Press Release

Food prices nudge CPI inflation higher

Sequential comfort derived from the decline in fuel prices

13 December 2021

After bottoming out at 4.35% in Sep-21, while India's retail inflation inched up further to 4.91% YoY in Nov-21, it was slightly lower than ours as well as market expectations of 5.1% YoY. However, it is important to note that annualized print rose for the third consecutive month thereby gradually drifting away from the mid-point of RBI's inflation targeting band of 2-6%. Sequentially, the momentum eased from a 5-month high of 1.4% in Oct-21 to 0.7% in Nov-21 primarily driven by the categories of fuel, housing and miscellaneous.

Food inflation trajectory has remained volatile since the beginning of FY22. While supply side interventions taken by the government through custom duty cuts in the case of pulses and edible oils helped in moderating the price pressures, incessant and irregular rains along with increase in transport cost amid elevated crude oil prices led food inflation to rise by 2.6% YoY and 1.2% MoM in Nov-21 from 1.8% YoY and 2.3% MoM in Oct-21 respectively. The increase in food inflation is predominantly led by vegetables (7.5% MoM) followed by eggs (1.0% MoM), with other categories recording a moderation.

Notwithstanding the jump in prices in Oct-Nov'21, food inflation is likely to remain broadly comfortable over the coming months as vegetable prices could see some seasonal normalization amid winter arrivals, healthy rabi sowing (as of 10th Dec-21, actual area sown as % of normal area stands at 82%) along with the recent dip in crude oil prices thereby easing transportation costs. However, the recent unseasonal rains in certain parts of India could lead the vegetable mandi prices to remain volatile in the short term.

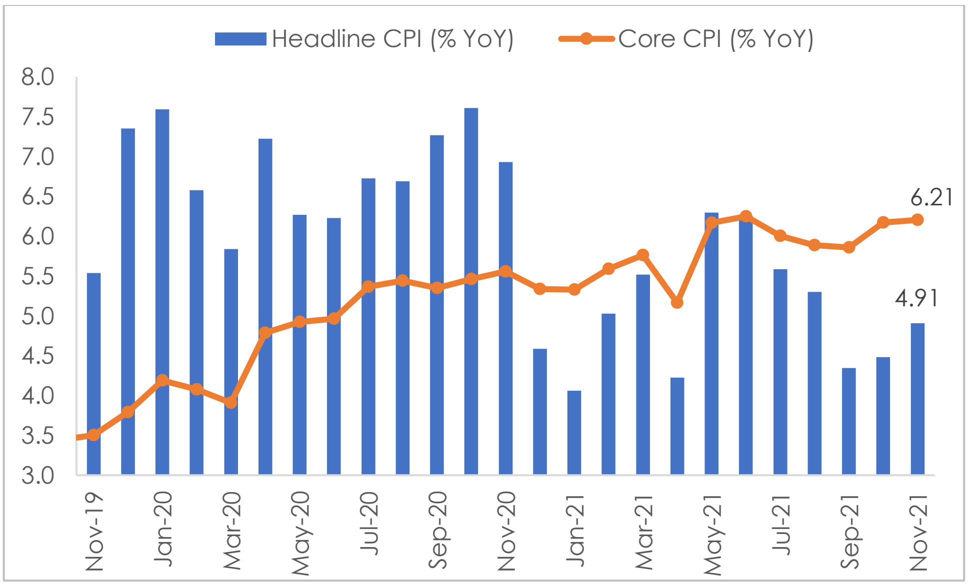
On the other hand, fuel inflation registered a sequential contraction of 0.2% MoM after a hiatus of 15 months led by decline in the price of diesel (-5.6% MoM) amid excise duty cut by the government followed by decline in cost of electricity (-3.2% MoM) and charcoal (-1.4% MoM). As such, annualized fuel inflation modestly eased from a series high of 14.3% to 13.3% YoY in Nov-21. Notably, the recent correction in crude oil prices which is hovering close to USD 75 pb in Dec-21 so far is likely to provide further comfort to fuel inflation in the near term.

Given the higher weightage of petrol and diesel (combined weight is 2.3%) in the miscellaneous category (a proxy for services inflation) of CPI basket, central as well as state government's move to cut excise duties and VAT on petrol and diesel has been more pronounced leading transport costs to contract sequentially to nearly a 3-year low of 0.6% MoM. This helped sequential momentum in core inflation (ex. Food & Bev, Fuel & light) to ease to 0.4% MoM in Nov-21 from 0.7% in Oct-21. However, the comfort on core front is expected to remain short lived as the recent hike in telecom tariffs is likely to have an impact in the next month as the they were rolled out towards the end of Nov-21. Additionally, demand for services is also seeing a strong pick-up. Not surprisingly, PMI services soared to over a decade high of 58.4 in Oct-21 and remained at 58.1 in Nov-21. This could trigger a faster upward adjustment in services inflation with individual mobility for retail and recreation back to pre-Covid19 levels.

In the last three months (Sep to Nov'21) base effects have kept average CPI within the range of 4-5%, but the trend in Q1 FY22 is likely to head further north towards 6.0% led by imported energy costs, narrowing output gap and higher pass through of input price pressures in manufacturing sector thereby keeping core inflation sticky at elevated levels of 6.2% in Nov-21. Overall, we continue to maintain our CPI inflation forecast at 5.5% in FY22 with upside risks in case there are strong signs of a demand pickup by end of Q3FY22.

Globally, inflation has become a major cause of concern amid surge in commodity and raw material prices, persistence of supply bottlenecks and demand push inflation thereby forcing many central banks to start considering normalization of pandemic era accommodative policies. However, from domestic standpoint the RBI is unlikely to face similar pressures. The focus of the RBI as also entailed in the Dec-21 policy review remains on ensuring a durable economic recovery. Consequently, from monetary policy perspective, while the calibration of the surplus system liquidity will continue till the next policy meeting, it is difficult to comment on the timing of the reverse repo rate hike. There may be a possibility of such an increase in Feb-22 provided the high frequent economic indicators continue to remain robust and the recent discovery of a new Covid variant "Omicron' doesn't start building up another pandemic wave in the country. Continuing uncertainty on the residual risks of the pandemic can reinforce the 'wait and watch' approach of RBI, thereby slowing down the progress on the policy normalization path.

Chart 1: CPI inflation further ticks up in Nov-21



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