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This is the second part in a special series by the Centre for New Economics Studies's InfoSphere team which aims to closely study and understand the macro-state of the Indian economy in a lead up to the next Union Budget. Read part one here.

In the previous part of this series, we examined the complexities of consumption and investment in India. Now, we turn our focus to a persistent and pressing challenge: inflation. This issue has profound implications for the country's economy, particularly when considering the significant weight of food prices in the Consumer Price Index (CPI) basket.

Food accounts for nearly 40% of the CPI, and historical data underscores that overall inflation cannot be effectively controlled without addressing food price inflation.

From 2000 to 2006, India experienced its most sustained period of low inflation, with the headline CPI averaging 3.9% and food inflation averaging 2.5%. This period of stability was marked by relatively benign food prices, which played a crucial role in keeping overall inflation in check. However, this stability has been elusive in more recent years.

In June 2024, the rise in food prices, driven by costlier vegetables, cereals, and fruits, pushed food inflation to a six-month high of 9.4%. This surge is particularly concerning given that, since 2000, the CPI has fallen below 4% in only six years.

The persistent high food inflation highlights the vulnerability of the Indian economy to fluctuations in food prices, which are often influenced by factors such as weather conditions, agricultural productivity, and supply chain disruptions.

The trend of high food inflation continued post-pandemic, averaging 6.4% between 2020-21 and 2023-24, surpassing the overall CPI inflation of 5.9% during the same period. Initially, projections from SBI Research suggested that retail inflation, measured by the CPI, would stay below or near 5% for the remainder of 2024-25, excluding September. However, recent data paints a more troubling picture, indicating that the battle against inflation is far from over.

Food prices have become a major concern, with inflation in this sector reaching a four-month high of 9.4% in June, largely due to extreme heatwaves affecting vegetable yields. Despite a favourable base effect, where inflation is compared to the previous year's figures, this reversal in the declining trend observed over the past five months is alarming.

The macro-data reveals a persistent problem: eight consecutive months of food inflation exceeding a concerning 8%, with year-on-year comparisons showing food prices nearly doubling. June's inflation rate of 8.36% starkly contrasts with the 4.63% recorded in the same month of 2023, illustrating the significant challenge for policymakers.

Overall retail inflation remains within the Reserve Bank of India's (RBI) comfort zone of 2-6%, but it still sits above the ideal 4% target.

CPI Inflation (in % Y-O-Y). Source: InfoSphere.

Adding to the concern, the Wholesale Price Index (WPI)-based inflation surged to 2.61% in May 2024, marking the highest rate in 15 months since February 2023, when it stood at 3.85%, before dropping to 1.41% in March 2023.

This increase was driven by a significant rise in vegetable prices, which soared to 27.33% due to ongoing heatwaves. Over the past 50 months, inflation has remained above 4% most of the time, with food inflation exceeding 4% in 39 months. Headline inflation has surpassed the RBI's upper tolerance limit of 6% in 24 months, while food inflation has been above 6% in 28 months.

Even as overall CPI slid to 5.4% in 2023-24, food inflation rose to 7.5%, climbing further to 8.7% in the first two months of the current financial year.

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Rural and urban consumers are both feeling the pinch, with rural inflation spiking to 5.66% from 5.3% a month ago, and urban inflation rising to 4.4% from 4.2%. Urban India faced higher food inflation at 9.55%, compared to 9.2% for rural areas. These figures highlight the significant challenge facing policymakers as they strive to achieve a sustainable 4% inflation rate. The immediate priority must be to tame the escalating food prices, while also laying the groundwork for long-term solutions to stabilise inflation and protect the most vulnerable segments of the population from its adverse effects.

The way ahead

This upcoming budget presents a critical opportunity to address not only the immediate issue of rising food prices but also to establish measures for long-term inflation stability. Policymakers need to implement strategies that enhance agricultural productivity, improve supply chain efficiency, and mitigate the impact of adverse weather conditions on food production.

Investments in advanced agricultural technologies, such as precision farming and drip irrigation, alongside initiatives to educate farmers on modern techniques, can significantly boost crop yields and reduce monsoon dependency.

Additionally, improving cold storage facilities and transportation networks will minimise post-harvest losses and stabilise food prices. Encouraging crop diversification and supporting allied sectors like dairy and poultry can provide farmers with additional income sources, reducing the risk of price spikes from single crop failures. Market reforms that simplify regulations and promote digital marketplaces will enable farmers to sell directly to consumers, ensuring fair prices and reducing intermediary costs.

Further strengthening subsidised food programmes like the Public Distribution System (PDS) and implementing stricter monitoring to prevent hoarding will protect consumers, particularly the vulnerable, from inflation’s impact addressing both immediate inflation concerns and lay the groundwork for long-term economic stability.

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