THEIR VIEW

Is Indian inflation something for our policymakers to worry about?

Core inflation fully shorn of elements subject to externally-driven volatility has held steady since June at an average 5.09%

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The consumer price index (CPI) for September shows inflation in India at a comfortable 4.35% year-on-year (y-o-y). But there were dark mutterings about how core inflation was continuing to ride high at 5.89% and that therefore the Indian inflation beast, shorn of exogenously affected food and fuel, needed taming.

The key issue here is how core inflation is measured. The overall CPI gives us headline inflation—an average across everything in the consumer basket. But ever since the oil price hike of 1973, it is also thought prudent to look at a subset of that basket, after excluding two classes of goods that are internationally traded, and subject to globally-driven supply volatility on account of weather (food) or cartels (fuel). The residual is called 'core' inflation, which captures the inflation-generating dynamic in the domestic economic system.

Headline and core inflation are not unrelated. Rising food prices (as for instance currently in October on account of weather vagaries) could lead to rising wage demands and therefore drive up the core. These relationships are not stable or predictable. At any point in time, however, headline and core are separate measures that do convey useful information.

The standard measure of core inflation in India removes two sub-groups: food and beverages (with a weight of 45.86%), and fuel and light (weight of 6.84%). That leaves the core with a residual weight of 47.3%. The weight of the core can be further ramped up by reducing the food sub-group, but I will deal with that at the end.

Of material consequence is what goes into the fuel and light sub-group. Its item-wise components include fuel only as used for cooking and lighting (gas, kerosene). It does not include conveyance fuel (petrol, diesel), which therefore goes into the core, through the transport section of the miscellaneous sub-group. The core, rightly calculated, should have excluded petrol and diesel. Until calendar 2021, international fuel prices were benign. Once international oil prices started shooting up, recalculating the core was not something I could really postpone doing.

Over the four months June to September 2021, petrol inflation averaged 23.63% y-o-y, and diesel inflation averaged 23.98%. The average over the same months in 2019 stood at -8.08% for petrol and -5.78% for diesel. These are wild swings, and the very reason why the push towards measuring core inflation shorn of these volatile products gained global popularity in the first place. Yes, there is a large tax element in the prices of petrol and diesel, but the point is that these gyrations reflect what happened to the international price of oil, without any compensating reduction in domestic taxes.

The Reserve Bank of India has taken cognizance of this, and the last two monetary policy reports for April and October have provided alternative estimates of core inflation after excluding petrol and diesel from the core. However, there are some elements which should be added to the core at the same time, and one such is electricity (from the fuel and light sub-group).

Unlike more developed countries, where the price of electricity is free to vary with the price of whichever fuel it is generated from, and is therefore in principle as volatile, power prices in India are regulated and hold steady for long periods.

Over June to September 2021 when international fuel prices were on the boil as shown above, electricity price inflation averaged 3.38 % y-o-y. Over May to September 2019, the corresponding average for electricity was -0.06 %, when petrol and diesel were declining much more sharply. Of course, what is measured in the CPI is electricity bought through the grid. Small-scale diesel generated electricity, an alternative used by assorted small enterprises when grid supply fails, would reflect the price of diesel in the core, but to weed that out takes a more complicated estimation procedure.

The core, excluding direct consumption of petrol and diesel, and including electricity, carries a weight of 46.35%, as against the unadjusted weight of 47.3 %. So adjusted, core inflation for September 2021 stands at 5.12 % (versus 5.89 % unadjusted), and has held steady at an average of 5.09% over June to September.

Finally, the official CPI is accompanied by a consumer food price index (CFPI), which excludes prepared foods from the food sub-sector. If we include prepared foods in the core along with the fuel adjustments detailed above, its weight becomes 53.15%, and core inflation in September 2021 goes up to 5.37%—and it has been steady around there for four months. It is higher because prepared foods currently run at inflation rates nearing the 7% mark, reflecting both the closure of small-scale units, which dominate the sector, as also the cost-push impact of diesel-generated electricity instead of power sourced from the grid.

QUICK READ

A core measure of inflation that is shorn of volatile elements has its distinct uses but some components such as fuel for transport and diesel-generated electricity are mis-categorized.

Adjusted for misclassifications, core inflation has held steady since June. Improved grid supply through power-sector reforms and the activation of small-scale units could cool rising prices.

Improved grid supply through power sector reform, and activating small scale units holds the key to bringing down core inflation, and will re-employ the skilled workforce previously employed in those units.

As for the non-core, inflation in oil and primary commodities is likely to persist for some time, on account of shortages in shipping containers and a number of other global supply-side disruptions.

