Press Release

Red alert on India's CPI inflation

8-year high print of 7.79% YoY in Apr-22 may trigger quicker rate hikes

12 May 2022

After moderating close to RBI's inflation target rate in Sep-21, headline CPI inflation has been rising incessantly with the print breaching the upper tolerance threshold in Q4 FY22, averaging at 6.34%. It has started to gather steam in Apr-22 gaining strength from the geo-political crisis and rising to an eight year high of 7.79%YoY from 6.95%YoY in Mar-22. On a sequential basis, the index rose by 1.43% MoM as compared to 0.96% in the previous month with pressures emanating from fuel, food as well as core inflation.

Food and beverage inflation soared to a 17-month high of 8.10% YoY compared to 7.47% in Mar-22. Sequentially, food and beverages index rose by 1.43% MoM in Apr-22 from an increase of 1.32% in Mar-22 with broad-based price pressures seen in Fruits, Cereals, Oils & Fats, Meat & Fish, Spices, Milk, and Prepared meals & snacks.

While food price pressure from perishables especially fruits are on an uptrend amidst the ongoing summer seasonality and increased transportation costs, elevated feed costs are also translating into escalation in poultry, milk and dairy product prices. These factors along with global shortages and price pressures already brewing in case of edible oils and cereals (particularly wheat) have added significant upside risks to food inflation trajectory for FY23. (Chart 2)

Given India's heavy reliance on imports of edible oils, export restrictions by key producing country (Indonesia announced a ban on palm oil exports to increase its domestic availability) along with drop in exports from Ukraine is likely to keep supply bottlenecks elevated. This is expected to put further upside pressure on edible oils prices thereby largely offsetting the government's earlier intervention in rationalizing import duties to control its rising prices. On the other hand, while India is the second largest producer of wheat, the high global prices has offered lucrative export opportunities which could partly reduce domestic availability, thereby pushing up its price in domestic markets. Additionally, the sudden spike in summer temperatures has caused a loss in yield, leading government to revise the wheat productions target for FY23 sharply lower from the proposed 111.34 mn tonnes to 105 mn tonnes. The increasing price pressures on cereals particularly that of wheat might warrant some government intervention in the form of draw-down of excess buffer stock/export restrictions. Nevertheless, manifestation of the anticipated normal monsoon (as per IMD, rainfall is likely to be normal at be 99% of the Long Period Average (LPA) with a model error of ± 5%) along with robust rabi arrivals would be critical to keep domestic food price pressures in check.

The transmission of higher crude oil prices by the OMC's to the domestic pump prices of petrol and diesel got clearly captured in the sequential momentum of fuel & light inflation which rose sharply by 3.11% MoM in Apr-22 from 0.91% in Mar-22. Broad-based expansion was seen in the categories of fuel inflation with the prices of Diesel, Kerosene and LPG rising significantly in Apr-22. On annualized basis, fuel inflation expanded in double-digits after a hiatus of 3-months rising by 10.8% YoY in Apr-22 from 7.52% in Mar-22. We expect the fuel inflation to trail higher with an assumption of crude oil prices averaging USD 100 pb in FY23, in our base case scenario.

Continued rise in price of clothing & footwear followed by miscellaneous and housing category led core inflation (inflation ex. fuel and food) to cross the upper end of RBI's inflation targeting framework for the first time since 2013, printing at 7.24% YoY in Apr-22 from 6.52% YoY in Mar-22. While the former reflects the impact of a hike in GST rate on footwear, increase in miscellaneous category is led by jump in transport & communication on the back of rise in the retail pump prices along with increase in gold and silver prices.

Going forward, we expect the core inflation to remain sticky at elevated levels given upward revision of petrol and diesel prices by the OMCs in order to reduce the under-recoveries being accumulated by them at the current crude prices of USD 100+ pb. The government, however, may also consider a partial absorption of the increased prices through a further excise duty cut on petrol and diesel which could provide marginal comfort from inflation perspective. While the direct pass-through of elevated commodity prices can be seen through increasing prices of petrol and diesel and non-subsidized LPG, indirect pass through of unprecedented input cost pressures by manufacturers is visible through rising prices of certain personal care products within FMCG sector which will get reflected in the core CPI print in the coming months.

The increasing price pressures was in motion even before the onslaught of the geopolitical conflicts. However, lingering war between Russia and Ukraine, unprecedented level of sanctions, elevated oil and commodity prices along with prolonged supply chain disruptions have escalated the inflationary concerns both in the global as well as domestic economies. Globally most economies have shifted from an extended disinflationary phase to tackling strong inflationary concerns, causing key central banks monetary policy rhetoric to switch to extreme hawkishness and policy tightening in 2022 from pandemic-era accommodative policies.

From domestic standpoint, for FY23, inflation drivers are likely to face considerable pressure from persistent hardening of input prices. The heightened pressure from commodity prices is also coinciding with unlocking of the economy post Omicron wave while vaccination coverage continues to gain traction. While we stick to our estimate of 5.9% for FY23 CPI inflation, we now believe that there is a buildup of upside risks.

