

Finance Minister's Suo-moto Statement on Inflation

Lok Sabha, November 22, 2011

Madam Speaker,

In response to the unanimous resolution of the House on August 4, 2011, I take the floor to make a statement on the inflation situation in India.

2. I must begin by pointing out that, while there has been a steady improvement in the inflation situation in India, there are important tasks ahead to be undertaken to get to the desired outcomes. I intend to elaborate the reasons that have prevented an appreciable drop in the headline inflation over the past two years, especially since August 2011. I would also like to share with this august House the policy framework that we hope will bring down the inflation rate to more acceptable levels in the next 6 to 12 months.

3. WPI Inflation has been high since January 2010. Headline inflation was 10.9 per cent in April 2010 and was showing signs of coming down when it touched 8.2 per cent in November 2010. Unfortunately, it rose again and has remained over 9 per cent from December 2010 with the October 2011 inflation rate being 9.7 per cent. However, food inflation, which was nearly 22 per cent in February 2010 declined to under 8 per cent in June 2011 and was 11.1 per cent in October 2011 and as of November 5, 2011 was 10.6 per cent.

4. Since August 2011, when we last discussed the issue of inflation in the House, overall WPI inflation has been stable. It was 9.8 per cent in August 2011 and 9.7 per cent in September and in October 2011. During this period food inflation first declined from 9.6 per cent in August to 9.2 per cent in September and then rose to 11.1 per cent in October. However, there was appreciable decline in non-food primary inflation from 18.2 per cent in August to 7.7 per cent in October. The inflation in manufactured goods also declined from 7.9 per cent to 7.7 per cent.

5. In these three months, certain food items namely, fruits and vegetables, egg, meat, fish and milk have been the major contributors to food inflation. Along with fuel and power items, which exhibited a rising inflation in October, it has led to the stickiness in headline inflation. Within food items the average inflation in cereals has been 4.7 per cent in the period August to October 2011, with negative inflation in wheat. The inflation in pulses was also negative 4.3 per cent in August and 2.8 per cent in September 2011.

6. Let me also give you an idea of movement in average monthly retail prices in a few selected food items over the last two years. Take the case of Delhi, wheat prices were Rs 15.03 per Kg in January 2010 and the same Rs 15.0 per Kg in Oct 2011, sugar was Rs 44. 2 per Kg in January 2010 declining significantly to Rs 33.3 per Kg in October 2011, Arhar dal was Rs 87.4 per kg in Jan 2010 declining to Rs 73.4 per kg in Oct 2011. Similarly, in Mumbai wheat prices were nearly the same at Rs 21 per Kg in Jan 2010 and in Oct 2011, sugar prices declined from Rs 42.1 per Kg in January 2010 to Rs 32.6 per Kg in Oct 2011 and arhar dal prices declined from Rs 76.8 per kg to Rs 70.5 in Oct 2011. In case of Patna, wheat prices were almost same at Rs 13 per Kg between

January 2010 and October 2011, sugar prices declined from Rs 38.3 per Kg to Rs 31.5 per Kg and arhar from Rs 66.3 per Kg to 54. 6 per kg during this period. In Hyderabad, which is a rice eating area, the rice prices were Rs 19 per Kg in January 2010 and Rs 20.8 in October 2011, suagar prices declined from Rs 36 per Kg to 31.2 per kg and arhar prices declined from Rs 82 per Kg to 63.5 per Kg during this period. Nearly the same picture can be seen for other centres in respect of these items. However, this was not the case with food items like vegetables and fruits as pointed out earlier.

7. Hon'ble Members are aware that inflation is caused by a mismatch of demand and supply, particularly demand overshooting supply. During periods of rapid growth and structural change, as India is currently undergoing, inflation does tend to increase. We have seen this happen in all emerging economies that have gone through such periods of policy changes and of rapid growth ranging from China, South Korea, and Vietnam to Argentina and Brazil.

Global Developments

8. In a globalised world, where the growing Indian economy is dependent on commodity imports in critical areas like fuel oils, edible oils and other primary imports, movements in international prices have a direct bearing on level of domestic inflation and its management. The post-global financial crisis conduct of macroeconomic policy in the developed world has also created problems for inflation management in the developing countries.