MINT CURATOR

Airlines ready for take-off can expect some turbulence ahead

Post-pandemic flying with heavy debt burdens will prove difficult

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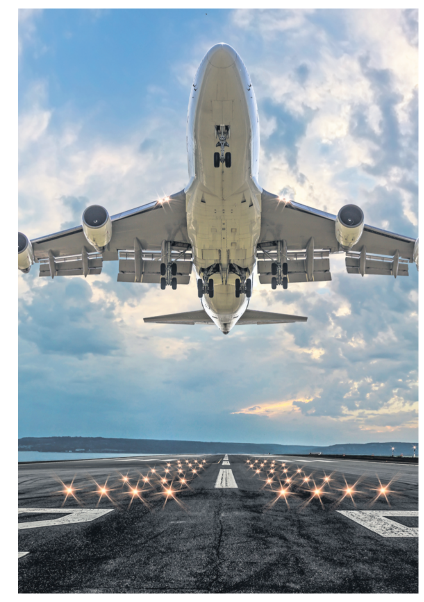

Global aviation looks set for a scarred revival as covid curbs ease GETTYIMAGES

The world's air carriers are preparing their cabins for take-off. After 18 months in which planes were laid up in desert boneyards, converted into makeshift medical-supplies freighters, and even flown on short return hops just to maintain their pilots' certifications, the machinery of the global aviation industry is gradually creaking back to life.

Emirates, the biggest carrier by international traffic, is planning to hire 6,000 people over the coming six months and will have restored 70% of its pre-pandemic capacity by the end of the year. London's Heathrow Airport Tuesday reported its first quarter of passenger growth since 2019. Sales from General Electric's business that makes and services jet engines climbed 9.7% in the September quarter. On a tracker of more than 100,000 daily flights maintained by FlightRadar24, a data provider, weekly average flight departures last week briefly moved ahead of the same period in pre-covid 2019.

It's hard to believe, but the moment that airlines have been waiting for is finally arriving. The European Union largely opened itself up to vaccinated travellers last month, as did Canada and Turkey; India followed 15 October, and Thailand will begin a limited reopening 1 November. The biggest change was announced Monday: From 8 November, the US, the biggest recipient of inbound tourist dollars and the second-biggest spender on outbound tourism, will join the club of nations largely open to vaccinated travellers.

This may all seem a little premature at time when half the world's population has still not been inoculated—but air travel, like vaccines, is a luxury good hogged by richer nations.

More than a third of international passenger air traffic in normal times is within China, North America and Europe. China's domestic market has been mostly open since the first half of last year. Europe's main restrictions were removed last month, and North America's will follow in November. Add in transatlantic flights and those between Europe and the Middle East, where most restrictions have also fallen for the vaccinated, and we're looking at around 50% of the global total.

That still leaves a giant China-sized hole in the global tourism market. Beijing is the only major national government still committed to a zero-covid strategy, and it's showing little sign of letting up. Travellers must spend up to 21 days in quarantine, rising to more than a month from some parts of the world such as the UAE. With Chinese outbound tourists having outlaid about $255 billion in 2019—equivalent to about a fifth of all international spending—that represents a significant blow.

Similar measures apply in Hong Kong, where the government this week tightened up already-strict quarantine requirements in the hope the policy would encourage mainland China to open up the border. Flights between Hong Kong and Taipei—which have traditionally vied with Singapore-Kuala Lumpur for the title of world's busiest international air route—have plummeted virtually to nothing. Hong Kong recorded just 50 visitors from Taiwan in June, a month that normally sees more than 160,000 visitors.

Other parts of the Asia region are a mess of conflicting regulations. While the aviation hub of Singapore has largely opened itself to long-haul travel and is reported to be looking at lifting most border restrictions with Malaysia, for the most part a region that accounts for about 15% of aviation traffic remains closed from New Zealand north to Japan.

At the same time, that's less of an issue than it may appear. Thanks to the limited range of aircraft and the difficulty of operating outside of home territory, the vast majority of airline revenue is local. The budget airlines that dominate short-haul travel have actually been running ahead of their pre-pandemic performance of late, with Ryanair Holdings up 15% since the start of 2020, India's InterGlobe Aviation gaining 44% and Mexico's Controladora Vuela Cia, or Volaris, jumping 77%.

Airlines still face immense challenges. Net debt is up by more than a third since the end of 2019 among 124 carriers tracked by Bloomberg, to $402 billion. Paying that off will require exceptional operating earnings, at a time when carriers are having to keep a lid on prices to tempt travellers back on board. Jet fuel, which accounts for about a quarter of costs, globally, is close to a seven-year high.

