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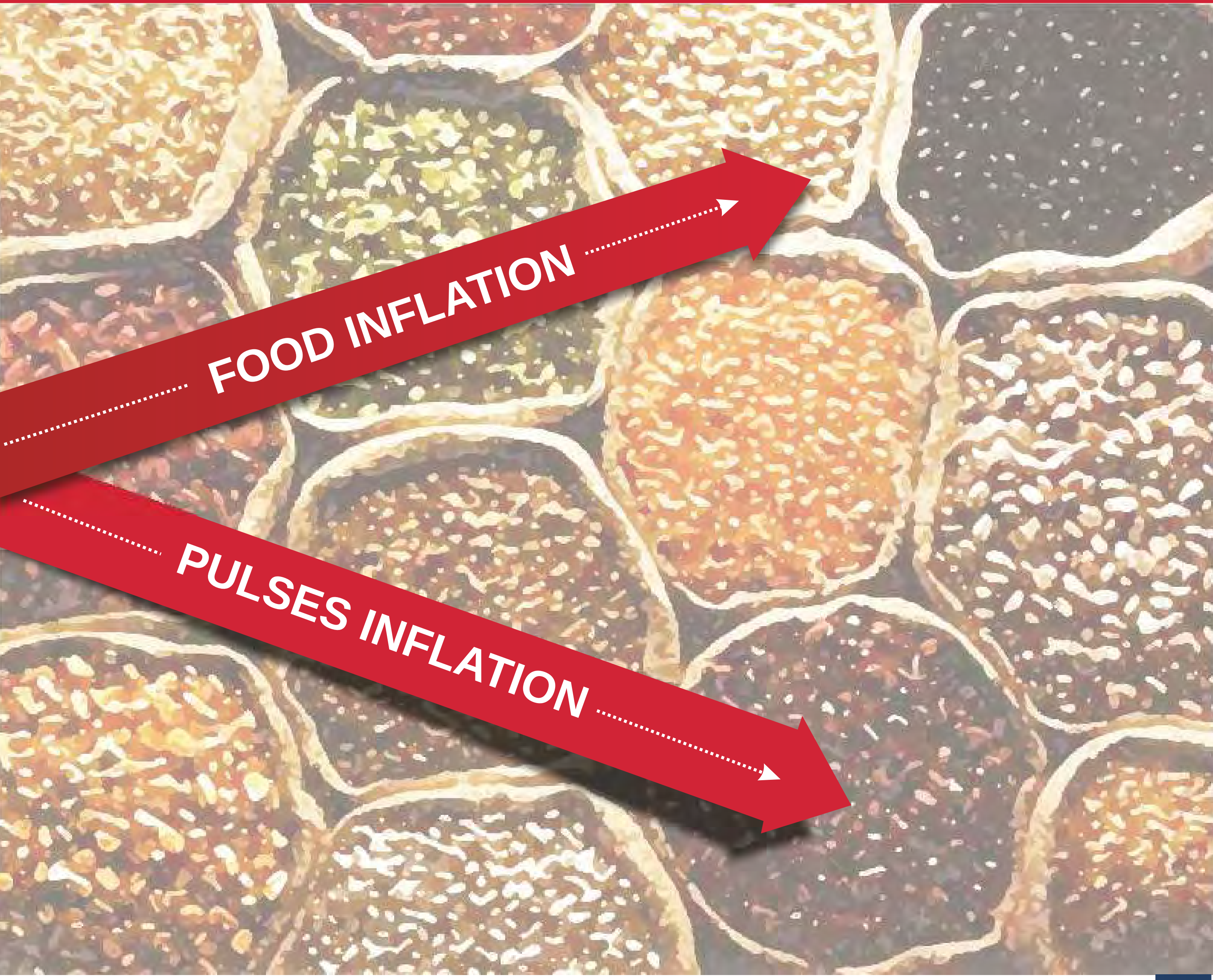
CRISIL Insight



A good turn: Prices of pulses to be subdued in the short term

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A good turn: Prices of pulses to be subdued in the short term

Key messages

- Inflation in pulses has fallen sharply to -4.8 per cent during April-October 2013, down steeply from 23.0 per cent in the same period a year ago.
- At a time when food inflation is high and rising, declining prices of pulses render huge benefit to Indian households where pulses form a dominant source of protein in the diet.
- Prices of the commodity are expected to look up somewhat in coming months as the base effect wears off. All the same, pulses inflation is likely to stay low over the next few months thanks to good monsoons, higher acreage, lower hikes in minimum support prices and moderate demand.
- Beyond that low inflation in pulses will depend on demand revival and whether farmers continue to increase production despite low returns on the crop due to declining prices.