9. In a bid to jump-start their economies and cut down unemployment, several countries have expanded liquidity in their

markets. The US Federal Reserve went in for a second round of quantitative easing, as it released 600 billion dollars into the American economy. Similar measures have been undertaken by UK, Japan and some other industrialised nations. In today's globalised world one country's liquidity easily flows into another country. We find that this increased liquidity in the industrialised countries has generated inflationary pressure in virtually all emerging economies and some developing countries. In the past five to six months, inflation has been at over 13 per cent in Pakistan, over 9 per cent in Argentina and Russia, at over 10 per cent in Bangladesh, and over 7 per cent in Brazil. Food inflation in China which is otherwise a low inflation country has increased from a negative 0.5 per cent in January 2010 to 5.2 per cent in January 2011 and is at 7.8 per cent in September 2011.

10. There is another peculiar development in the international markets that has contributed to inflationary trends being sustained over the past 12 months in import-dependent emerging markets. Despite weak prognosis of global growth and trade in the short to medium term, international commodity prices have not softened at the anticipated pace. For example, crude oil was around 75 USD a barrel in January 2010, but on an average continues to be around USD 110 in the current year. Speculative activity in commodity markets and some supply disruptions in fuel oil (Libya) have kept the commodity markets tight.

11. The increased uncertainty in the Euro-zone on account of sovereign debt crisis has led to shifting of capital from Europe to USA which has hardened the US dollar against most currencies. The Indian Rupee which was Rs 44.4 to a dollar in April 2011 has depreciated to Rs 52 as of November 21, 2011. As a result whatever little benefit could

have been derived from the softening of international commodity prices, has been wiped out by the depreciation in Rupee.

12. We have tried to address these concerns in our external sector in the international fora like the G20 and in the IMF. The Reserve Bank of India has been monitoring the foreign exchange markets closely and will take the required action in light of the international developments as the situation unfolds.

Domestic Demand-Supply Imbalances

13. Let me now turn to the domestic demand supply factors that have contributed to the present state of inflation in India. When there is a mismatch between demand and supply, it follows that there are two things to do - improve supply and moderate demand. But it is not always possible to increase supply to desired levels in the short-term. We can resort to imports or ban exports and take measures that will increase supply over time. On the demand side, while in principle it is possible to compress and restrict it through tighter fiscal and monetary policy control, the risk is that if it is done rapidly then growth may decline sharply creating unemployment.

14. Sustained high economic growth in recent past has led to improvements in purchasing power in both rural and urban areas. The 12th Plan Approach Paper says that average real wage rate between 2007 and 2010 has increased by 16 per cent at the all India level. The growth was fastest in Andhra Pradesh, 42 per cent and Odhisa, 33 per cent. Even in States like Bihar and UP the real farm wages went up by 19 and 20 per cent respectively over this period. This has increased demand for certain goods and services, which has translated into

persistent high inflationary pressures for those goods in the economy. The supply response has been inadequate and along with weather induced shortages in the food economy, have resulted in significant challenges for inflation management.

15. A range of administrative, fiscal and monetary measures have been used to address the problem in the term. Among fiscal measures:

- Import duties reduced to zero on rice, wheat, pulses, onion, edible oils (crude), and to 7.5 per cent on refined and hydrogenated oils and vegetable oils;
- Maintained the Central Issue Price (CIP) for rice (at Rs 5.65 per kg for BPL and Rs 3 per kg for AAY) and wheat (at Rs 4.15 per kg for BPL and Rs 2 per kg for AAY) since 2002.
- Duty under Tariff Rate Quota for Skimmed Milk Powder (SMP) reduced from 15% to 5% for import upto an aggregate of 10000 metric tonnes in a financial year. National Dairy Development Board (NDDB) has been allowed to Import of 30,000 tonnes of Milk Powder and 15,000 MT of related products at zero per cent concessional duty for the year 2011-12.

16. In terms of administrative measures, at different points of time, the following steps were taken:

- The export of all varieties of onions was prohibited w.e.f 9th September, 2011. Later the prohibition on export of onions was withdrawn w.e.f 20th September 2011 and export of all varieties of onions is now allowed.
- Import of raw sugar allowed at zero duty under open general licence (OGL).

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- Suspension of Futures trading in Rice, urad and Tur by the Forward Market Commission in the year 2007-08 continues during 2010-11. Futures trading in sugar were suspended wef 27.5.2009 up to 30.9.2010. However the future trading in sugar has since been resumed, with effect from 27.12.2010.
- Banned export of edible oils (except coconut oil and forest based oil) and pulses (except Kabuli chana and organic pulses up to a maximum of 10000 tonnes per year).
- Stock limit orders extended in the case of pulses, paddy, and rice up to 30 September 2011 and edible oil and edible oilseeds up to 31 March 2011.
- Export of milk powders (including skimmed milk powder, whole milk powder, dairy whitener and infant milk food), Casein and Casein products has been prohibited with effect from 18.02.2011.
- An additional adhoc allocation of 50 lakh tonnes of foodgrains made on 16th May, 2011 to all State/UTs for BPL families at BPL issue price for distribution during the current year up to March, 2012.
- An additional adhoc allocation of 25 lakh tonnes of foodgrains made on 6.1.2011 to all States/UTs for APL families @ Rs. 8.45 per kg for wheat and Rs. 11.85 per kg for rice for distribution upto 30.9.2011.
- Scheme for distribution of subsidized imported edible oil through state governments/ UTs with Subsidy of Rs/kg for distribution to ration card holdrrs @ 1 liter per ration card per month.

