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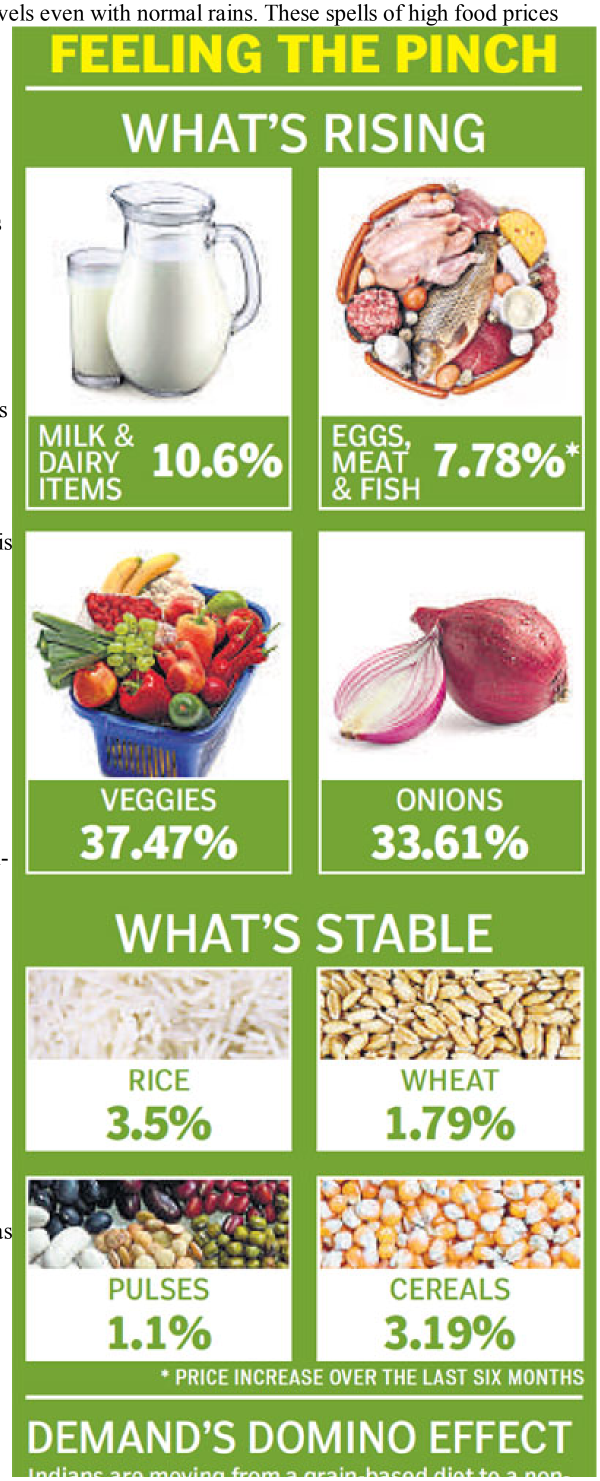
Protein shake up

Plotted on a graph, the inflation worms looked like trails left behind by a missile, as prices spiked between October 2009 and March 2010; April and July 2010; August and November 2010; and then December 2010 onwards.

Rates of primary articles were defying usual trends by not falling back to previous levels even with normal rains. These spells of high food prices hung over Subir Gokarn's head like a riddle.



Gokarn, the Reserve Bank of India's deputy governor and one of India's well-regarded economists, knew something was firing up prices. In northwest Delhi's More Megamart, one of India's largest retail foodstores, homemaker Baharuna Sultana's shopping cart may hold a clue to the puzzle.

As she walked between the aisles of the well-stocked racks, the 30-year-old mother's grocery list is no longer about the staples of a traditional Indian meal, such as okra, brinjal or gourd.

She would stock up on two different types of cheese - one creamy and the other mozzarella. The creamy tube is for spreading on paranthas, the grated mozzarella for pasta toppings. The list also had two different types of milk in it: "full cream" for Sultana's school-going daughter and a skimmed variant for herself, apart from veggies and fruits.

Sunil Kumar, a carpenter, buys vegetables on a daily basis. But once a week, the father of three brings home stuff he seldom had as a boy: chicken, fruits, butter, eggs and paneer, a type of cottage cheese. Even so, Kumar says he has had to cut down his spending on food lately because of high prices.

When Gokarn broke down food inflation data into categories, something stood out. While prices of most other articles were somewhat reversing or at least stabilising, inflation remained entrenched in a clutch of protein-rich items, such as pulses, milk, eggs, fish and meat.

One of the reasons why Indians are paying the highest food prices in a decade has to do with their radically changed diets. As incomes rise on the back of high growth, as Gokarn later found out, demand tends to shift more towards protein-rich items.

The RBI calls this "structural inflation". On Gokarn's desk, the price graph of protein-packed items looked "structurally" different from others.