Food inflation in India has been on a steady uptrend this fiscal, rising to 18.2 per cent in October. Surging prices of rice, fruits & vegetables and animal protein (eggs/meat/fish) have been the primary drivers of inflation. While overall food inflation has averaged 13.3 per cent during April-October, inflation in these three commodity categories alone is at 15.1 per cent. With a weight of 79 per cent in primary food, they have contributed 84 per cent to food inflation in the fiscal so far.

But contrary to perception, not all food items have seen a spike in prices. Pulses, for one, have actually seen a decline. In sugar, too, prices have fallen 6.9 per cent in October compared with the previous peak of 18.4 per cent seen in September 2012. Edible oils prices are lower at 0.7 per cent in October compared with around 10 per cent inflation a year ago.

As measured by the wholesale price index, pulses prices fell 4.8 per cent in the first seven months of this fiscal.

What gives?

Increases in acreage, a marked improvement in yields and lower reliance on imports have kept a leash on pulses prices. Slowing income growth and a likely moderation in demand for pulses have helped, too.

So much so, though some increase is expected in coming months as the commodity corrects from the current bout of deflation, good monsoons, lower hikes in minimum support prices and moderate demand could well keep pulses inflation low over the next few months, too.

To be sure, several other food categories have also begun to witness a decline in inflation rates. And this demands attention.

For instance, cereal inflation has declined to 12 per cent in October after hovering around 17-19 per cent a few months ago.

But the sustained decline in the prices of protein items offers greater relief, given that India is the world's largest producer, consumer and importer of pulses, which are also a primary source of protein for vegetarians.

Overall protein inflation (which includes, meat, eggs, fish, milk and pulses) has fallen steeply to an average 7.3 per cent this fiscal, compared with an average 11 per cent in the past two years.

But the decline in pulses has been sharper. Prices of pulses, which fell 11.2 per cent on-year in October, have shed an average 12 per cent in the last four months. In contrast, inflation in pulses stayed in the 11-35 per cent range for the larger part of 2012-13 and has been falling since August 2012, when it flirted with the 35 per cent mark.

Pulses inflation is highly cyclical and moves from deflation to high inflation *(see Figure 1)*.

It will however, rise in the coming months. But a better supply position due to good monsoons, higher acreage, lower hikes in minimum support prices and moderate demand will limit the rise over the next few months. Beyond that, the trajectory will depend on demand revival and on whether farmers continue to increase production despite low returns on the crop due to declining prices.

Figure 1: Deflation in pulses is at a record low of 12 per cent in the past 4 months

Source: Ministry of Commerce and Industry

At a time when food inflation is high and rising, declining prices of pulses afford huge benefit to Indian households where pulses form a dominant source of protein in the diet.

According to a study[1] based on the National Family Health Survey 2005-06, consumption of pulses in India is at a much higher frequency than other sources of protein. About 89 per cent of the population consumes pulses at least once a week, while only 35 per cent consume animal protein.

Consumption spending on pulses has seen a huge lift in the past few years.

The National Sample Survey Office (NSSO) data suggest that household spending on pulses has risen almost 12 per cent per year between 2004-05 and 2011-12. Over this period, inflation in pulses rose to 9.6 per cent from 1.1 per cent between 2001-02 and 2004-05. In 2012-13, pulses inflation again touched a high of nearly 20 per cent.

