

Press Release

Rise in food prices reverses three-month downtrend in CPI inflation 50 bps rate hike quite likely in the forthcoming MPC meeting

12-Sep-2022

India's CPI inflation in Aug-22 rose marginally to 7.0% from 6.7% recorded in Jul-22, thereby reversing a three-month downward streak in the price momentum. After peaking out at 7.8% in Apr-22, India's retail inflation continued to ease on a sequential basis with the print consolidating below the 7% mark in Jul-22. However, the rise in food prices amid an erratic monsoon pattern and GST hikes on certain food products of mass consumption has again pushed the CPI print at 7.0% in Aug-22. On sequential basis, the print inched up slightly by 0.52% from 0.46% MoM with price pressure seen primarily in the food category.

Sequentially, food and beverages index rose significantly by 0.74% MoM in Aug-22 from an increase of 0.06% in Jul-22 led by an increase in price of cereals, milk & milk products, vegetables, pulses, sugar, and spices. However, some offsetting impact emerged from meat & fish, eggs, and edible oils. It's interesting to note that edible oil prices have contracted sequentially for the third consecutive month in tandem with global edible oil prices. The UN Food Price registered its fifth consecutive monthly decline of 2.7% MoM in Aug-22 from a decline of 8.7% in the previous month on the back of significant drop in edible oil prices, of which India is a major importer.

Overall, while monsoon performance has picked up post a sluggish start registering a cumulative rainfall of 4.9% above the long period average (as of Sep, 7th), there has been an uneven monsoon distribution (with state level cumulative deficits of 45% in Uttar Pradesh, 38% in Bihar, 26% in Jharkhand, and 10% in Kerala) and the kharif sowing activity has been relatively muted, especially in case of pulses and paddy. Given the significant rainfall deficiency in some of the major paddy growing states, irrigation support would be a critical factor for the rice output in the current season. This poses some risk to food inflation, esp. coming from rice and related products (cumulative weight of 5% in CPI basket). In the past couple of months, the retail price of rice has already been increasing and currently is trailing ~8% higher than last year. In order to tame the domestic food price pressures especially for cereals, the government, after imposing restrictions on export of wheat, has banned export of broken rice and imposed an export duty of 20% on whit non-basmati rice. The 20% export tax will slow India's exports ensuring domestic availability and augmenting supply thereby moderating inflationary pressures. However, from the global perspective, while the food prices have been gradually easing, the reduction in outbound shipments of rice (accounting for more than 40% of global shipments) and wheat from India would impart some upward pressure on cereal prices, likely causing fresh pressures on global food inflation.

On the other hand, while fuel and light continued to remain in double-digits in Aug-22 at 10.8% in Aug-22, sequentially it contracted by 0.45% MoM for the first time in nine months led by decline in price of kerosene, diesel, coke, charcoal, and dung cake. In a major relief to the domestic economy, the crude oil prices have corrected

significantly in the month of Sep-22 to average ~USD 90 pb despite OPEC's announcement to cut supply by 100,000 barrels per day beginning Oct-22. While the prices have been softening over the last couple of months, the recent sharp decline is due to renewed fears of recession in Europe and decline in demand from China, which brought in new Covid lockdown measures amid weakening factory activity. While this could provide some breather to the domestic OMCs profit margins, we don't expect a significant impact on fuel inflation as domestic pump prices may remain unchanged until crude oil prices continue to tread lower on a prolonged basis.

Core (i.e., CPI ex indices of Food & Beverages, Fuel and Light) inflation momentum rose by 0.51% MoM in Aug-22 from an increase of 0.59% in the previous month. The increase was broad based with categories of clothing, housing and miscellaneous category recording a sequential increase. Going forward, we expect the sticky core inflation to persist with a strong pick-up in retail, lagged pass-through of elevated input prices and impact of GST rate hike on certain household consumption items.

In terms of trajectory, after averaging at 7.3% in Q1FY23, we expect inflation to display some downside in the ongoing quarter, notwithstanding a marginal upward bias that months of Aug-Sep-22 carry owing to an adverse base. H2 FY23, is likely to see a more favorable inflation outturn with Kharif harvest coming onboard, winter seasonality in perishables kicking-in and a lagged pass-through of commodity price softening amidst a favorable base. However, impact of GST rate hikes on several food items, continued rupee depreciation, risks of a shortfall in paddy production amid uneven rainfall distribution, and rise in services inflation amid strong demand for contact-intensive services could act as a upside risk to overall inflation trajectory. Taking these factors into consideration, we continue to expect inflation at 6.7% for FY23.

Says Suman Chowdhury, Chief Analytical Officer, Acuité Ratings & Research "While concerns over inflation appear to have eased marginally on the domestic front, it continues to remain an evolving concern globally with leading major central banks continuing with their monetary tightening journey. In the domestic context, we also expect the RBI to remain hawkish till the CPI headline print sustainably drops below the 6.0% MPC- the upper tolerance threshold. Accordingly, there is an increased likelihood of another 50 bps rate hike in the Sep-22 policy review itself or spread between the former and Dec-22 meeting to combat the residual inflationary expectations and arrest further rupee depreciation."

