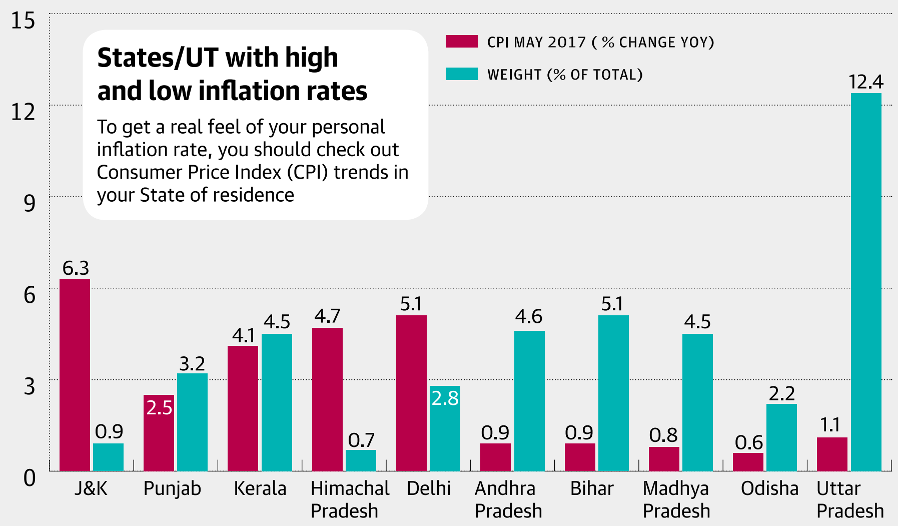
Decoding inflation

Inflation has moderated of late, but for most middle class consumers it is likely to be perceived higher



• One should know the products and services that make up the lion's share of his/her budget to judge the real inflation.

Swing States: Runaway inflation in less populous low-spend States and Union Territories is unlikely to show up as a big swing in the index. But even small blips in the States of Maharashtra (13.1% weight), U.P. (12.4%) and T.N. (7.3%) can swing the headline number

Products vs Services: Because the majority of Indian households belong to lower-income strata, the CPI General Index carries a far higher weight to products than services

Monsoon Impact: Every year, food prices usually soar in the months of April-May as they represent the pre-monsoon months when food crops are in short supply

The CPI basket: Item weights

Food & beverages	45.86
Pan, tobacco & intoxicants	2.38
Clothing & footwear	6.53
Housing	10.07
Fuel & Light	6.84
Health	5.89
Transport	8.59
Recreation	1.68
Education	4.47
Personal care	3.89
Household goods & services	3.8
Total	**100**

• The weights are based on the NSSO's Consumer Expenditure Survey 68th Round

• Both graphs refer to the CPI Combined Index, New Series, 2011-12 Base Year

Source: MOSPI

Why you don't feel the record-low inflation

Your personal experience with price rise may not gel with the official reading as it depends on three main factors

AARATI KRISHNAN

It is not just RBI's forecasters who are likely to be scratching their heads after the release of India's latest retail inflation numbers for May 2017. *Aam aadmi* is quite bewildered too. The data shows that the inflation rate, measured by the Consumer Price Index (Combined – new series) was 2.2% for May 2017, slipping from a 3% reading for April which everyone thought was the rock-bottom. The food component of the index actually deflated by 1.1%.

A CPI inflation rate below 2.5% is a once-in-a-blue-moon occurrence in India. Looking back at the history of the CPI - Industrial Workers (the older avatar of the index which has a longer history), we find that India has registered CPI inflation of less than 2.5% only in 12 months in 20 years.

But if retail inflation is at a stand-still, how come most of us don't feel it? Shouldn't this be boosting our purchasing power and visibly fattening our wallets?

There are three reasons why your personal experience with price rise may not gel with the official reading.

Where you live

If you live in Jammu & Kashmir, Puducherry or Sikkim, the inflation rates in your household budget may bear no resemblance to the headline inflation number.

This is because the All-India CPI Combined is compiled by collecting town and village-level data on the prices of goods and services across States and then aggregating them.

Now, all States and Union Territories do not get equal weighting in the total. The weights are decided by the consumption expenditure within each State relative to the all-India consumption basket. While the State of Maharashtra gets a 13.2% weight in the all-India CPI (Combined), J&K weighs in with just 0.94%, Puducherry with 0.17% and Sikkim with 0.05%.

In effect, price trends at Maharashtra carry nearly 260 times the influence that Sikkim carries in deciding the final CPI number. Runaway inflation in India's less populous low-spend States and Union Territories is unlikely to show up in the form of a big swing in the overall index. But even small blips in the States of Maharashtra (13.1% weight), UP (12.4%) and Tamil Nadu (7.3%) can swing the headline number.