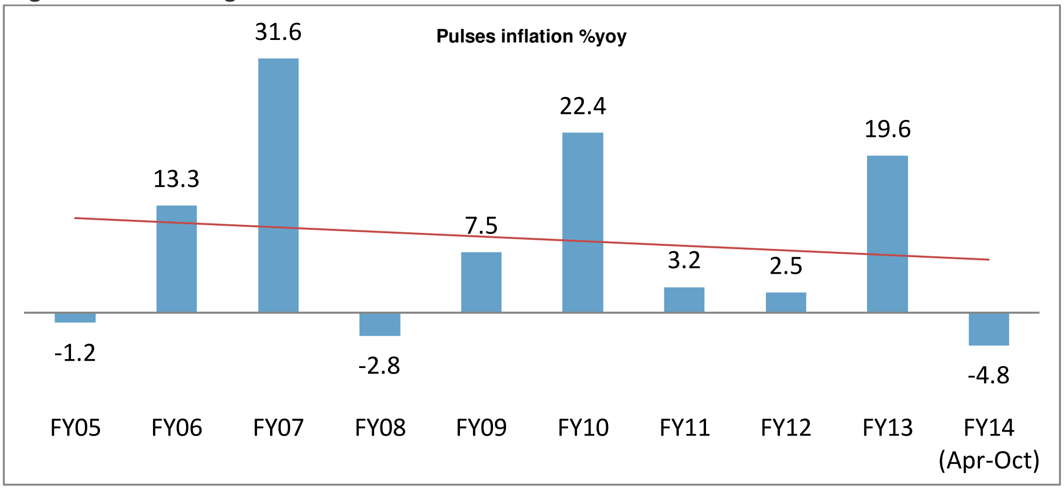
[1] IIPS and ORC Macro. 2007. National Family Health Survey (NFHS-3), 2005-06: India. Mumbai, India: International Institute for Population Science

But while per person spending on pulses doubled between 2004-05 and 2009-10, the net availability of pulses remained stagnant. This means in real terms, consumption is likely to have seen very little pick-up.

Moderate downtrend in pulses inflation

Despite bouts of highs and lows, pulses inflation has been easing over time. Also, each successive peak in annual pulses inflation is lower than the previous one.

Figure 2: Trending south over time



Source: Ministry of Commerce, CSO, CRISIL Research

Why had pulses prices run up so high?

Inflation in pulses started accelerating in 2005-06. Both supply and demand side factors have been responsible for structurally raising the price level.

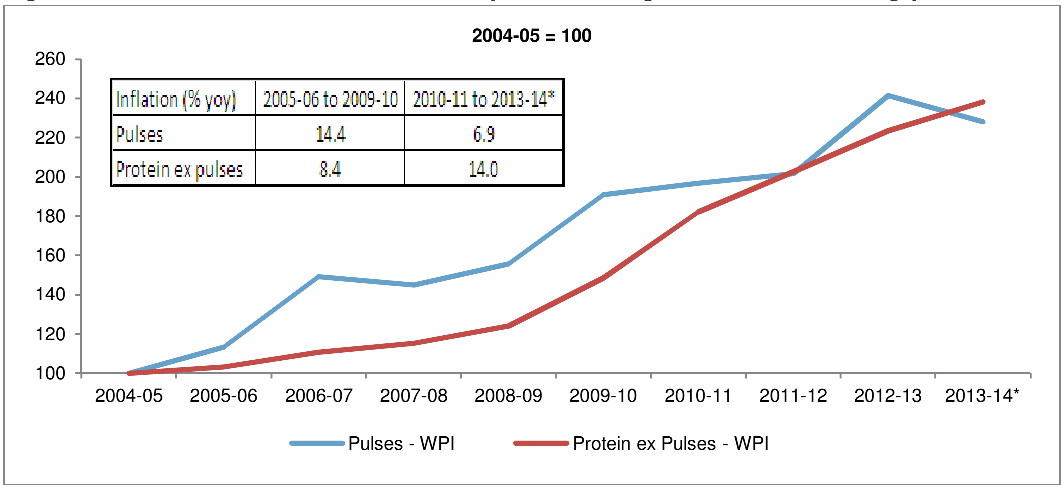
Supply constraints arose from lower production, while the demand push came from a shift in the food consumption pattern – from mainly cereals/staples to more protein-based items (including pulses).

This happened as rapid economic growth during the high growth phase of 2003-04 to 2007-08 led to a sharp rise in incomes and greater affluence. The second big push to pulses demand came when rural incomes spurred in response to implementation of rural welfare schemes since 2008-09.