Annexure

Chart 1: Aug-22 CPI print inches back to 7.0% YoY

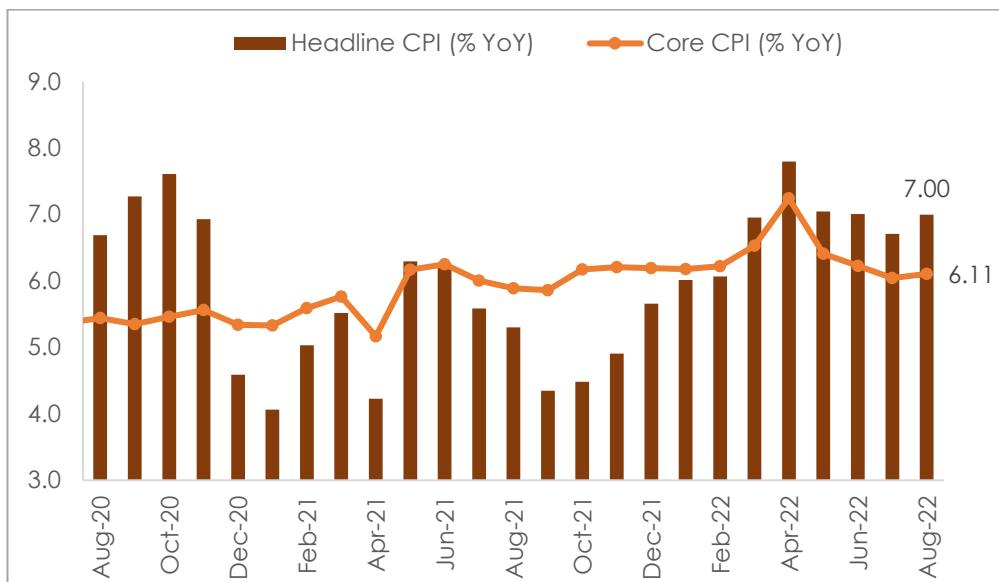


Chart 2: UN FAO price index eases further in Aug-22 led by drop in edible oil prices

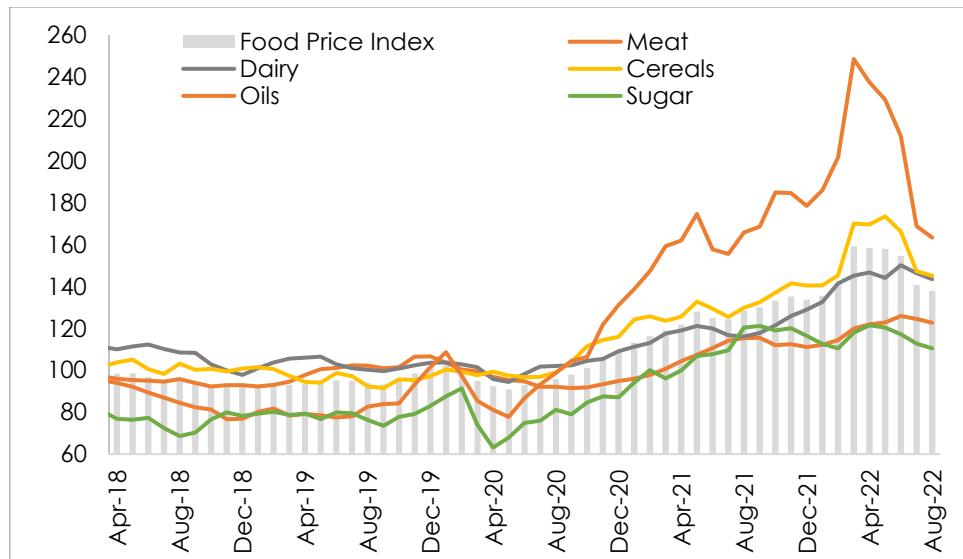
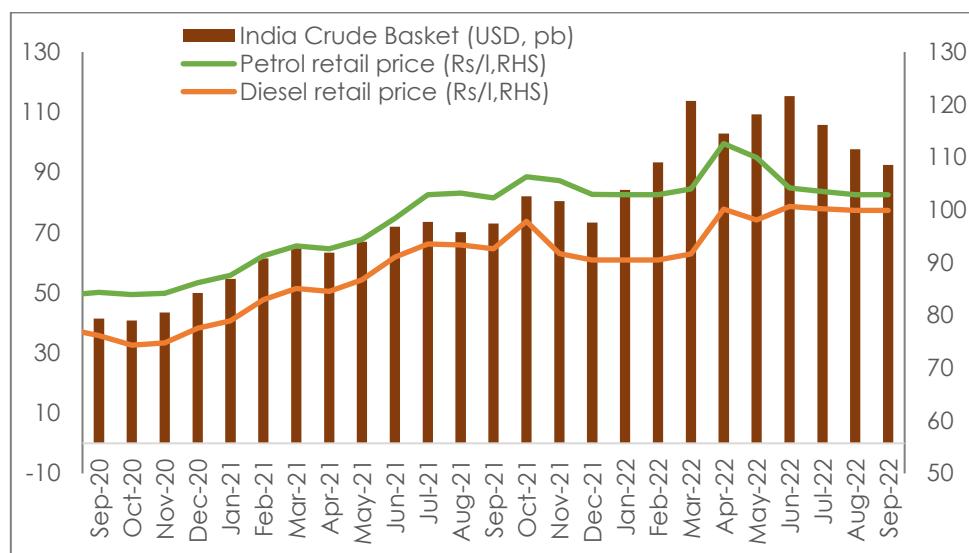


Chart 3: Easing of crude oil price below USD 100 pb to provide some comfort



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