

India Strategy: Food Inflation – reined in!

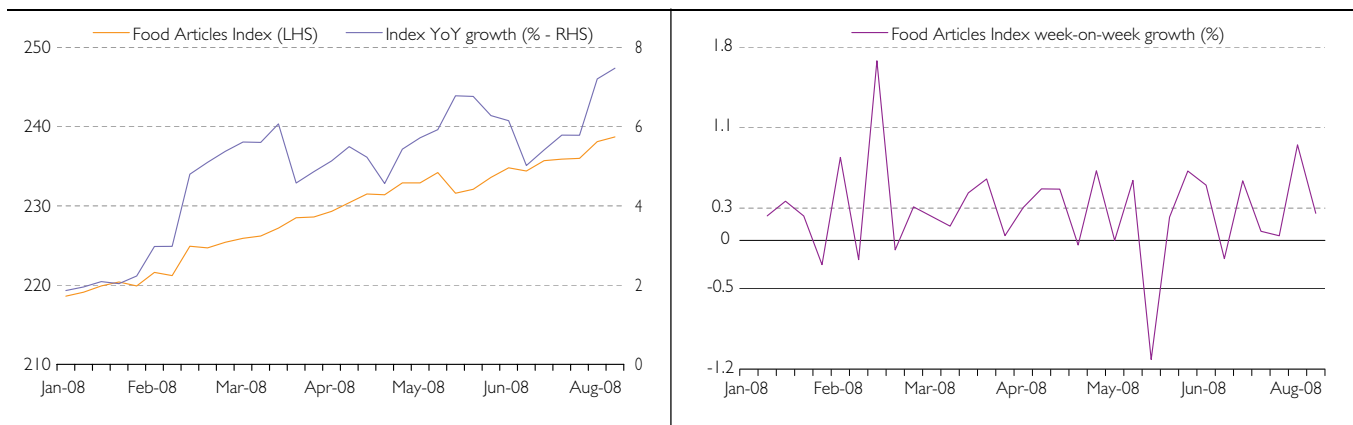
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Concerns over inadequate rainfall have receded as monsoons returned with a bang in August, largely making up for the dry spell of July. In the current season, rainfall situation thus far has been the best in the last five years in terms of spatial distribution. Overall, sowing for Kharif-2008 is largely on track with rice harvest expected to be higher than last year. Though the dry-spell of July could cast a shadow on yields of oilseeds and cotton (re-sowing could nevertheless alleviate the concern), our estimates for food inflation already build in higher prices of cotton, oilseeds and sugar. A record procurement of foodgrains due to bumper production last year has provided the government with sufficient leverage to control supply shortages by releasing buffer stocks and act in a timely fashion (as has been demonstrated in the recent past). Globally too, foodgrain and edible oil prices have started softening (by ~10-40% for foodgrains and ~30% for palm oil) on the back of slowing demand outlook. We expect food inflation to remain tepid in coming months and peak at around 8-8.5% by November and see it coming down to 5-6% by end-FY09.

FOOD INFLATION: NOW UNDER CONTROL

Food inflation has been running high over the past year and touched 7.5%yoy for the week ended 9 August 2008. In recent weeks, though, sequential price growth in food articles has flattened and we see prices stable to declining as far as major foodgrains are concerned. In this light, we reiterate our stance that the inflation peak is in sight on the back of good recovery in monsoon in the month of August, which ensured smooth sowing for Kharif crop 2008, and with the government releasing buffer stocks of sugar to augment supply in the local market.

Exhibit 1: Food Inflation



Source: CSO

MONSOON 2008: BACK WITH A BANG!

Rainfall situation in the country improved significantly in the month of August with recovery in parts of Maharashtra and above-average rainfall in the North-west region. Cumulative rainfall for the season for India (as a whole) stands at 662.8mm – just 1% short of the long period average (LPA).

Exhibit 2: India Rainfall – Largely in line with LPA

Regions (as on 24 August 2008)	Actual rainfall (mm)	% departure from LPA
Country as a whole	663	(1)
Northwest India	546	19
Central India	698	(7)
South Peninsula	498	(6)
Northeast India	1,017	(5)

Source: IMD

Rainfall situation has been the best over a five-year period in terms of number of regions receiving normal/ excess rainfall. Such situation was last observed in 2003. No region has witnessed scanty rainfall in the current year.