17. Special Scheme for distribution of subsidised imported pulses as well imported edible oils was initiated to address shortages in the availability of these commodities. The Government also held back the pass through of international prices of fuel oil (diesel, kerosene and LPG) up until June 2011 with a view to mitigate the impact of inflation on the consumers. As of now the under recoveries of PSU Oil Marketing companies for diesel is Rs 10.17 per litre, PDS Kerosene Rs 25.66 per litre and LPG Rs 260.50 per cylinder.

18. Hon'able Members are aware that in the last two Union Budgets we have tried to improve the supply response of agriculture with a view to address the inflation in food items. We have taken steps to better manage our food supply including by extending the green revolution to Eastern region, enhancing production of edible oils, pulses, milk, coarse cereals and vegetable production. There has also been considerable improvement in storage and cold chains. That these measures have had positive impact can be seen from the inflation figures for cereals and pulses over the last two years.

19. On the demand side, in these difficult circumstances, the Reserve Bank of India has tightened liquidity by raising the interest rate. The repo rate has been raised by 350 basis points during this time in a series of small steps from March 2010. It currently stands at 8.5 per cent.

20. The fiscal deficit as a percentage of GDP was 6.4 per cent in 2009-10. In 2010-11 this was brought down to 4.7 per cent. This year we have set ourselves a target of 4.6 per cent. This is a difficult target, given the deterioration in the global economy and its impact on India over the

last 3 to 4 months. We have to be careful not to over-do ourselves in reaching this target since that can have an excessive slowing down impact on growth.

Policy Stance Going Forward

21. A durable solution to inflation in an economy with rising income levels lies in improving agricultural productivity, strengthening food supply chains and augmenting capacities in the manufacturing sector to keep pace with the growth in demand. It requires a facilitative policy environment and, where required, increased public investments, so that these measures can be actively pursued. Both the Central Government and the State Governments have a specific role to play. We at the Centre are addressing the policy lacunas and creating mechanisms to catalyse the required activities, The State Governments also have to do the needful in several areas, particularly so in agricultural extension, public investment in agriculture and in agriculture marketing as it falls under their purview under the Constitutional division of responsibilities. More importantly they have to come forward and take advantage of various initiatives that have been launched by the Central Government.

22. There is an urgent need to amend and enforce the Agriculture Produce Marketing Act to enable farmers to bring their products to retail outlets and also allow retailers to directly purchase from the farmers. This would bring better remuneration to farmers, check wastage and allow competitive prices in retail markets. Collectively, we also need to take steps that allow unhindered flow of food and other perishable items from one region to another.

23. The Government is working to improve the delivery of benefits, including subsidies to the vulnerable sections of the population using the UIDAI platform. We are close to launching a pilot project on new system of LPG distribution based on the recommendations of the Task Force for Direct Transfer of Subsidies on Kerosene, LPG and Fertilizer headed by Shri Nandan Nilekani. This should lead to considerable saving in subsidies and improve targeting.

24. PDS is an important vehicle to address price rise. In fact the moderate inflation in cereals has been facilitated by improved PDS operations in some states. Accelerated PDS reforms are essential and States need to take the necessary initiative as we move towards a food security Act to insulate the poor and vulnerable from the impact of food inflation.

25. Expeditious action is being taken to create storage space for centrally procured foodgrains. As on 30.6.2011, 16.8 million tons (as against 15 million tons decided earlier) of capacity creation has been approved on the basis of storage gap. The total capacity sanctioned so far is 7.37 million tons. It is expected that 4 million tons of additional capacity will become available by the end of this financial year. The next round of sanctions is in progress.

26. Going forward, I am sure the RBI takes into account the important concern of balancing the targets of controlling inflation and keeping up growth and employment generation.

27. In conclusion, let me assure this House that the Government is committed to bring down inflation to more acceptable levels. I hope to

see the March end inflation between 6 to 7 per cent. While we are doing all that we can do to address the issue, I look forward to suggestions from the floor of the House that can help us in addressing this concern.

Thank you
