

# INTELLECT

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## The new VIP



# Ouch!!!! Food inflation hurts

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While onions seem to have done the disappearing act, the tears haven't disappeared anywhere. An onion deficit market has transformed tears of joy into tears of sorrow.

The price of onions has risen from Rs.20 per kg to Rs.60 per kg ( as in January 2011) in a matter of a few months leaving people stunned. When the price of one staple food item goes beyond reach, people look for alternatives. So the rise of one commodity leads to a chain effect raising prices of other food items. Food inflation seems to have unmistakably settled down in our backyard.

While price rise is always painful, this time it is worse because:-

- 1) The magnitude of price rise is more.
- 2) Onion being an integral part of cooking is consumed by both the rich and the poor alike.

- All of a sudden the importance of the onion has dawned upon us. Thanks to food inflation. Where is food inflation heading and what does the future look like?
- A revolution called 3G has been launched and is all set to transform business models beyond recognition. It is imperative to harness this technology and make businesses more efficient.
- The structure of the European Union is under stress due to lop-sided development of countries within the Union. What this holds for the future of the union?

Read on and explore the above stories and stay abreast with macro-economic changes taking place around us.

The “aam aadmi” at the epicenter of price rise has become a headache for the authorities because if the “bottom of the pyramid” rumbles, governments can tumble. So they are doing what they can by lifting import duties and banning exports. But this does not seem to be good enough to retract prices.

So what is causing this pain and how does one alleviate the suffering?

Poor infrastructure is at the heart of this impasse and manifests itself by way of:-

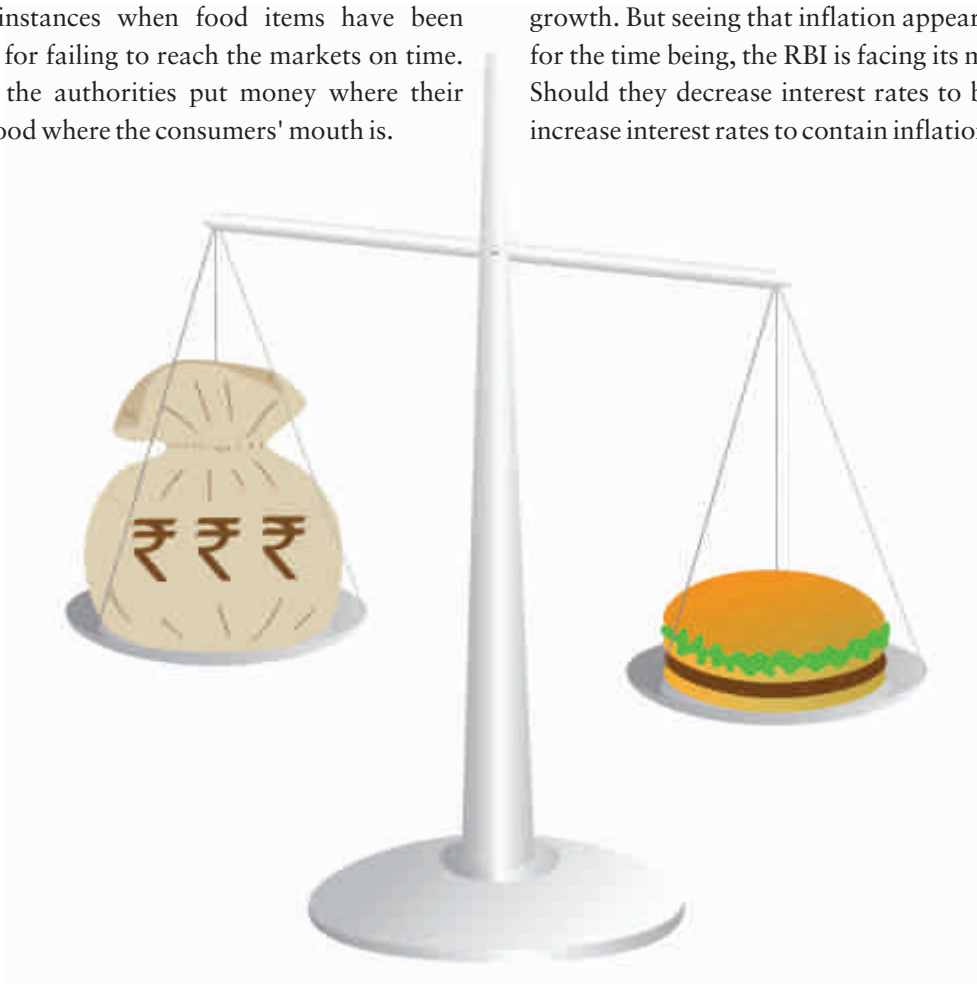
- 1) Poor road networks that connect the centers of production to the centers of consumption.
- 2) Lack of warehousing facilities for storage at close proximity to markets.
- 3) Lack of a cold chain (refrigerated trucks) to preserve food items during transportation.