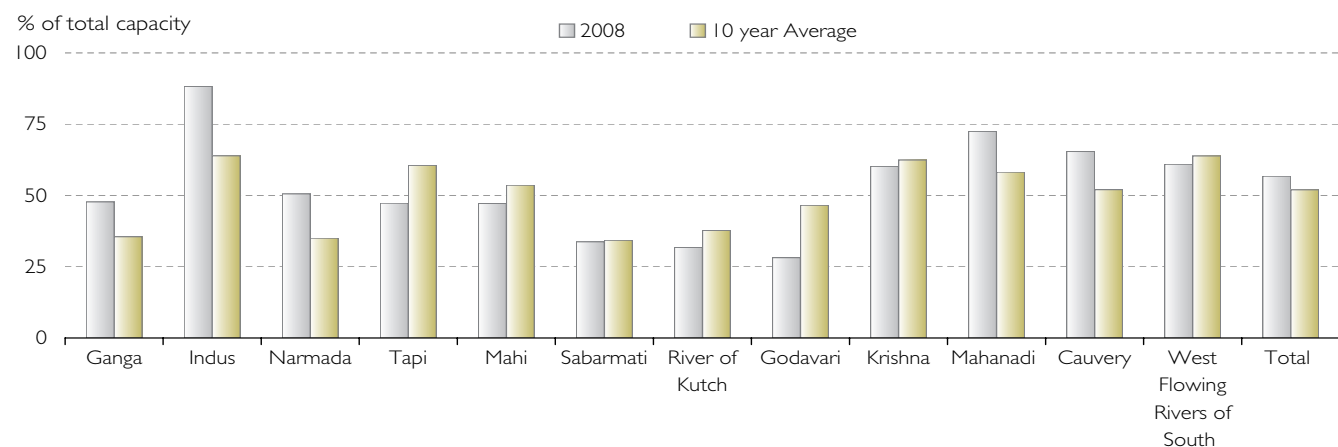
Exhibit 3: Rainfall – well distributed



*Till 3rd week of August; Source: IMD

Consequently, water levels in major basins of the country stand comfortable with a departure of +9.17% over the last 10-year average.

Exhibit 4: Water Levels at India's major basins



Source: Central Water Commission

COMFORTABLE FOODSTOCK SITUATION: GOVERNMENT AUGMENTING SUPPLY

- Rice procurement for FY08 was 26.59m tonnes, an increase of 5.95% over the previous year. Consequently, rice stock with government agencies by October 2008 is estimated at 6.25m tonnes as against a buffer norm of 5.2m tonnes.
- Owing to record wheat production during Rabi 2007-08, wheat stocks with government agencies by end of FY09 are estimated at 7.86m tonnes against a buffer requirement of 4m tonnes.
- With outlook on sugar production looking gloomy this year, the government plans to release 0.5m tonnes of additional sugar in the market (0.2m tonnes in August 2008 and 0.3m tonnes in September 2008) besides the estimated monthly releases totaling 1.6m tonnes during Aug-Sep '08.
- In addition, the government has taken up the following steps to augment foodgrain supply in the market:
 - open market sales of up to 6m tonnes of wheat
 - supply of edible oil with a subsidy of Rs.15 per kilogram
 - supply of 0.4m tonnes of pulses with a subsidy of Rs10 per kilogram

KHARIF 2008: SOWING ON TRACK; CONCERNS OVER OILSEEDS RECEDING

The month of July 2008 had witnessed a long dry-spell in the major oilseed producing states of Maharashtra, Karnataka and Andhra Pradesh.

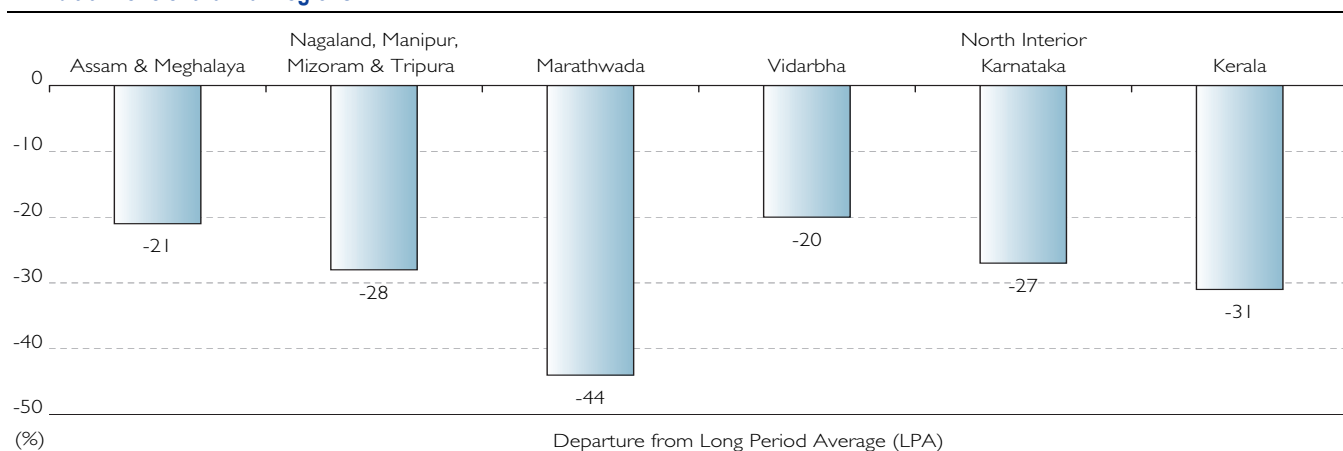
Exhibit 5: Deficient rainfall in July to impact yields

No. of subdivisions	Till 25 July 2008
Excess	9
Normal	12
Sub-Total	21
Deficient	14
Scanty	1
No rain	0
Sub-Total	15
Total	36

Source: IMD

Though overall rainfall has improved significantly, crop yields are expected to be lower in regions that faced the dry-spell in July.

