

Press Release

CPI inflation nearing 5% likely to lead to a pause in rate cuts

Kharif crop shortfall and impact of lower rates to keep inflation firm in near term

Consumer inflation is set to climb further beyond 5.0% in the near term with lower crop production in the just concluded kharif season and the expected impact of the monetary transmission on core inflation. The CPI inflation rate has sharply increased to 4.61% in October 2019 which is higher by 62 bps and 123 bps respectively as compared to 3.99% in September 2019 and 3.38% in October 2018. Such an increase in CPI can be attributed to food inflation which has sharply risen by 490 bps over the past two months to reach 7.9% last month. While the spurt in the rise of vegetable prices (26.1%), meat and fish (9.7%) and pulses (11.7%) may be a short term anomaly due to supply side constraints arising from weather disruptions, Acuité believes that non-core inflation (food and fuel) is moving in a cyclical trend and is expected to accelerate in H2 FY20. Further, core inflation is also likely to inch up with better transmission of the lower interest rates and a gradual pickup in demand over the next 2 quarters. In our opinion, this may lead to a pause in the accommodative monetary policy of RBI and lessen the possibility of a further cut in interest rates.

There is a significant risk of a protracted period of higher CPI inflation in the next two quarters given that the food grain production in the concluded kharif season is set to be moderately lower than the estimates available in August 2019. This has been mainly due to two factors – higher acreage on commercial crops vis-à-vis food grains initially driven by late monsoon rains and further, unseasonal rainfall in the months of September and October which has led to crop damage in some regions and is likely to lead to lower crop yields. While the hopes of a better rabi output are high and the country has adequate food grain reserves at this point, a lower kharif output can build inflationary expectations. Acuité had highlighted such trends in its articles on agriculture and inflation in October 2019 (*please refer to the links below). Further, we also note that the increase in food inflation had been marginally offset by the deflation in fuel prices (-2%), thereby moderating the growth in non-core inflation year-on-year to 6.4%. Given the geo-political landscape, upside risks to fuel inflation will however remain in the domestic economy, the weak global economic outlook notwithstanding.

Core inflation, on the other hand, has remained steady at 3.3% in October 2019 due to continuing moderation in demand. Nevertheless, the impact of the declining interest rates is expected to give fillip to private consumption in the coming months,

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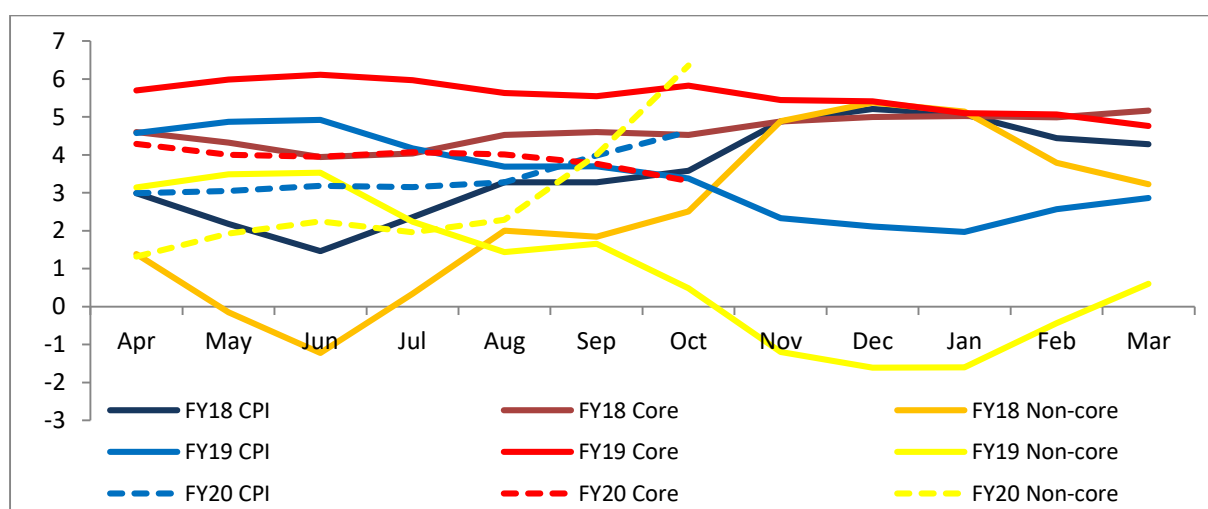
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thereby pulling up core inflation. While the intensity of the economic slowdown has not yet made the role of monetary easing visible yet, its impact on demand core inflation is inevitable. Acuité, therefore, expects the inflation rate to remain in the bank of 5.0%-6.0% in H2 of current fiscal year. While the effect of the 135 bps rate cut in this calendar year is yet to be reflected, inflation has already reached the 4.5% mark. Clearly once the core inflation starts on its upward trajectory to 5.0%, the overall inflation may touch the 6.0% levels.

*https://www.acuite.in/pdf/Monsoon_Impact_Oct_2019.pdf

*https://www.acuite.in/pdf/CPI_Acuite_Oct_2019.pdf

Chart 1: Category wise inflation movements during FY18-20



Source: MOSPI, Acuité Research

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