Press Release

Still some time away from an inflation pivot

Core inflation remains steady above 6%, another round rate hike likely in Feb-22

13-Dec-2022

The monthly CPI inflation data print for Nov-22 has surprised the markets, clocking 5.88% YoY, significantly down from 7.41% in Sep-22. This is the first time after eleven months that the headline print has dropped below the RBI upper band of 6.0%. Further, this is also the first time since Feb-22 that there has been a sequential contraction in the index at -0.72%. While this comes as a relief to the central bank and the market participants and may reflect in bond prices to an extent, the sustainability of the decline below the 6% mark needs to be seen over the next few months. It may be noted that the print had a moderate base factor benefit in Nov-22 which will not be available in the next two months.

Given that food comprises 45.86% of the retail inflation basket, the latter's linkage with food and beverage (F&B) inflation is particularly strong. This is also reflected in the data for Nov-22 where F&B inflation slid below 6.0% YoY for the first time after Mar-22 after holding over 7.0% in almost all the months. On a sequential basis also, the F&B inflation print has seen a 0.7% contraction for the first time since Feb-22.

Higher inflation in cereals driven both by the extension of the PMGKAY programme and the shortfall in cereal procurement along with higher vegetable inflation for a protracted period due to irregular rainfall had been the key factors for the above average food inflation in the first half of the year. Cereal prices continued to show a sequential rise from Sep-21 but it accelerated from Jul-22 onwards and has been a primary contributor to the high F&B inflation. Cereal inflation stood at a high of 12.96% YoY in Nov-22 and is unlikely to come down in a hurry, given the reduction in buffer stocks. Vegetable inflation has been volatile and in high double digits in the first half of the current fiscal but from Oct-22 onwards, the winter seasonality has kicked in, bring the much needed relief in vegetable prices. Interestingly, fruit inflation has been relatively benign in comparison and reflects the increased investment in horticulture and storage infrastructure apart from higher imports. The animal protein inflation (egg, fish, and meat) has also been largely stable from Sep-22 onwards although egg prices have seen a sharp uptick in Nov-22. One of the categories that has helped to offset the price pressures in cereals and vegetables is edible oil where prices had been very high for a protracted period in FY21 and FY22 but has dropped steadily from a peak in May-22 and stood 6.7% lower in Nov-22. This can be attributed to the measures taken by the government to facilitate higher and cheaper imports of edible oil through duty rationalization. Similarly, pulses inflation has also seen a gradual moderation and stood at less than 3.0% in H1FY23. While milk prices have been increased by the producers in the current year, the rise has been gradual. Heavier than usual rains in South India has led to lower crop and higher inflation in spices although they have a small weightage in the consumption basket. Overall, the food inflation has started to show a sequential decline in Nov-22 and this is expected to sustain in the remaining months supported by the moderation in the Global FAO Food

Price Index by 17.2% since the peak in Mar-22. Further, as in the previous months, the government is likely to take additional measures to cool down food prices in case there is any sharp blip. Nevertheless, we believe that the moderation in food inflation will be in a gradual manner given the high cereal prices and MSPs.

While crude oil prices have been on a downtrend, there has been a modest rise in the fuel and light inflation to 10.6% in Nov-22 from 9.9% in Oct-22 with a sequential uptick of 0.4%. The uptick in sequential momentum was primarily on account of the revision in electricity tariffs, firewood and chips as well as kerosene. It may be noted that inflation in this basket is not directly related to the transportation fuel prices and more linked to the electricity tariffs and LPG/CNG prices used in households.

While housing inflation continues to be stable at 4.6% YoY, clothing and footwear and miscellaneous category inflation continue to be relatively high at 9.8% YoY and 6.1% YoY respectively in Nov-22. The sequential inflation in both the latter categories continue to be positive throughout the current year, reflecting the transmission of higher food and fuel prices to the other goods and services consumed by households. The steady inflation print of around 6.0% in the miscellaneous category in the current fiscal reflects a broad based increase in the charges for household services, healthcare, transport, communication, recreation, education and personal care. Clearly, the demand in these segments have seen a significant recovery after the prolonged pandemic and has allowed the pass through of higher operating costs by the service providers.

