made to the provisional estimates indicated improved buoyancy.
- Deceleration trend in manufacturing sector continued. Manufacturing output growth slowed down from 12.7 percent in the first quarter to 5.5 percent in the last quarter.
- Production of electricity, gas and water supply sector remained subdued. But, of late, some degree of revival is noticed.
- The momentum lost by the construction sector during the first half of the year has partially been regained in the second half.
- Traditional services have registered falling growth. However, the last quarter figures give raise to some optimism.
- Strategic business services, barring the provisional estimates for the last quarter, mainly riding on the healthy performance of IT and financial services, have recorded good performance.
- Non economic services did not sustain its previous years of growth but, still expanded at a healthy rate.
- By and large, agriculture, strategic business services like finance and IT and government expenditure have helped GDP maintain higher growth rates, while the industry and traditional services have found pulling the growth rate downwards.

Short term Implications and Way forward

- Healthy agriculture growth helps in inflation control via cooling of food prices.
- The demand for consumer goods especially, the FMCG and even durable goods will increase.
- The lack of matching growth in the manufacturing sector would result in build up of core inflation (non-food manufacturing).
- The slower but certain recovery in the developed world and the Japanese economy experiencing inflation after a long time will push the prices of energy and materials up.
- The country needs to strengthen its manufacturing on priority basis as a strategy to address inflationary concerns effectively on one hand and help traditional services to register higher growth and thereby sustain high growth rates.

Source : Assocham Bulletin

Cold Chains

As an emerging market with an economy which is developing at an exuberant and attractive growth rate, India faces a piquant situation in a strategically important sphere of its rapidly developing economy - the slow and poor development of the cold chain supply and logistics system in the country. Cold chains or what in effect is the cold supply chain, has often been scarcely understood or worse, misinterpreted, leading to parlous conditions in the economy which could stymie its growth. A burgeoning economy with global aspirations can hardly afford to be sidetracked by reasons which span the entire gamut from not having understood the cold supply chain system to callous neglect.

Natural Advantages

According to the Federation of Indian Chambers of Commerce and Industry, food wastage reached the incredible figure of `30,000 crore in 2010 (it has declined from the stratospheric level of `58,000 crore in 2004!). This despite the fact that India is the second largest producer of fruits and vegetables in the world, but with cold storage facilities available for only 10 percent of the produce. Industry sources disclose that the country is the fifth largest producer of eggs and the sixth largest producer of fish, but with an abysmal supply chain system, 35 percent of production is consigned with depressing regularity to the trash can. India has certain vital attributes and natural resources - it has 52 percent of the total land that can be cultivated as against 11 percent in the rest of the world and 20 diverse agro-climatic regions in the country. These advantages, if properly harnessed, could equip the country to feed not just its own people, but the rest of the world. A well-defined logistics and cold supply chain system working in tandem could power the country to this enviable position and also immeasurably energize its growth.

"Apart from rejuvenating its own economy, India could be the food basket of the world if we had an efficient cold chain supply system," says Mr Pawanexh Kohli, Founder of CrossTree techno-visors and Senior Vice President, Arshiya International Ltd. "To be the food basket you have to export food to Europe, Dubai, Singapore, the US and maybe, one day, Africa and only the cold chain will allow India to expand its portfolio of food exports."Mr Kohli received the Cold Chain Personality of The Year (individual) award at the KPMG-Supply Chain Leadership Council Summit Awards on December 3, 2010.

Huge Market

Increasingly, the consumption pattern of Indian consumers is changing swiftly with more customers consuming frozen food and vegetables. Malls and food courts across the country, even in Tier-II and Tier-III cities, stock abundant quantities of perishable food to cater to this ever-increasing market. But acute deficiencies in the cold chain supply system have prevented this nascent industry from fulfilling its true potential and growth.

The market for cold chain supply systems is estimated to balloon to US $ 9 billion by 2015 according to Mr Kohli, who apart from being a cold chain specialist, offers innovative advice with a few professional peers on the website www.crosstree.info. Their entrepreneurial vim has cleared many of the misconceptions about the industry which now stands on the threshold of growth. The industry, however, will have to clear the obstacles in its path before it can dream of unfettered growth.