This is why, in May 2017, CPI inflation at J&K (6.3%), Delhi (5.1%) and Himachal Pradesh (4.7%) ruled at many times the all-India reading of 2.2%.

Consumption basket

Does 45.8% of your monthly household budget go towards food and groceries? Would house rent makeup just 10.1%? Do you fritter away 2.4% on 'tobacco and intoxicants'? If not, the inflation in your household is likely to be very different from the official inflation rate.

In order to arrive at a CPI General Index that is representative of both India and Bharat, the statistics office assigns different weights to the different products and services. These weights are derived from the actual spending patterns of rural and urban households as captured by the NSSO's ground-level survey of expenditure patterns across India. The latest such survey was the 68th round conducted over 2011-12. (See graphic).

> **If we focus on three-year trends, we find that price levels have gone up steadily**

Because the majority of Indian households belong to lower-income strata, the CPI General Index thus carries a far higher weight to products than services.

Services often witness higher price rise than products in the Indian context. But in practise, more affluent households will tend to spend a far lower proportion of their income on food and essentials and make a higher allocation to non-essentials and services.

One-offs

The official CPI print captures the point-to-point change in the index in the latest month, compared to the same month last year. This makes the number susceptible to distortions from one-off factors both in the base month and in the current one.

The CPI inflation rate for May 2017 has, for instance, been suppressed by the base effect. As we know, a bountiful monsoon this year has led to a bumper production of pulses, oilseeds and horticultural crops. This has triggered a rout in agri-commodities ranging from tur and urad dal to potatoes, onions and tomatoes, prompting farmers to protest. Agri-market watchers also add that the note ban and GST impact on the agri-supply chain have led to poor offtake and offloading of stock, thus adding to this downward spiral.

But a fall in retail food prices at this time of the year is quite a one-off situation. Every year, food prices usually soar in the months of April-May as they represent the pre-monsoon months when food crops are in short supply. In May last year, for instance, two consecutive poor monsoon years had fuelled a sharp flare-up in the prices of pulses, oilseeds, vegetables and spices. In May 2016, therefore the item-wise breakdown of CPI showed the prices of pulses up 33% (year-on-year), vegetables higher by 10% and spices rising 9%.

But in May 2017, the respective CPI index for vegetables was down by 13%, that for pulses had plunged 15% and fruits and oils were up by just 1-2% compared to the same time last year.

If we ignore the monthly numbers and focus on three-year trends instead, we find that price levels have continued to creep up steadily. Between May 2014 and now, the CPI Combined has risen at an annual 4.5%.

Food prices in this span have climbed 4.1%. In the preceding three-year span from 2011 to 2014, the CPI Combined had soared 9.6% and the CPI Food Index 10.9%.

In short, yes, inflation has moderated of late, but for most middle class folk, it is likely to be higher than 2.2%. To get a real feel of your personal inflation rate, you should check out CPI trends in your State of residence, and in the products and services that make up the lion's share of your budget.

GUEST COLUMN

Success, the 'ZED' way

RANA KAPOOR

The 'Make in India' initiative unveiled by Prime Minister Narendra Modi in 2014, provided the much-needed boost to the languishing manufacturing sector and also an overarching framework for long pending structural reforms. Supply side interventions including FDI reforms, ease of doing business, scaling up physical infrastructure and competitive federalism are all being addressed under this initiative.

While the 'Make in India' program has been incessantly analysed by economic commentators, the relatively less talked about the initiative is the effort to align with "zero defect, zero effect" (ZED). The ZED focus of the program is not only the most arduous to achieve but also most durable in its impact on overall competitiveness.

A survey conducted by Statista-Dalia Research in 52 countries showed that 'Made in Germany' products were perceived as the best among 49 countries analysed followed by Switzerland and EU reflecting the inherent strength of their manufacturing engines. Interestingly, China was ranked last (49th) in terms of quality perception. India only fared marginally better at 42nd position.

Silver lining

Nonetheless the silver lining for India is that no other Asian country is listed in the rankings, presenting an opportunity. Despite the two-decade lead taken by China in unleashing its manufacturing prowess, it continues to be at the bottom in the battle for perceived quality.

Enhancing the quality quotient of 'Made in India' is a huge challenge as well as an opportunity for India's manufacturing push. The Global Manufacturing Competitiveness Index published by Deloitte Touche and the Council on Global Competitiveness indicated the rise of the "Mighty Five"–Malaysia, India, Thailand, Indonesia and Vietnam. Indian manufacturing stakeholders should be acutely aware of the following in this regard.