The 61st round (2004-05) of the National Sample Survey is the most recent reliable data available for how Indians spend on food. Though slightly dated, it provided a basis for Gokarn to analyse the relationship between "household affluence" and "expenditure on various items".

Between 2004-05 and 2009-10, the real per capita income of Indians grew by about 39%, a fact borne out by GDP figures. Essentially, this was an analysis of tipping points. So, Gokarn asked himself a question. What is the threshold level of income (or, in this case, monthly household expenditure) at which the composition of diet changes significantly? This led to a dramatic - though provisional - finding about India's food-price situation. Based on that kind of growth, it turns out there are two inflection points of Indian monthly household expenses: Rs 580-Rs 690 for rural areas and Rs 1,100-1,380 for urban dwellers.

Gokarn's simulation revealed that about 220 million Indians in the past five years alone would have crossed these two thresholds of monthly expenditure at which "diets shift decisively towards higher consumption" of more nutritious food, especially proteins.

But higher demand was never met by adequate supplies from higher farm output,

resulting in what has been the single longest episode of food inflation in recent years (see box, below left).

"At the aggregate level, this analysis presents a dramatic picture of how increasing affluence is impacting spending on protein sources. This pattern is in complete conformity with global historical precedents," Gokarn states.

This is in addition to people who had already crossed that expenditure milestone back in 2004-05. "Imagine the shock this kind of enhanced demand will have on food prices?" asks V.K. Rajan of Comtrade, a Mumbai-based analytical firm.

Indians are moving from a grain-based diet to a non-grain-based one, a fact borne out by several studies, including ones by the flagship National Sample Survey Organisation. Rising income is quietly stoking demand. What started off as food-cost inflation in 2009 soon spread, causing core inflation — or prices of non-food and non-fuel items — to rise. Private demand isn't the only reason for high food prices. India also runs the world's largest food welfare programme, including free school meals, pressuring supplies additionally. Then, the government began tightening its fiscal belt by making oil pricier. All this is showing up in your food bill.

High prices and their jolting effects are now the stuff of even Bollywood ridicule. Aamir Khan's Peepli Live, a recent spoof on television news, clicked with an apt folk-based song Mehangayi Dayan. It personified inflation into a notorious witch chipping away at the resources of ordinary Indians. However, analysts argue income growth cannot just fuel demand for food alone. It will also fan demand for manufactured goods and services. Nonetheless, prices of goods did not surge because industry - flush with capital and installed capacity - was in a position to scale up supplies. Put plainly, industry delivered for a while before succumbing; but farms couldn't cope at all.

"Indians are clearly shifting from grain-based diets to non-grain based foods," according to Upali A. Amarsinghe of the International Water Management Institute, who co-authored a landmark study on changing consumption patterns.

Consumption of meat is rising quickly, according to a Goldman Sachs estimate, and is expected to rise 40% in the near-term. With large-format retail stores, such as More Hypermarket, Indians can now buy all kinds of foods and chilled dairy items. This leaves less liquid milk for consumption.

Although the world's largest milk producer at 112 million tonnes, India's domestic milk demand is growing by six million tonnes every year.

One of the sharpest rises, therefore, has been in milk prices. Nestle, the world's largest food company, expects Indian milk consumption to triple in the coming years, while Mother Dairy, a market leader in branded liquid milk, has upped prices twice this year.

As India's summer-crop season ends, the government's final among four yearly projections shows that output of major crops, including sugar, pulses and cereals, would be better or equal to last year's output. But food prices are unlikely to return to normal levels. Food inflation may have permanently changed to stay on the higher side, economists say.

High is the new normal

"Higher consumption is just one of the reasons. Food inflation has acquired a large permanent component, like higher assured prices offered to farmers by the government and increased production costs, including for labour. Rising fuel costs itself directly impacts food costs," said N.R. Bhanumurthy, an economist with the state-owned National Institute of Public Finance and Policy.

THE FINE PRINT

10.5% Average food inflation in last 18 months

9.6% Average monthly overall inflation

12 Number of years after which India has seen such high prices

12 Number of times interest rates have been hiked since then to control inflation

The RBI's July review cites renewed pressures from an upcoming revision in Minimum Support Prices or MSP for major farm produce, which essentially is like a pay hike for farmers. "Near normal monsoon may not ease pressure on food inflation," it stated.

People are doing everything to cope. Property dealer Arun Lal, proprietor of Balaji Associates in Delhi's Mayur Vihar, says he gets more inquiries for two-bedroom apartments than for larger ones, a reversal of past trends. This suggests many tenants could be giving up larger rented homes for smaller, cheaper ones.

Surging food prices are a political threat. Angry voters can punish politicians. But India looks unlikely to trigger a radical response to arbitrarily bring down prices for fear of sacrificing growth, which fired prices in the first place.

