

Inflation will crush middle class

By Gopal Vittal & Rajesh Shukla, Mon, Jan 31, 2011

Last week, we met Mrs Soma Mukherjee in rural Bengal. She lives in a two-room home with her six-year-old daughter, her mother-in-law and her husband, who works as a mason. Her daughter goes to the school nearby. Her house has basic furniture, a colour TV, a DVD player and represents what we would call Middle India. Mrs Mukherjee's household expenditure has spiralled out of control in recent months. As a result, she has cut back on eggs, has switched to a coarser rice that costs less, consumes less cooking oil, uses the same washing powder for utensils that she washes her clothes with and has stopped using the cosmetic cream that she loves. Despite these sacrifices, she is unable to save any money.

Take a look at the data. NCAER-CMCR has divided the country into five income quintiles based on the National Survey of Household Income and Expenditure. The top quintile (20% or about 45 million households) accounts for almost 52% of aggregate income and 39% of consumption. However, they account for an even larger 45% of aggregate non-food consumption. This is the upper class that has driven a bulk of the incremental consumption in India. They have adopted a whole set of new categories and their consumption baskets have widened dramatically. This set of consumers epitomises the surging confidence of India having arrived. Considering that this quintile contributes almost 93% of aggregate savings, food inflation will have no impact on it.

Then there are the bottom two quintiles (40% or 90 million households) that account for 14% of income and 22% of consumption. Their share of food consumption is 26% and non-food consumption 17%. They spend a bulk of their income on food (63) and buy the bare necessities in terms of non-food items. Given their massive spend on food, these are households that are being squeezed with inflation. They are being forced to make even greater sacrifices than they are normally used to. However, there is no impact on their savings since these households did not save money anyway.

The most transformative impact, however, is felt by households like Mrs Mukherjee's. These are households that fall in the middle two quintiles (40% or 90 million households). These households account for almost 34% of aggregate income and 39% of aggregate consumption. They spend about 54% of their income on food and about 5-7 % each on housing, education, clothing, durables, health, transport and other nonfood items. Their spend on food has now spiralled up to 65-67 % of their income. To cope with this, they are the ones that are likely to cut back consumption where possible, buy cheaper products given alternatives, postpone the purchase of little indulgences and cut out discretionary spend altogether. With food sucking up more of their incomes their saving is likely to disappear altogether.

What happens to Middle India will affect the Indian consumption story. Many categories that form a part of routine consumption could see a slowdown in growths. Equally, there could be downtrading with consumers buying cheaper products as they seek to cope.

However, what is even more significant is the impact on consumer confidence. After all, the Indian consumption story is not just based on what happens today but the confidence and the hope of a better tomorrow. Middle India today accounts for only 15% of aggregate household savings. With burgeoning spend on food, savings will evaporate. Tragically, this drop in savings will be invisible at the aggregate level given the relatively low contribution of this consumer class to overall household savings.

While consumption attitudes may be severely affected in Middle India, life will continue as usual for the top quintile of households. Their attitudes will continue to remain positive since they will see little or no impact on their disposable incomes due to inflation.

As a result of the difference between the impact on the top quintile and the middle quintiles, the structure of consumption could become even more polarised. We could see a schizophrenic situation with a widening disparity in consumption and attitudes amongst the top and middle.

This volatility and structural shift in consumption will have consequences for both companies and policy-making. Companies will need to be far more flexible in understanding and navigating this new reality. The need for clarity on which consumer to target, how to play the product portfolio, clarity on what will drive growth, the role of pricing and innovation, and the need to weed out all unwarranted costs will be ever more important.

From a policy perspective, however, it is clear that food inflation is a national crisis of economic, social and emotional well-being that will affect not just the poor but also Middle India. If this is not addressed with urgency, there could be a slow down in consumption . But the real damage will be to confidence, well-being and social disparity.

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