Between 2004-05 and 2009-10, as demand steadily rose, supply of pulses continued to lag far behind. Years of stagnant acreage (22-23 million hectares) and low yield (around 500 to 570 kgs per hectare) led to low and stagnant production (13 to 15 million tonnes). Despite higher spending on pulses, per capita availability of pulses stood around 13 kg/year between 2004-05 and 2009-10. All this, in addition to the sharp increase in MSPs, structurally pushed up pulses inflation. Per capita availability of pulses, however, increased to 14.4 kg/year in 2011-12; pulses inflation in that year fell to 2.5 per cent.

The rise in pulses inflation draws a parallel with overall protein inflation (pulses, milk, eggs, meat and fish) which also gained pace during these years. As incomes rose, so did the demand for protein. Inflation in this category as a result sped as supply failed to catch up. Moreover, unlike pulses, which display pronounced cyclical behaviour, inflation in the rest of the protein category exhibits a steady uptrend. Over time, however, inflation in the two categories has traded places.

Figure 3: Inflation in Pulses and other protein categories – now trading places



Note:*Protein ex pulses includes milk/eggs/meat and fish, **Data for 2013-14 is for April to October 2013, Pulses includes arhar, moong, gram, masur and urad

Source: Ministry of Commerce and Industry, CRISIL Research

What a difference supply can make

2010-11 was a game changer. Pulses inflation started falling in 2010-11 when prices fell for 10 consecutive months on the back of a bumper crop. Production in that year jumped to 18 million MT from 14.7 million MT in the previous year as area under acreage increased by 3 million hectares. For 2010-11 and 2011-12, pulses inflation averaged at a low 2.9 per cent. In 2012-13, however, some damage to the crop due to delayed and uneven pattern of southwest monsoons put pressure on prices. Prices have been on a steady downtrend thereafter. During this period, though the increase in acreage helped raise production, the bigger push to production came from a steep improvement in yields. Rise in yields was led by the following factors: (i) High MSP in pulses which incentivised farmers to shift acreage towards pulses production, (ii) The National Food Security Mission-Pulses (implemented in 14 pulses producing states covering about 98 per cent pulses area in the country) aimed at increasing pulses production by 2 million hectares by 2011-12. Under the programme, the government not only promoted improved technology and crop advisories, but also distributed critical nutrient inputs free of cost and provided seeds and extended nutrient management at subsidised prices to the farmers. Yield in pulses has risen from 570 kg/hectare in 2009-10 to 650 kg/hectare in 2012-13.

The declining trend in pulses inflation – is it here to stay?

The recent decline in pulses inflation suggests that the underlying trends are akin to 2010-11 when inflation fell sharply in response to higher production. With prices already declining, a well-distributed and abundant monsoon will keep the trough prolonged. First estimates suggest an increase in production this year as well.

A seasonally adjusted three-month moving average indicates some pick-up in pulses inflation in the past two months. Even if prices see uptick in the months ahead, overall pulses inflation in the near future is unlikely to surge into double-digit growth as seen in the past. In fact, inflation will most likely remain significantly low in the next 12 months as the rabi crop – which forms over 60 per cent of total pulses production in India – enters the market.

Broadly, four factors support our view on a downtrend in pulses inflation over the next few months:

1. Good monsoon and an increase in production

For 2013-14, pulses inflation is likely to be lower due to expectations of a bumper crop. Already, first estimates of kharif pulses *(as per Ministry of Agriculture)* and estimates of rabi *(as per a statement by Indian Pulses and Grain Association)* place the output at around 20 million tonnes, which is 7 per cent higher than last year.

The good monsoons this year will also help sustain low levels of inflation in coming quarters. Most of the kharif pulses are rain-fed. With monsoons being good, both spatially and temporally, a healthy output will support lower prices.

As of 30th September 2013, cumulative rainfall for all India was 6 per cent above normal. The top 5 producing states – Madhya Pradesh, Maharashtra, Uttar Pradesh, Rajasthan and Andhra Pradesh, which account for 75 per cent of the total production – have received rainfall of about 20 per cent above normal.