First, Chinese factory wages have trebled over the past decade and are almost at par with eastern Eurozone countries. Low-cost production jobs are now moving to countries in South/South-East Asia. India could potentially be one of the countries to benefit from this realignment.

> **"Zero defect, zero effect" program is most arduous to achieve but also most durable**

Second, about 131.29 million people are employed in as many as 58.5 million establishments in our country, according to the sixth economic census, 2016 reflecting the ultra fragmentation of our manufacturing base. The baby steps taken by some States in labour reforms need to be scaled up to remove the hurdles for micro units in achieving the scale of operations. Only reasonable sized enterprises shall have the economies of scale to compete globally.

Finally, while low-cost manufacturing is important for India, a comprehensive policy on value-addition to transform the economy is needed. Existing competitive edge in sectors like textilesneeds to be supplemented with focused strategies under the ZED philosophy (certification, productivity, technological depth, energy efficiency and IPR).

While Government's immediate concern is job creation , it has to be kept in mind that unless India starts competing on quality and technology, healthy moats around manufacturing can't be created. The initiatives under ZED Model, National Productivity Council and QCI need to be amplified multi-fold for achieving quality consciousness at the MSME level.

(The author is MD & CEO, YES Bank)

EXPLAINER

Nitty-gritty of bankruptcy code

SANJAY VIJAYAKUMAR
CHENNAI

Last week, Reserve Bank of India said its internal advisory committee (IAC) had identified 12 accounts, which account for 25% of non-performing assets of the Indian banking system for immediate resolution under the Insolvency and Bankruptcy Code (IBC).

The gross bad debt in the banking system as on March was ₹7.11 lakh crore, which means the 12 accounts contribute to about ₹1.78 lakh crore.

What does bankruptcy mean?

■ A company is bankrupt if it is unable to repay debts to its creditors (banks, suppliers etc). The inability to repay debts by some of the Indian firms has resulted in a huge pile of non-performing assets for the banking system. A mechanism to free up the money stuck as bad loans is one of the key for the banking system. IBC is seen as one such.

Which are the most stressed sectors having a problem of non-performing assets?

■ While the names of the 12 accounts which have been referred have not been made public officially, the RBI had earlier hinted that stress was coming from sectors such as power, telecom, steel, textiles and aviation. Union Finance Minister Arun Jaitley later said the number of highly stressed accounts would be about 40-50.

How the RBI came into the picture of referring accounts for resolution under IBC?

■ The government had recently amended the RBI Act, which gave powers to the central bank to direct banks to take punitive action against individual accounts under IBC.

How does the process work under IBC?

■ To being with any creditor including banks can start bankruptcy proceedings against defaulters by filing a petition with the National Company Law Tribunal.

After that, an insolvency professional with significant powers is appointed to take control of the defaulting company and assist the process.

A creditors committee is formed to represent the interest of lenders and any other party that have been affected due to the default by the company.

The committee should come up with a resolution plan (which may include selling off defaulted loans or liquidate the company outright). The resolution would require a nod from 75% of the creditors on the committee.

The insolvency professional gets 180 days to come up with a feasible solution on the default issue. The timeline can be extended by another 90 days. If no solution is found within 270 days, a liquidator is appointed. The company can also opt for voluntary liquidation by a special resolution in a general meeting.

Does IBC resolve the bad assets crisis of the banks?

■ Only time will tell. The proceedings under IBC are at a nascent and untested stage in India.

INTERVIEW | DINESH KUMAR SARRAF

'I kick-started ₹1 lakh crore of stalled projects'

We are spending public money and we have to generate returns for stakeholders. This was the biggest challenge'

PIYUSH PANDEY

Dinesh Kumar Sarraf, *chairman of the $33-billion energy major ONGC, will retire in the next couple of months. In this interview, he talks about his stint at the helm of ONGC. Edited excerpts:*

How satisfied are you with your term as the chairman of ONGC that comes to an end in August?

■ I am very satisfied. A lot of things were done in the last 3 years or so. I kick-started a majority of incomplete and stranded projects. Also, significant discoveries were made during my term. The development plan for cluster 2 of KG block 98/2 at a cost of $5 billion is quite significant. That field alone will produce 27% of ONGC's gas and 17% of crude oil. Such developments don't come every year. We have made up our mind to go for the development of cluster 3 in some time. Believe me, this is going to be much bigger. We expedited production and kept the development cost under control. The production of oil and gas were falling each year, and we arrested the fall in oil and gas production. And now, the production is rising. I kick-started more than ₹1 lakh crore of stranded projects during my term.