The worst period for the aviation sector may still be ahead of it, as the public and private lenders that have kept the industry afloat through the past two years seek to recover the money they have extended. Still, after a long and lonely pandemic, the welcoming landing lights of home are finally within sight.

MY VIEW | PEN DRIVE

People may now be ready for a renewable revolution

RITESH PANDEY

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Strolling the streets of Tanda or Jalalpur in Uttar Pradesh (UP) on any given evening, you can't miss the rhythmic click-clacking of power looms emanating from rows of one-room shacks—each housing, on average, seven power looms that work in tandem to produce the *lungis*, *gamchhas* and *rumaals* sported by men in eastern UP. The income of over half a million people in my constituency, Ambedkar Nagar, and close to 8 million in UP has entirely depended on them for the past three decades. But this income, already under duress due to an increase in prices of yarn, drop in wages, a new electricity tariff regime (*bit.ly/2Zovhp7*) and the economic fallout of covid, faces yet another setback: power cuts.

The post-covid boom in economic demand, coupled with flooding in coal-producing regions, has led to major shortages of coal at power plants across the country. By October, some coal plants had dangerously low stocks of only two days; in a country where 70% of the power is generated from coal, this spells disaster. Given the global energy supply crunch, the precarious situation of coal plants in India could prevail for the next six months (*bit.ly/3BciXoX*). To mitigate the pressure on coal supply, the government has ordered the temporary closure of some power plants and reduced electricity supply, particularly across rural India.

These random power cuts that last 5-7 minutes hurt commercial operations more than the long scheduled cuts—this is especially true for small-scale industrial outfits with basic operational setups (like power loom shacks) that employ a vast majority of workers in India, upon whose backs rides India's development trajectory.

Although economic growth remains inextricably linked to coal in the medium term, India has never been more primed for increased investment in renewable energy technology. This is partly because the economics of new coal plants (*bit.ly/3vEUFCC*) does not make sense. Most of the 33 gigawatts (GW) of coal power generation capacity under construction and the 29GW in pre-construction stage will end up as stranded assets. According to a report authored by Kashish Shah, research analyst at the Institute for Energy Economics and Financial Analysis (IEEFA), there have been no new coal plants announced and no movement on the 29GW of pre-construction capacity in the last 12 months. This, according to Shah, is because "coal-fired power simply cannot compete with the ongoing cost reductions of renewables. Solar tariffs in India are now below even the fuel costs of running most existing coal-fired power plants."

From a policy standpoint too, India is creating a favourable investment climate in the renewable energy tech sector. It has set a target of 450GW of renewable energy capacity (including solar, wind, hydro and biomass) by 2030. To meet this ambitious target, the government has been taking sustained steps to attract foreign investment partnerships, partly as an antidote to the weak debt financing ecosystem. Existing regulation allows 100% foreign direct investment in renewable energy projects, without prior government approval. A $600-million incentive scheme for new solar power projects will boost the production of polysilicon, wafers, cells and modules over the next five years. Most importantly, there is also an appetite to reform the power distribution sector, if budgetary allocations are an indication of the government's inclinations.

QUICK READ

Incomes in large swathes of UP depend on power supply disrupted by coal shortages while coal-fired electricity generation loses economic viability in our clean-energy shift.

We must adopt green sources of energy without switch-over jitters because future elections could be fought on power and the power cuts then could well be of the electorate's making.

There are economic, environmental and moral imperatives for foreign investment in renewable energy. While India is the third largest carbon emitter after the US and China, its per capita energy consumption is a third of the world average. The increase in per capita household consumption of energy will be a key driver of growth in the global energy market. India needs more energy, and it needs that energy to be cheap, reliable and clean. How it fulfils this energy demand will determine the success of the global climate action movement. With less than three days to go for CoP-26, any country or bloc serious about curbing emissions should remember that it is in its best interest to help India wean itself off dirty fuels.

This seems easier now than ever before. While coal ostensibly remains a powerful political constituency, providing jobs in some of the country's poorest regions, necessity breeds change. As Coal India, the state-run giant that accounts for nearly 80% of domestic coal output, automates and upgrades its infrastructure, its recruitment has fallen below its retirement level. With little commercial interest in new coal mines, the obstinate power of coal as part of India's development story may finally be in for a shake-up. The government must read the headwinds and introduce fiscal incentives like tax breaks and excise relaxations for research, development and production of renewable energy technology, particularly off-shore wind and hydro power.

People, especially the smartphone-armed children of the power loom generation, want more. More power that is more reliable and more affordable. Future elections could be fought over power, but this time, it could be the public making the power cuts.