Thanks to the abysmal state of infrastructure, there have been several instances when food items have been allowed to rot for failing to reach the markets on time. It's high time the authorities put money where their mouth is and food where the consumers' mouth is.

Besides the infrastructure deficit, an erratic monsoon that extended all the way to November adversely impacted the produce. To make matters worse, hoarders too have joined the party by adding fuel to fire. Barriers to movement of commodity due to a complicated tax and octroi structure between states are another impeding factor.

While supply has been under stress on one hand, there has been a surge in demand on the other hand. According to RBI, a 39% increase in income per person in the last 5 years has added 220 million regular consumers for milk, eggs, meat and fish. Thus economic prosperity too has had a role in driving up prices. Supplies have not kept pace for bridging the deficit gap. So while the economy is growing at a healthy pace of roughly 9%, food inflation is nearly double of economic growth. Thus there seems to be no succor for the teeming millions.

The obvious remedy for a current account deficit of 4.3% (quarter ending September) is higher economic growth. But seeing that inflation appears uncontrollable for the time being, the RBI is facing its moment of truth. Should they decrease interest rates to boost growth or increase interest rates to contain inflation?



The manner in which the common man finds himself at the center of the inflation inferno, both the government as well as RBI would like to contain inflation in the short term. Hence interest rates might soar to stave off inflation even at the cost of trading off some of the growth momentum. An unpalatable situation of high interest rate in tandem with high inflation has already spooked the stock market causing it to come off its recent highs.

However the question to be asked is whether inflation would be contained by monetary policy considering the several supply and infrastructure related causes. Whatever be the short term outcome, the writing is clear on the wall that it is time to bring in reforms to the Agriculture sector by way of

- 1) Modernization by upgrading irrigation and water conservation, by making hothouse conditions available for growing vegetables round the year (even when outdoor conditions aren't appropriate), increase of R&D in seed and soil quality etc.
- 2) Establishing well founded infrastructure to help efficient movement of produce from farm to

market.

- 3) Encouragement to farmers' cooperatives, contract farming to overcome impediments caused by unviable land size and deploying capital and technology more efficiently.
- 4) Freeing farmers from the strangle hold of middlemen by opening up the retail sector and helping them realize appropriate prices for their produce.

There's no doubt that India is well positioned to become a large economic power in the future. There is no doubt that per capita income across the social spectrum has risen. There is no doubt that rising income has caused an increase in demand. There is no doubt that India is not the only country bearing the burden of food inflation and that mounting international food prices have rocked several governments triggering alarm bells in global financial institutions. (See box below)

However, there is also no doubt that we could do a lot better with well designed relevant policies that benefit both the consumers and producers alike.

■ Dharmendra Satapathy

## Food Crisis Makes The World Cry

The food deficit clearly seems to be the harbinger of sleep deficit not only for leaders in India but the world over. The unprecedented demand for commodities from emerging market economies like China, Brazil, India and others has taken Food Price Index past its previous peak in 2008. The Food Price Index is a monthly measure for change in prices of a basket of food items including cereals, dairy, meat, oil and sugar among others. Food inflation has touched double digits in India, China and Brazil, all leading emerging market nations. In fact Algeria has seen food riots break out. Brazil has warned of a trade war. France is taking the issue to the G-20 platform. It is expected that international prices of daily products, meat and oilseeds would remain firm this season while sugar is expected to be volatile. However the biggest worry appears to be wheat where unfavorable weather conditions in Russia are expected to bring the output down by 5%. India is not a major importer of food items but economists believe that high international prices would have a rub off effect on prices in India as well. Besides there is always the threat of a supply shock like the one we have seen for onions. While milk and edible oil are under stress, a bumper food grain and sugar production along with lower demand for meat augurs well for India.