With an aim to mitigate inflationary pressures and keep inflation expectations anchored, the RBI in a surprising inter-meeting move raised repo rate by 40 bps to 4.40%, resulting in the MSF and SDF rates to also adjust upwards to 4.65% and 4.15% respectively. In addition, the RBI also announced a 50 bps increase in the CRR to 4.50% of bank's NDTL (net demand and time liabilities). Given the tone of urgency in RBI's statement to support the altered inflation-growth dynamics, we now revise our call and expect the RBI to hike repo rate by an additional 60 bps in the rest of FY23. However, if inflation pressures continue to mount there is a likelihood of additional hikes thereby taking the rate to its pre pandemic level of 5.15% or even higher in FY23. Additionally, we also expect CRR to be hiked by another 50 bps by H1FY23.

Annexure

Chart 1: Apr-22 inflation rises to an 8-year high of 7.79% YoY

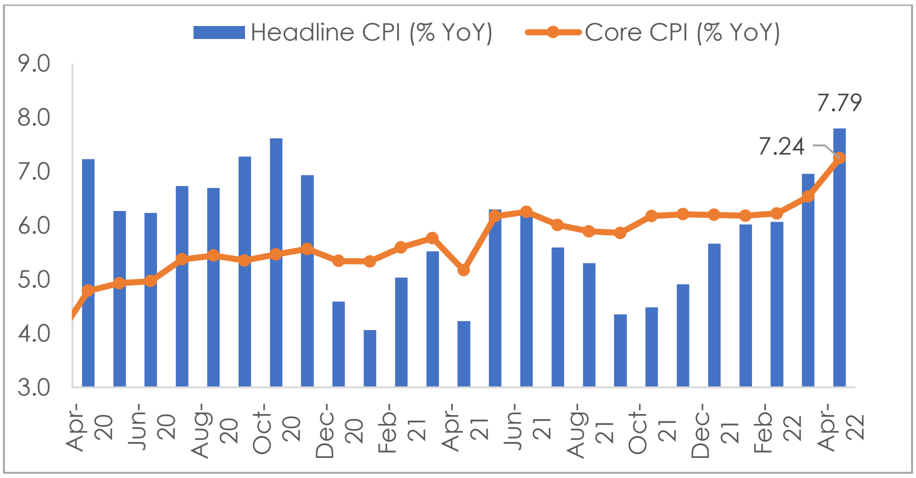


Chart 2: Rising commodity prices to keep input costs inflated

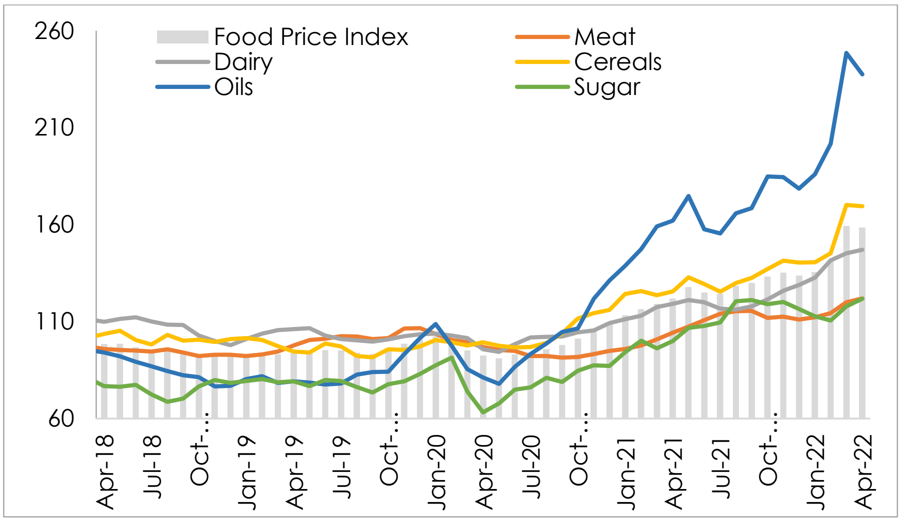
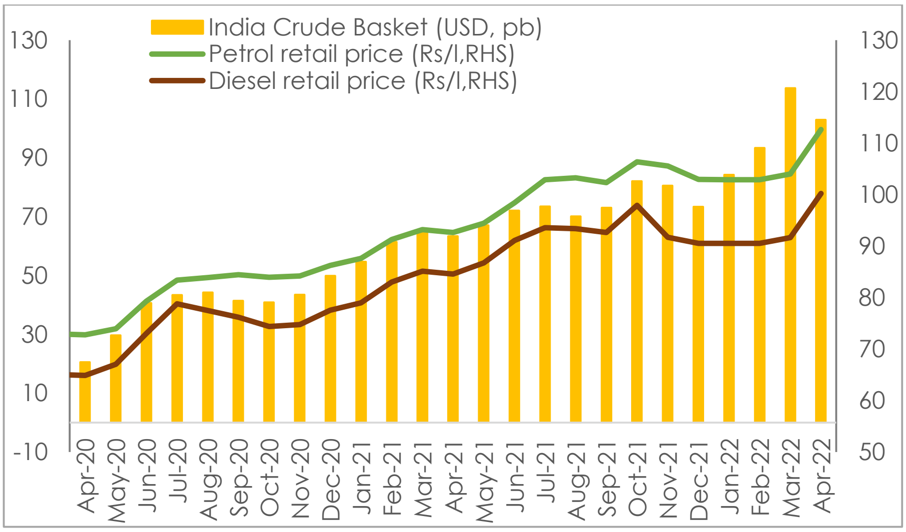


Chart 3: Rise in energy prices led fuel inflation to rise in double-digits of 10.8% YoY



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