The only overnight solution to such inflation is to offset it with more income. So, Kashif, a rickshawpuller in Delhi's Punjabi Bagh area, charges nearly a dollar Rs 45) for a mere three-km ride, ferrying passengers from a nearby Metro station to their homes in the locality. You can't blame Kashif. He consistently misses his monthly target of Rs 4,000 he needs to send back to his folks in native Bihar. "Nikammi sarkar kuch nahin kar rahi hai (An inept government does nothing about prices)," he says.

How the global food crisis is worsening ours

The world has become increasingly vulnerable to food crises, the UN's food body said in a flagship projection report in March this year. India, like most countries, is importing some of this global vulnerability.

Arguably, India's situation is worse than most other emerging economies, meaning double-digit inflation seems more deeply embedded in the country that in, say, Brazil or South Korea.

TRACKING THE SPIKE

The December 2009 rise that started it all

April 2010: peaked to 11%

April-Nov 2010: Prices stabilise around 8%

Dec. 2010: Inflation picks up again at 9.94%

Sept. 1974: Highest recorded inflation at 33.3%*

(*resulting from the infamous oil shock)

According to the Food and Agriculture Organization report, while world food prices are seen falling after the 2008 spike, they remain elevated, a situation "likely to continue" owing to rising production costs, financial crises, growing demand from biofuels - fuel made from crops - and pressure on supplies from a rapidly-expanding global population.

So, how is the global food crisis worsening ours? India imports major commodities from the global food market, including pulses, edible oil, milk products and, at times, sugar. Costlier imports ensure higher domestic prices. Increased demand for vegetable oil to produce biodiesel in the EU, Argentina and Brazil, where supplies rose 57% in 2010, directly affected cooking oil prices in India, a net importer for years. To meet domestic requirements, India

imports 80% of its crude, the single biggest driver of inflation. Nothing fans prices of other commodities more than the price of oil itself.

Sometimes, India even has had to contract vegetables for import, like onions in December from Pakistan, when bad weather in Maharashtra shaved off 30% output. The import, in turn, made onions costly in Pakistan's domestic markets by 25%. Shortages in one country can roil prices in another. Sugarcane output in Brazil, the world's largest exporter of the sweetener, took a hit in 2009, the same year India's cane crop came under a drought. With little available to import, this resulted in abnormally high domestic prices, which have now stabilised.

The FAO report says that with global food consumption outpacing supply, "prices are projected to increase over the next decade and to continue to be at levels, on average, above those of the past decade". World food output will have to rise 70%, no less, by 2050 as the global population climbs to 9.2 billion from an estimated 6.9 billion in 2010, the FAO estimates. Episodes of high prices are detrimental to food security, and the high uncertainty associated with price volatility affects producer viability and may lead to reduced agricultural investments.

Problems such as climate change are also expected to play a part in leaving countries more vulnerable to shocks. "Since the mid-1980s, the general trend has been towards an increase in the number of countries affected by (food) emergencies," the report said. For instance, the number of Asian countries which faced a food crisis doubled from 5 a year between 1981-2002 to 10 during 2003-2009.

Global weather disruptions have been a key driver affecting global crop prices between June 2010 to April 2011, according to a United States Agriculture Department report. These include rains in Canada and northwest Europe, Russia's wheat export ban, dropping US corn yields due to temperature spike, Australian rains damaging wheat crop, droughts in China, East Africa, Argentina, and in the US's "hot red wheat" belt.

The report states that between early June 2010 and February 2011, prices of food commodities increased sharply, surpassing the 2008 peaks that had spread anxiety among low-income consumers around the world.

Most of the long-term trends in agricultural production and consumption that contributed to the 2002-06 price increases and the 2007-08 price spike also contributed to the recent price surge, including global growth in population and per capita incomes, increasing world per capita consumption of animal products, rising energy prices and growing global biofuel production, depreciation of the U.S. dollar, and slower growth in agricultural productivity. Higher food prices and volatility in commodity markets are here to stay, according to yet another new report by the OECD and the FAO.

The OECD-FAO Agricultural Outlook 2011-2020 says that a good harvest in the coming months should push commodity prices down from the extreme levels seen this year. However, it states that over the coming decade, real prices for cereals could average as much as 20% higher and those for meats as much as 30% higher, compared to 2001-10. These projections are well below the peak price levels experienced in 2007-08 and again this year.

The Outlook, which covers fisheries for the first time, sees global agricultural production growing more slowly over the next decade than in the past 10 years. Farm output is expected to rise by 1.7% annually, compared to the 2.6% growth rate of the past decade. Per-capita food consumption will expand most rapidly in Eastern Europe, Asia and Latin America, where incomes are rising and population growth is slowing. Meat, dairy products, vegetable oils and sugar should experience the highest demand increases, according to the report.

Most Indians reeling under high food prices will agree.

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