### **Inflation won't be invisible for long**

Past performance is not an indicator of future performance. This phrase is as true about inflation as it is about mutual funds investment. If one takes a peek inside the window of history, an interesting story emerges. The nations which witnessed stupendous economic growth and consequent prosperity were historically countries with a small population. Never in the past had the world seen prosperity in heavily populated countries. This time, however, it is not just about a heavily populated country but a heavily populated region comprising of China and India which is putting unprecedented demand pressures on commodities leading to sky rocketing prices. Thus consumers are feeling the heat of inflation over the chilled winter months.

Despite the recovery of economic growth, India hasn't been able to avert the menace caused by inflation

thereby offsetting the positive sentiments caused by healthy economic recovery.

Inflation is like an additional tax on people bringing down their abilities to spend on goods and services. Food consumption is non-negotiable in nature. Food inflation hits all citizens but more so the poor who spend a disproportionately larger proportion of their income on food items. Hence rising food prices bring about a reallocation of domestic budgets which consequently depresses demand for other non-food products.

Inflation affects retired folk and people with fixed incomes because they are caught between limited incomes and falling value of money. They have no recourse to expand their income.

Inflation thus destabilizes the economy converting investors to consumers.



Inflation is caused because of two principal reasons.

- 1) **Due to excessive demand:** When demand for products and services outstrip the supply capacity, equilibrium between the two gets manifested by way of higher prices.
- 2) **Due to pressure on costs:** When manufacturers raise wages of workers, more often than not this increase is passed on to the consumers by way of higher prices.

As far as India is concerned, both demand-led as well as cost-led factors are simultaneously at play. The healthy economic growth has placed money in the hands of a large consumer base leading to increase in demand of goods and services. Due to rising competition in the market, salaries too are heading northwards. This leads to further increase in demand and so on and so forth. Call it virtuous cycle or vicious cycle as you may, the outcome clearly is inflation.

Be it food inflation, commodity inflation or manufactured goods inflation, they are all headed up north.

Spiraling global crude oil prices have worsened the situation in India as this is one precious commodity which is in short supply.

In order to combat inflation, the government would do the following:-

- 1) Tweaking of monetary policies resulting in higher interest rates. By making the cost of money dearer, this policy would decelerate consumption growth alleviating inflation.
- 2) Increase in the supply of goods. However increasing supply is easier said than done. It has its own gestation period challenges and takes effect over a large period of time
- 3) In order to supplement supply the government could have to resort to imports and policies such as reduction in import duties can ameliorate the situation to some extent.
- 4) For underprivileged section of the society the government could provide subsidies and improve the public distribution system to ensure that benefits reach the right people.

Whether these measures bring down inflation and food prices would depend upon the efficacy of implementation.

# Europe's unique problem



Will the partial bail-outs be enough to revive the debt ridden economies of Ireland and Greece? Will it be enough to make these economies competitive? Will it be good enough for them to exit the grip of fiscal deficit?

Unlike others, the economies of the European Union have a unique problem. They are part of a monetary union and hence they do not have the leverage of individually altering the exchange rate. In a sense this can be compared to a building which has central air-conditioning. Due to the central air-conditioning, the people working on each work station have very little control over the cooling. Even if they feel cold they cannot reduce the cooling locally for their own comfort. Any reduction in cooling would have to be done centrally and hence would need the concurrence of others in the building. Similarly any change in the exchange rate of the euro would require the concurrence of all the countries of the union. In this context Greece or Ireland cannot use currency depreciation (the most common method) to gain export competitiveness. So the only option left for these countries is to reduce prices by way of margin contraction, wage reduction and productivity growth.

To make matters worse, these countries (Greece, Ireland, Portugal and Spain) had become extremely uncompetitive due to rigid labor markets and high wages but had survived on the back of high domestic

demand fuelled by a low interest rate regime. However after mid-1995, as the euphoria in the sentiments started fading, it was Germany that took the lead and embarked on the reform path by holding wages and increasing productivity. This further dented the competitiveness of the other nations of the Union.

Hence the task to increase competitiveness becomes a very onerous one for the debt-ridden nations. Greece is trying to reduce red-tape and monopolies to increase competition and productivity. Ireland has succeeded in bringing down labor costs as well as the public sector pay packet.