What were the major challenges faced by you?

■ Market conditions are a major challenge. The crude oil was trading at $120 per barrel when I took over as chairman, and within a year, it fell below $50 a barrel. Further, the prices touched its low of $28 a barrel in January 2016. When crude oil prices are $28 a barrel, how do you take a capex (capital expenditure) decision of $5 billion? It is not a matter of joke. What we are spending is public money, and we have to generate returns for the stakeholders. This was the biggest challenge. Despite all these challenges, we took the investment decision in most adverse time.

Does it make commercial sense to invest $5 billion when oil and gas prices are so low?

■ Yes. I believe this is the right time because prices of oil field services are low, new contractors are available and best of the technologies are available. All these have helped. The challenge is that the contractors are failing. This means that while there is a silver line, there is black line too. We need to evolve a strategy to deal with this.

Why are the contractors failing? What strategy are you talking about?

Some of the business partners in project execution have failed and left us midway. The financial position of one of the contractors became bad and they went into liquidation. They were handling three major projects, including the Daman project. This forced us to think how to evaluate the business partners and keep an eye on the financial status of our business partners.

Any regrets about things you wanted to do but couldn't do within your term?

■ I wanted to do the cluster 3 development within my tenure. Significant work has been done on that front, and I will ensure that there is no looking back. ONGC is a vibrant organisation. Many things are happening at any given point of time.

Many past chairmen also wanted to complete cluster 3 during their term.

■ Many people tried. Cluster approach for development of discoveries started seven years back. I have the satisfaction that cluster 2 has been done. And, cluster 1 field development plan (FDP) will be made for whatever gas is remaining as it is in dispute for migration of gas to Reliance since 2013.

■ The GSPC deal is a game-changer, and it would bring much expertise to ONGC especially in HP-HT (High Pressure-HighTemperature) production that ONGC was not able to do so. We will pay them $1.2 billion - $1 billion for the Deendayal block and remaining $200 million for other discoveries. $1.2 billion is just a fraction of the cost that they incurred to develop the block, infrastructure and platform. We will use this platform for Deendayal as well as KG basin and other discoveries nearby. We will integrate the development to produce from other fields as well. Some of the gas from our cluster 2 can be produced from GSPC's platform. So, it can be also used as back up. All this benefits will accrue in due course.

> **GSPC deal is a game-changer as it brings expertise to ONGC in HP-HT production**

If GSPC can't develop the block after $2 billion of investments, how can ONGC?

■ We have to do it the right way. They have lots of experience on HP-HT discoveries, and it will come to ONGC. All the decision were taken by the ONGC board and committee after deliberations of 8-9 hours.

We have bought it at quite a reasonable price as we have paid them less then the cost of facilities that they have created. Not just money, but you have to look at it from time value of money concept.

Going by your time value of money concept, similar investments in Russian fields have given you profitability of Rs 700 crore. GSPC investment will, however, take 10 years to give results.

■ Each investment is of different nature. If I invest in exploration, it will give me return in 10 years but if I invest in producing field, it will start giving returns from next month itself.

Are you looking at monetizing the downstream assets as they near completion?

■ We had initiated many joint ventures such as Opal, OTPL, Dahez SEZ, Mangalore SEZ and Mangalore-Bangalore pipeline. All these projects were completed in 2016-17. Monetisation has already started in some of the projects. OTPL has given a dividend of 7.5%, and it is the first stand-alone gas based power plant in India to give dividend. We are looking at all options, and what is required to be done will be done in today's context.

Is ONGC making profits in selling gas at $2.48 per mmBtu? The price of gas used to be $2.5 per mmBtu 10 years ago.

■ There is no point in finding about the losses. What is required to be done is to find a solution and implement the solution. If you talk of crude oil, the price of crude oil today used to be the same 10 years back also. These are all cyclical, and the biggest challenge of oil industry. If oil firms can't withstand this, they will not exist. Having said that, crude oil prices are deregulated, and we float or sink with market.

Gas prices are artificially fixed. We have been requesting the government to remove the benchmark and allow the prices to be fixed by demand and supply. But the government has its own concern for city gas distribution, power and fertilizer consumers.

What is the update on the mega merger of PSU oil firms to create a oil behemoth? What role is ONGC playing?

■ I would not like to speak much as this is a price-sensitive issue. Whatever role we can play, we have informed that role to the government. The government had asked us to give our views and we have given ours. Now it is up to the government to decide what is to be done.