Hard Realities

The cold chain industry's dreams of proliferation have been turfed out by hard realities on ground. Says Mr Abhijit Upadhye, Senior Director-National Supply Chain, McDonald's India: "There's not enough demand for quality cold chains because high costs prevent usage of such facilities. A lot of companies are ready to compromise on such facilities. We are one of the few users of cold chains."

But Mr Kohli cites deeper reasons for the malaise. He believes that the industry has been established "in a very fragmented and unstructured way" by small and medium enterprises (SMEs) and single entrepreneurs in a manner which has not permitted development of skill sets. "The ground work has to be laid out very carefully for any new industry which starts off," argues Mr Kohli. "After all, even with the software industry it took 12-15 years before it reached the stage where an Infosys could happen. So similarly, the cold chain industry which at one level has been around for 25 years, but at another level, where we are talking about a structured cold chain industry with organized sourcing and moving of goods from one place to another, it has happened at a real scale for not more than four or five years. So this has not permitted any development of skill sets."

The complicated nature of the industry has also hampered growth. In any other supply chain when a factory manufactures a product, the supply chain delivers it to the market, with an attractive price realization accruing to the product. The cold supply chain is the only supply chain which not only transports the value of the product, but actually affects the value realization of the product. This is due to the fact that the cold supply chain transports fresh products which have to be delivered in a particular time matrix, else the price declines. Defective supply chain Service Level Agreements (SLAs) and an inability to maintain required parameters force the price to slide further. "Any ordinary person who gets into the business," notes Mr Kohli, discussing the subject with great fervor, "is suddenly affected by debit notes, and penalties because he did not realize the operational excellence that needs to be maintained. While the rest of the supply chain says, 'I'm carrying boxes', in the cold chain you need to understand the product."

Poor Industry Knowledge

A further impediment to the development of cold supply chains has been the government's inability to understand the industry. For the government, the growth of cold chains has been unfortunately linked with the construction of cold stores which are just a component in a complicated supply chain. Industry sources reveal that over the last 20 years the government has indulgently loosened its purse strings for the construction of cold stores. This has led to a proliferation of cold stores, especially in Uttar Pradesh and West Bengal. "Uttar Pradesh and West Bengal have above 50 percent of the cold storage capacity in India," reveals Mr Pradeep Dubey, General Manager, Snowman Frozen Foods Limited," but most of them are just single commodity stores. In UP, where 41 percent of the stores are located, most of them are used for storing only potatoes." The construction of cold stores cannot be arbitrarily equated with the development of the cold supply chain industry. "Look, anyone who sells anything knows that you need to move to the market," remarks Mr Kohli candidly. "In the cold store, if you are going to store things long enough, it's going to perish. And this is how the situation is in the cold chain sector, we have 12 percent of transport and 88 percent of storage when it should be the right opposite! You produce something, please move to the market, reach the consumer and sell it. Don't store it, for God's sake!"

Financial Incentives

The government appears to have read the script well and in the Budget 2011-'12 has attempted to make generous provisions for the cold chain sector. Some of the salient features of the Budget are that full infrastructure status with Viability Gap Funding has been announced for the industry. Customs duty to set up cold storages has been further reduced to 2.5 percent, while excise duty has been exempted on all cold chain equipment. Fifteen more mega food parks will be set up in the country (15 such parks were sanctioned in the last fiscal).

With the financial buffer of the budget, the mood in the industry appears to be reasonably upbeat. Mr Purvin Patel, Chief Operating Officer, Radhakrishna Foodland Pvt. Ltd, emphasizes that "new investments are coming in whether it's in cold chains or movement of goods and products. There will be a good return on investment for the right business model, with the right clients and the right approach." The government is hoovering up its investment in the cold chain sector and according to Mr Kohli (he is a member of the task force set up by the Centre and the Confederation of Indian Industry (CII) in 2006-'07 which is still active) is planning an investment up to Rs 8000 crore in the agri-business which includes the cold chain sector.

The government's largesse, combined with its newfound sense of purpose and understanding of the sector, could mean that cream salad days are here for the cold chain industry in India.

Source : CII Institute of Logistics - Weekly Newsletter, June 15, 2011.