However there are problems on the way for these nations which stand as hurdles on the path to recovery these are :-

## 1) Insignificant past record:

While these austerity measures have borne fruit for Ireland by bringing down its inflation rate, the same is not true for Greece, Spain and Portugal. One, there aren't too many instances of sustained deflation which would provide an empirical road map. Argentina did experience a 3 year deflationary period in 1991 but that could not restore competitiveness. So was the case with several African countries between 1986 and 1993. However the Baltic countries of Estonia, Latvia and Lithuania which lost competitiveness in 2008 have

recovered well through austerity methods. This however is being attributed to the fact that these economies were relatively more open and secondly the fear of losing their hard fought independence created enough resolve among its people to follow the austere policies with discipline.

Thus the track record of austerity measures does not paint a very rosy picture for the fringe nations to unshackle their way into prosperity and well being.

**2) The Commodity dependence trap:**

Another cause of concern for them is that unlike Germany which is renowned for its premium value added products, the peripheral European nations do not possess any such expertise. As a result while Germany continues to double the exports of Mercedes cars into China, most of the fringe European nations still depend upon commodity exports. Unfortunately for them, they do not have the wherewithal to supply commodities at lowest possible prices.



**3) The China factor a boon for some a bane for some**

Due to its abilities to manufacture value added premium “margin rich” products, China becomes a lucrative market for a country like Germany to export its way to prosperity, the same cannot be said for the debt inflicted countries. Instead the situation for them is quite contrary. While China may be a boon for Germany, it is nothing short of a problem for the pained nations because of their dependence on low-tech products and commodities for exports. Instead of being a huge market for exports, China is more of a competitive threat to these nations.



**4) Debt Trap – No easy solutions**

While the current strategy is about deflating their way to competitiveness, one needs to ponder over the efficacy of this approach. A deflationary economy leads to lower GDP and thus lower wealth creation which actually increases the debt burden in real terms because there will be less money to service the debt. The ideal way would have been to export competitive and value added premium products and grow the economy instead and thereby ease the debt burden. However it is easier said than done. So it is indeed a tight rope walk. Not only do they have to do the rope walk with dexterity but also have to do the walk with a huge burden of debt on their shoulders. Such a walk can never be easy even for efficient countries, leave alone nations who are already in the throes of economic collapse.

# A revolution called 3G



The cellular phone has been evolving by leaps and bounds each year in ease of use, voice quality and data communication.

The history of cellular technology starts at Bell Labs in the 1960's and 70's where they began to iron out the details on what a commercial cellular network would be. A cellular network is a network of base stations, or antennas. With a technology called "handover," if you made a call using one base station, and you then moved out of that base station's range and into another base station's area, your call could be "handed over" to the base station closest to your location. Thus base stations allow you to make calls to other cellular phones or to wired landline phones.

Over the years, the evolution of cell phone technology has been broken up into "generations." It started with the first generation (1G) and it continues to the upcoming fourth generation (4G). In the beginning, cell phones weren't much more than huge walkie-talkies. Over time, though, they evolved into the data powerhouses that we carry around in our pockets.

**1G technology** was analog. A cell phone's connection to the cellular network wasn't much more than a radio signal. Cellular phones had to be so large that most had to be installed into your car. Later, cell phones were reduced in size to fit into bulky cell phone packs that you could carry with you using a shoulder strap. In 1983,

Ameritech launched a 1G cellular network in Chicago that offered the Motorola DynaTAC "brick" mobile phone. It was small enough to bring with you, but it still weighed two pounds.

**2G technology** was digital. It was a huge leap forward for cellular technology in that the signal between your cellular phone and the cell tower was made digital from analog. It was much more efficient and allowed cellular networks to expand their capacity immensely. On the consumer side, the technology allowed for much clearer voice communications and it also allowed the beginning of the text message (SMS) and "Smartphone" markets.

**3G technology**, the current standard in cellular service, improved cellular service even more. On the network side, it was more efficient than 2G and allowed greater capacity on the cellular network. It allowed much faster data connections that approached broadband speeds. It also allowed a consumer to use both voice and data features on their phones at the same time. 3G simply means "third generation" based on the amount of data the network can distribute to a device. This does not take up space on the GSM bandwidth because it's a separate signal working side by side to handle wireless data and to help eliminate dead zones in the metro areas.

