

Onions Bring Tears to RBI's Rajan as Prices Surge: India Credit

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By Unni Krishnan and Prabhudatta Mishra

Nov. 19 (Bloomberg) -- Record onion prices and the soaring cost of rice and coriander are frustrating Reserve Bank of India Governor Raghuram Rajan's battle to curb inflation while supporting growth in Asia's third-largest economy.

The wholesale-price index for onions, a staple food for India's 1.24 billion people, has climbed 155 percent this year, hitting an all-time high of 820.5 in September, according to the Ministry of Commerce and Industry. The index, set at 100 in 2004, has almost quadrupled in 12 months. A broader measure for food is up 19 percent in 2013, while spot prices for coriander climbed about 29 percent and basmati rice advanced 40 percent.

The RBI has said that it faces an "unenviable task" of trying to address the slowest economic expansion in a decade while tackling the fastest price gains among the largest emerging markets. Local newspapers have reported scuffles at vegetable markets in eastern India and food inflation is set to dominate state elections being held through Dec. 4. High onion prices were cited for the Bharatiya Janata Party losing a 1998 vote in New Delhi.

“We do not see any scope for rate cuts,” said Leif Eskesen, HSBC Holdings Plc’s chief economist for India and the Association of Southeast Asian Nations. “Underlying inflation pressures are rising. The RBI has to maintain a hawkish stance and stand ready to tighten further, if needed.”

Food articles, including fruits, vegetables, milk and eggs, accounted for 47 percent of the increase in the benchmark inflation gauge, the wholesale price index. The measure rose 7 percent in October from a year earlier, compared with 6.46 percent the month before and exceeding the 6.95 percent median estimate of 40 economists surveyed by Bloomberg.

Currency Impact

Food prices climbed 18.2 percent in October from a year earlier, down from 18.4 percent in September, the Nov. 14 report showed. Fuel and power increased 10.3 percent. So-called core inflation accelerated as a weaker currency impacted manufacturers, according to HSBC.

India’s rupee is the third-worst performing Asian currency versus the U.S. dollar this year, down 12 percent. It climbed 0.3 percent to 62.2475 at 9:52 a.m. in Mumbai today.

Less than half of India’s fields have irrigation, so food prices are beholden to the vagaries of the monsoon. India’s agricultural development has slowed in recent decades and a lack of irrigation and infrastructure exacerbates weather-induced supply shocks, according to the World Bank.

Downward Pressure?

Rajan, who has increased benchmark rates twice in two months, said Nov. 13 that food inflation is "worryingly high" and that the RBI is awaiting the impact of the harvest before deciding its next move. Weak growth, a good harvest after a strong monsoon season and the raising of the benchmark rate to 7.75 percent from 7.25 percent will "provide a disinflationary impetus over time," he said.

That may not be enough to mollify the likes of 48-year-old Mohammad Mohit, whose family lives 1,250 kilometers from New Delhi, where he plies his trade as a plumber. Onions feature prominently in his Muslim diet, he said.

"They're difficult to buy now," said Mohit, who has two children out of 11 still living because he was unable to afford timely medical care for the others. "A few days ago I had a fight with the vendor from whom I have been buying vegetables for last few years after he refused to sell me 250 grams of onion. Why is the government there at all if it can't control price rises?"

People looted vegetables from about 200 vendors in Malda district in West Bengal state, angered by price of potatoes, The Statesman newspaper reported on Nov. 13.

Rain Damage

Prices for onions have already come down in the growing areas of Maharashtra state, India's largest producer, according to C.B. Holkar, a director at the National Agricultural Cooperative Marketing Federation of India Ltd. High prices have encouraged farmers to plant more onions for their late summer crop after heavy rains in September cut production by as much as 50 percent of the usual 850,000 metric-ton output in the state, he said.

Higher food prices eat into consumers' disposable incomes which in turn causes a reduction in household savings and harms bank liquidity, Shubhada Rao, chief economist at Yes Bank Ltd. said in a Nov. 14 interview. National household savings fell from 11.6 percent of gross domestic product in 2007-2008 financial year to 8 percent in 2011-2012, the RBI said in its Financial Stability Report in June.

The monsoon rains will ease some pressure off food prices but fundamental change is going to require agricultural transformation, said Dharmakirti Joshi, chief economist in Mumbai at Crisil Ltd., the Indian unit of Standard & Poor's. The average food inflation is close to 10 percent compared to 5 percent a couple of years back. The volatility is pretty high and we need to bring it down by increasing supplies.

Junk Threat

India's credit rating may be cut to junk next year unless national elections due by May lead to a government capable of

reviving growth, S&P said in a Nov. 7 statement. The yield on the 7.16 percent government notes due May 2023 climbed about 39 basis points this month to 9.02 percent.

The cost of insuring the debt of State Bank of India, a proxy for the sovereign, against default for five years climbed to 332 basis points on Nov. 15, the highest since Sept. 12. That's almost five times the 68 basis points for China and more than the 190 basis points it costs to insure Brazil's debt.

Structural weaknesses and seasonal volatility are being combined and that's why we're seeing gains in double digits, Rao said. The RBI will be closely monitoring food and fuel inflation over the next couple of months when food prices are broadly expected to decrease. If that doesn't happen then the RBI would be forced to raise rates at a faster pace.

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