Exhibit 6: Deficient rainfall regions



Source: IMD

Out of the above regions, Marathwada and Vidarbha are major producers of cotton and soyabean. Also, North Interior Karnataka and Marathwada are significant contributors to sugarcane production in respective states. Farmers have had to re-sow in some parts of these affected areas.

Exhibit 7: Planned acreage – Kharif 2008

(m hectares)*	2008	2007
Rice	32.46	30.36
Jowar	2.75	3.33
Bajra	7.24	8.05
Maize	6.66	7.18
Total of coarse cereals	18.41	20.4
Groundnut	4.95	5.08
Soyabean	9.41	8.68
Total of oilseeds	16.87	16.75
Arhar	3.15	3.7
Urad	1.96	2.5
Moong	2.29	3.03
Total of pulses	9.56	11.29
Cotton	8.59	9.07
Sugarcane	4.41	5.3
Jute	0.74	0.83

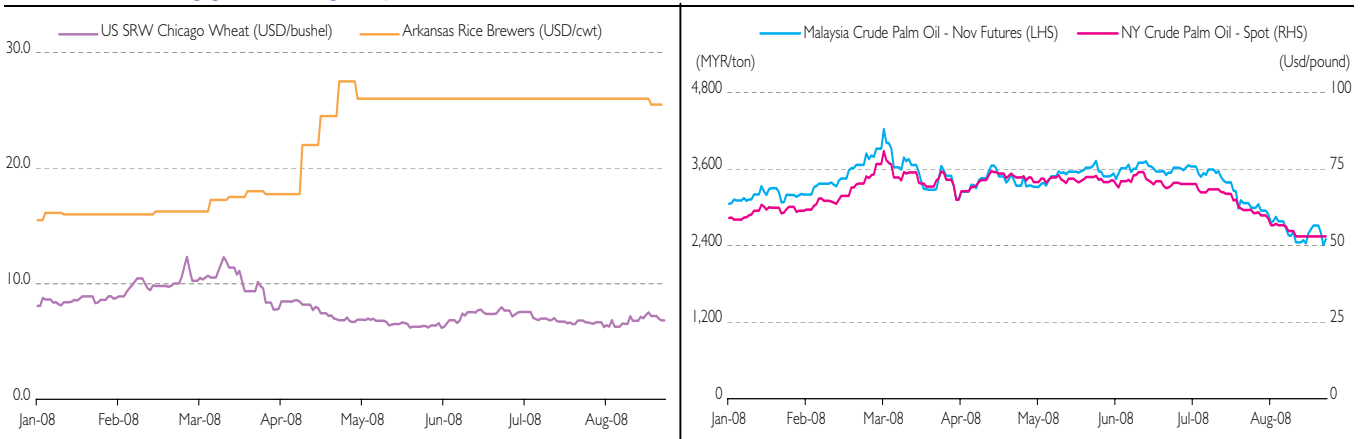
* As on 22nd August; Source: Ministry of Agriculture

- Rice acreage has increased substantially yoy in Tamil Nadu, Madhya Pradesh, Uttar Pradesh and Rajasthan owing to higher MSP and partial lifting of ban on basmati-exports.
- Oilseeds acreage has remained constant on an overall basis, but has shifted from groundnut to soyabean due to firm soyabean prices. Though crop yields will fall in areas with deficient rainfall, we believe recovery should be possible due to re-sowing.
- Cotton acreage has decreased, mainly in Rajasthan and Haryana. We expect cotton prices to remain firm due to strong demand and lower output.
- Sugarcane acreage has reduced considerably. This is mainly a cyclical phenomenon, as there was a supply glut last year due to record production.
- Acreage for pulses has gone down considerably due to reported drop in Karnataka and Bihar, which we believe is an area of concern. Thus, prices are unlikely to soften in the near term.

GLOBAL OUTLOOK: SOFTENING PRICES ON THE BACK OF SLOWING GROWTH

Global foodgrain prices are seeing a downturn after touching record highs in the first half of 2008 on the back of an impending slowdown in developed economies. Wheat prices have fallen considerably while rice prices too are showing signs of softening. Price of palm oil, of which India is an importer, have also softened considerably. However, in terms of key foodgrains (read rice and wheat), domestic production is more than sufficient to meet the demand. As a result, we do not expect any import of major foodgrains except pulses.

Exhibit 8: Softening global food grain prices



Source: Bloomberg, IDFC-SSKI Research

Pass-through of global price-signals bodes well for inflation expectations on the domestic front. Consequently, we see food inflation peaking at around 8-8.5% by November 2008, while we see it coming down to 5-6% by end of FY09.

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