Press Release

June CPI: Offers some comfort, but risks persist

Q1 FY23 average inflation stands at 7.3% vs. RBI forecast of 7.5%

12 Jul 2022

Headline CPI inflation eased marginally to 7.01% YoY in June-22 from 7.04% in May-22 partly aided by continued favourable statistical base of the previous year and full impact of the reduction in excise duty on retail fuels coming on board. While the month of Jun-22 marked the sixth consecutive month of CPI inflation remaining way above the 6.0% policy tolerance threshold, Q1 FY23 print has averaged at 7.28%, encouragingly lower than RBI's expectation of 7.50%. On sequential basis, the print eased to 0.52% MoM from 0.94% with moderation recorded in the categories of fuel, food, and core inflation.

Sequentially, food and beverages index rose by a moderate 0.92% MoM in Jun-22 from an increase of 1.46% in May-22 with easing price pressures recorded in pulses, fruits, and oils & fats. However, adverse summer seasonality, exacerbated by elevated agricultural inputs kept price of vegetables higher. Additionally, higher feed costs are also translating into escalation in poultry, milk, and dairy product prices. That said, the recently announced hike for kharif crops by an average of 5.9% (vs. last 3-year average of 4.0%) appears moderate amidst the backdrop of pickup in agricultural input prices. This, as per our estimates would provide subdued impact of 10~15 bps to FY23 CPI inflation. On the other hand, there are signs of partial respite due to resumption of palm oil exports from Indonesia and imposition of domestic export ban on wheat, the impact of which is clearly captured in the monthly momentum of cereals and edible oil prices. Looking ahead, we expect the food price pressures to moderate given normal monsoon spell and prospects of good kharif sowing so far.

On the other hand, fuel and light inflation moderated to 1.03% in Jun-22 from 1.39% MoM in May-22 reflecting the excise duty cut and VAT reduction by the Centre and states. For the month of Jun-22, broad-based moderation was recorded in the categories of diesel, coke, charcoal, and electricity. Although retail pump prices have remained unchanged since the reduction post the cut in excise duties, incremental buildup of under recoveries could eventually result in upward adjustment in prices by oil companies or a further buildup in fiscal headwinds via subsidies. Additionally, some of the states have also revised their electricity tariffs higher, that is yet to get captured in CPI data as of now.

Core (i.e., CPI ex indices of Food & Beverages, Fuel and Light) inflation momentum remained flat, leading the annualized rate of core inflation to ease to 6.22% from 6.41%. The moderation was primarily led by the transport and communication within miscellaneous category (capturing excise duty cut on petrol and diesel prices). Sequential momentum in Clothing & Footwear category also eased, albeit marginally, despite the impact of earlier hike in GST rate along with strong pickup in retail mobility in the post Omicron phase. Going forward, with complete opening up of the economy, strong pick-up in retail, and vaccination attaining critical mass, the passthrough of elevated input prices is likely to hasten, keeping core inflation sticky at elevated levels of 6.0% in FY23.

The moderation in sequential momentum in case of most items within CPI in May-22 offers some respite and hope that inflationary pressures may ease going forward. The latest data indicate that the concerns of slowdown or even recession in some nations have started to have a counter effect on the global commodity prices. While crude oil prices still continue to rule above USD 100 pb (while has moderated from USD 115 pb in Jun-22), prices of metals, precious metals, fertilizers, and non-energy commodities have clearly moderated to some extent. Further, good progress in monsoon and likelihood of further duty cuts by both the central and the state governments to moderate the impact of increased crude oil prices could help to rein in elevated prices pressures.

Nevertheless, it would be premature to pronounce a trend reversal at this juncture as the ongoing geopolitical conflict show no signs of abatement. Another major reason for discomfort is the rise in the imported inflation amid significant rupee depreciation which has made inbound shipment of commodities such as oil, metals, coal, and fertilizer costlier. As per RBI's own study, a 5% depreciation in rupee leads the inflation to rise by nearly 10-15 bps. Considering INR's 6.3% depreciation in 2022 so far and given India's heavy reliance on crude oil imports, the risk of imported inflation will remain high in the near term.

As per our inflation model, we expect headline CPI inflation to average at 6.7% in FY23 with an assumption of crude oil averaging at USD 110 pb in FY23. From policy perspective, we expect an incremental 75 bps hike in repo rate between Aug-22 and Dec-22. This will take the repo rate to 5.65% i.e., 50 bps above the pre-pandemic level. Post Dec-22, RBI could take a pause and reassess the evolving domestic growth-inflation scenario, in the global context.