It will change the face of mobile advertising, mobile content and kick-off the nascent mobile TV scenario. In

simple words you can enjoy saas-bahu serials or catch up on the latest news on the move. It doesn't end here! With mobile videos you can give an interview for a job in the UK and even see a property you desire to buy on your mobile phone. If you need to see your kid or friends, you can make a video call.



The multi million dollar mobile VAS market is shaping up for this novel technology to kick in. Here are a few VAS services that could start-off a whole new mobile ecosystem:

1. **Mobisodes:** Mobisodes are TV episodes for mobile phones. Live and delayed videos of TV serials, movies and news will be optimised for mobile phones. This seems to be one of the main drivers with millions expected to access mobisodes.
2. **Video SMS:** Now mobile users can simply shoot a video and send it across to a friend or colleague just like an SMS. (though the cost of video SMS would be higher than text SMS.)
3. **Multi-Player Games:** The arrival of 3G technology will encourage individuals to play multi-player games like Chess, Tennis etc.
4. **Matrimony and Dating:** The advent of mobile video will enhance matrimony and dating sites. Mobile video would help individuals to see each other before they meet.
5. **Mobile TV Rating Agencies:** 3G technology will help boost mobile TV which in turn will attract advertisers. And with a rise in mobile TV advertisers there would be a need of rating agencies to reflect the popularity rating.
6. **M-Commerce:** 3G technology will add sheen to the dormant m-commerce industry and help it reach its tipping point.

**Concerns**

1. 3G cellular phones are more expensive as compared

to the 2G cellular phones. However with an increase in volumes the cost of 3G handsets could come down and become more affordable.

2. Features such as video conferencing work between 3G phones and not between a 3G and a 2G phone.
3. The internet experience offered on 3G mobile phones won't be able to replace the experience on a desktop or laptop. However, many webmasters have designed mini sites to give same amount of info without all the fluff.

Even with all of these features available, 3G mobile phones still need to be cheaper and have more battery life if they are to gain popularity. Expenses are likely to become the biggest obstacle for 3G services. Therefore service providers and mobile phone makers would have to collaborate to make the services affordable by smartly packaging the services for different customer segments.

**4G technology:** The march of technology goes ever forward and now there is a fourth generation of cellular technology just over the horizon. Unlike previous generations of cellular network technology, 4G is not designed around voice services but is designed around the Internet. It will also do away with many of the cellular network incompatibilities between carriers and countries. It will have blazing fast data speeds starting at 100 Mbps (approximately DSL speed), and top out at 1Gbps (approximately LAN speed). It is designed to be used with both mobile phones and more static computers.

The developments in cellular technology promise a worldwide network of mobile voice and data communication like we've never seen before. Get ready for 4G!



# Understanding the difference between “bottom-line and top-line growth”

– By Prof. *Simply Simple*™

- We come across these terms so very often and perhaps have got use to it without even understanding.
- As always let us try and understand these concepts through a story.
- Bikas was a “Bhelpuriwala” in Mumbai. He would sell Bhel at Marine Drive. Every day he would buy the ingredients worth ₹ 1000 to prepare his “Bhel”. By the end of the day he would sell all his stuff for ₹ 1200 thereby pocketing ₹ 200 for a day's efforts.
- Thus from his perspective, his topline is ₹ 1200 while his bottom line is ₹ 200 ( $₹ 1200 - ₹ 1000 = ₹ 200$ ).
- Thus the aggregation of “selling price” of the product comprises the “top-line” whereas the aggregation of “profits” comprise the “bottom-line”.
- Thus “top-line” growth would be in the shape of selling more units of Bhel which he can achieve by either working for longer hours or by hiring people under him or increasing the price per unit of bhel.
- When the top-line (i.e. no. of units of bhel sold ) goes up profit margins remaining the same, the bottom-line too goes up proportionately.
- But it also important to note that “bottom-line” growth would also take place if the “bhelpuriwala” decides to increase the price of his “bhel”.
- Or is able to buy the ingredients at lower price.
- So in a sense to increase his bottom-line it is not necessary to increase top-line.
- Hope this lesson has succeeded in clarifying the difference between Top line & Bottom line Growth.

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