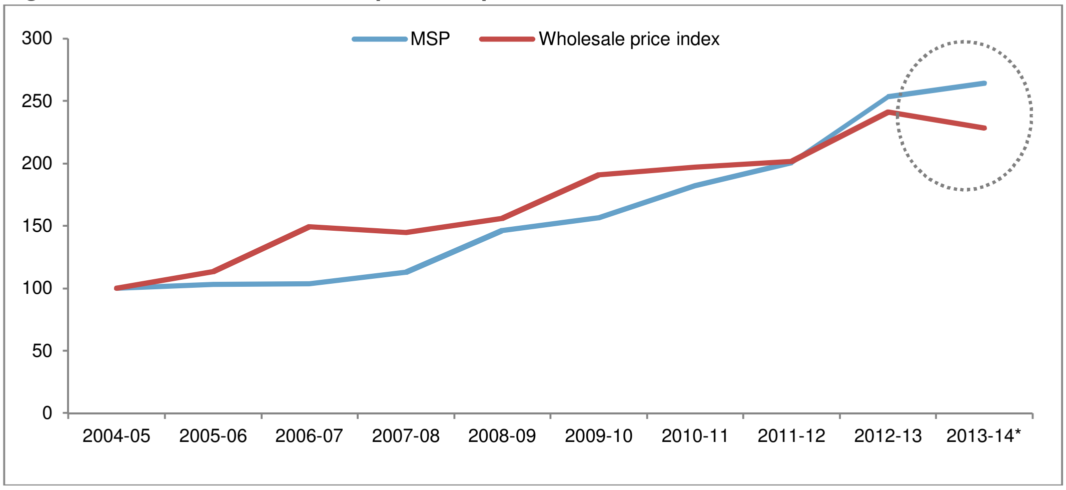
While good monsoons helped the kharif output, healthy reservoir levels bode well for the rabi output as well. At the end of the southwest monsoon season, reservoir levels across the country were almost 86 per cent of the total capacity and 18 per cent above the average of the last 10 years.

High MSPs over the past few years and abundant monsoons have incentivised production of pulses, which is reflected in the increase in pulses acreage.

2. Lower increase in MSP

Lower increase in pulses support prices is also likely to have kept inflation low this year. 2013-14 saw the least increase in pulses MSP in the past 6 years. In 2013-14, MSPs were hiked around 5 per cent, while in 2012-13, MSP hikes across pulses were in the range of 20 to 33 per cent. In the 3 years ending 2012-13, average increase in MSP was around 18 per cent

Figure 3: MSP and wholesale price of pulses



Source: Ministry of Commerce and Industry, Ministry of Agriculture, CRISIL Research

3. Slowing income and slowing demand

As incomes rose, protein consumption demand (including that for pulses) shot up. There was a huge boost to spending in the last 7 years when pulses consumption growth was high in both rural and urban areas.

In rural areas, spending on pulses grew almost 14.4 per cent per year between 2004-05 and 2009-10, which declined to 6.5 per cent per year by 2011-12. During this entire period, rural wages in particular grew at an average 8 per cent in nominal terms. However, recent data indicate a deceleration in rural wage growth, which could have some impact on consumption. Similarly, in urban areas, too, spending rose almost 15.8 per cent per year between 2004-05 and 2009-10, but fell to 2.4 per cent per year by 2011-12, possibly in line with slowing incomes. About 81 per cent of the total urban consumers are employed in the manufacturing and services sectors and have been impacted by the slowdown in these sectors.

Over the last two years, domestic consumption of pulses has stagnated at around 20 million tonne. The gap between domestic supply and demand is met by imports. India has been importing about 3-4 million tonne of pulses in the past few years. Higher domestic production could also lead to lower import of pulses if the demand remains weak. In 2012-13, while domestic production increased by 1.4 million tonne, imports rose only marginally. This indicates that increasing domestic production is able to cater to a large part of the demand, which possibly remains weak. It appears, therefore, that a revival of demand for pulses also depends on income growth as the economy revives.

Conclusion

While the above factors support the decline in pulses prices, the extent of fall is also in part due to the high base of last year. Pulses inflation in April-October this year stood at -4.8 per cent, while it was as high as 23.0 per cent in the same period of 2012. Yet it could continue to remain low for a few more quarters. By the time the positive impact of the high base wears off, the rabi crop – which is expected to be bumper – would have entered the market, keeping a fresh tab on prices. Beyond that, however, inflation in pulses will depend on demand revival and on whether farmers continue to increase production.

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