Says **Suman Chowdhury, Chief Analytical Officer, Acuité Ratings & Research** "While the continuing rupee depreciation has raised the risks of imported inflation, several steps taken by the government to rein in prices of essential commodities and lately, by RBI to stabilise the rupee may help to address such risks. Overall, the current picture of inflation raises hopes of a gradual moderation going forward with Q1 average CPI inflation already lower than RBI's forecast by 20 bps. This has the potential to slow down the pace of rate hikes in the current year."

Annexure

Chart 1: Jun-22 CPI print moderates for the second month in a row to 7.01% YoY

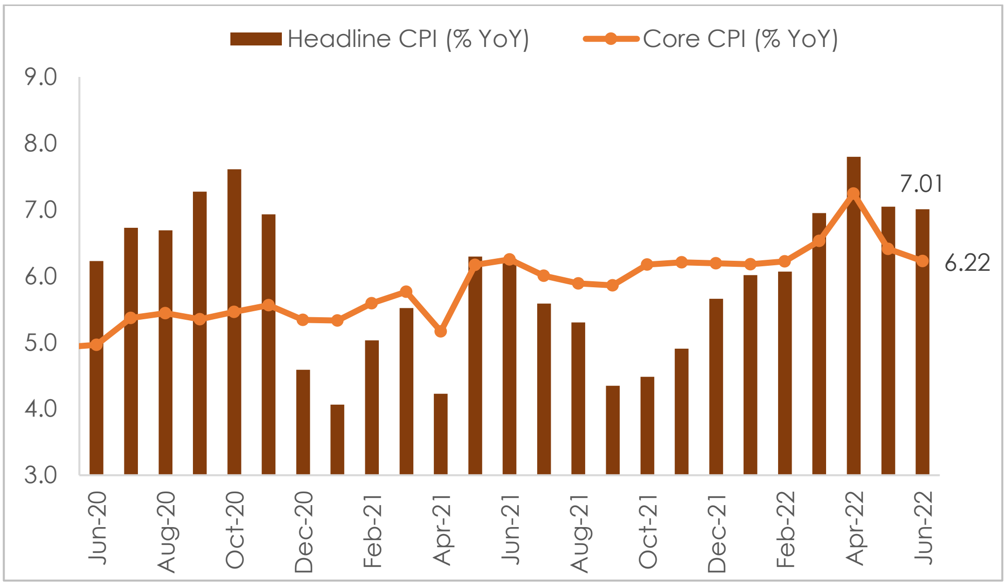
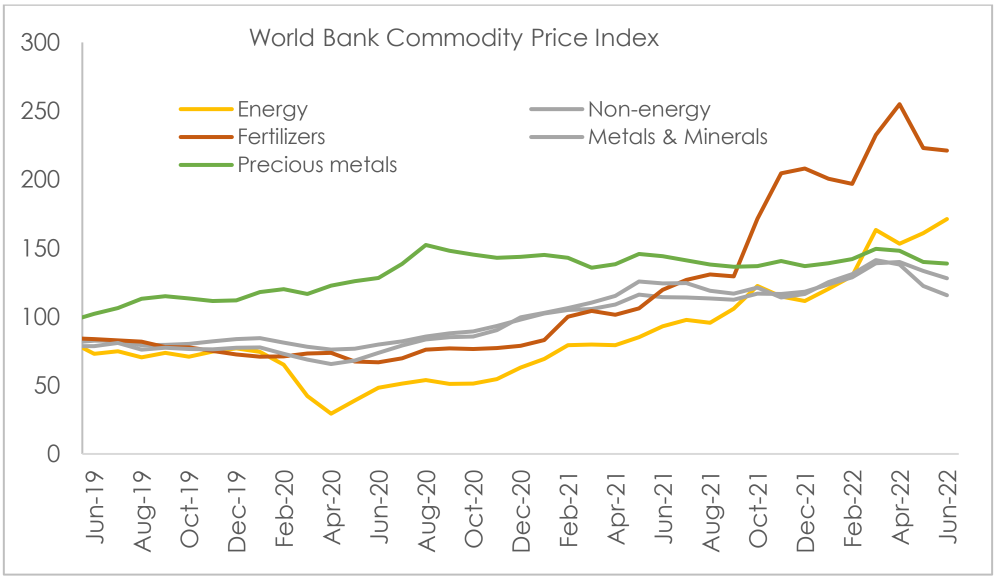


Chart 2: Global commodity prices record some moderation



About Acuité Ratings & Research Limited:

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