Consequently, Core (i.e., CPI ex indices of Food & Beverages, Fuel and Light) inflation momentum rose further by 0.43% MoM in Nov-22 after a 0.60% rise in Oct-22. Further, annualized Core CPI increased marginally to 6.29% in Nov-22 from 6.23% YoY in Oct-22 and has consistently remained above 6.0% for fourteen months since Oct-21. Going forward, we expect the sticky core inflation to persist and hold at over 6% in the near term due to the ongoing pick-up in retail demand and the lagged pass-through of elevated input prices to end consumers particularly in the services sector.

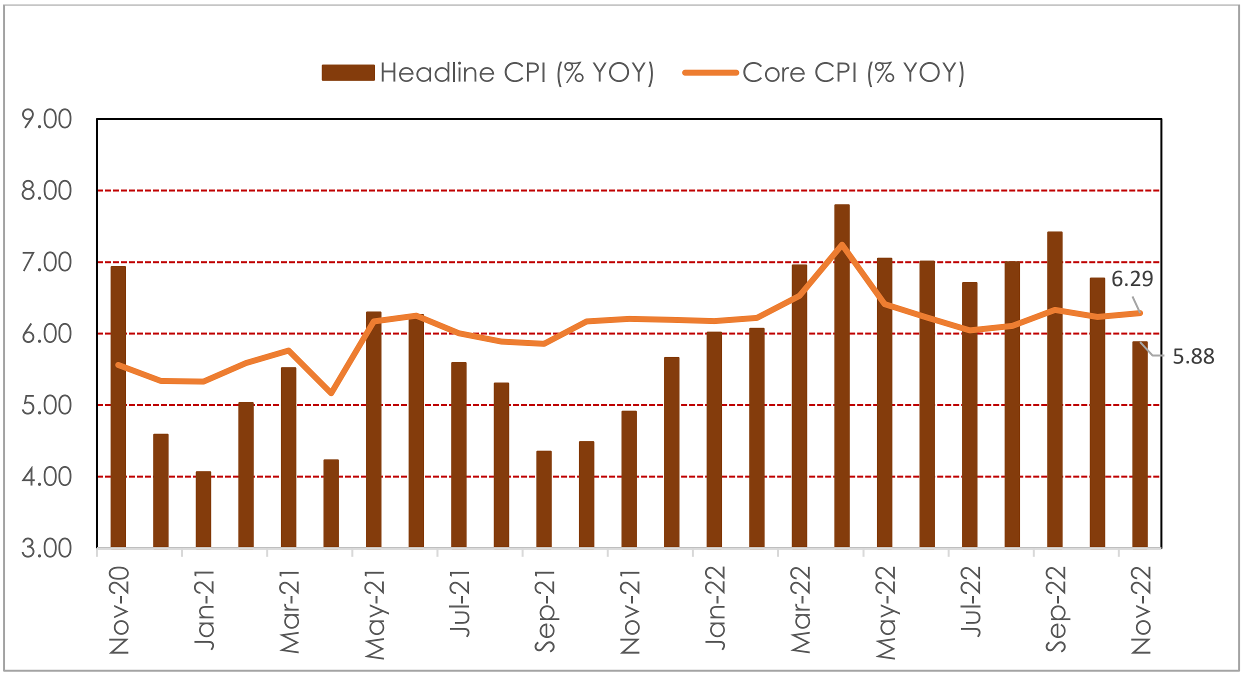
The quarterly CPI inflation print in the current fiscal suggests a gradual moderation from 7.28% in Q1 to 7.04% in Q2 and going by the data points of Oct-22 and Nov-22, we expect the Q3 print to be between 6.20%-6.30% which is still above the upper band of RBI MPC. We hold on to our forecast of 6.7% average CPI inflation for FY23 as a whole based on the expectation of an Q4 average of 5.8%.

RBI MPC has raised the repo rate by 35 bps to take the repo rate to 6.25% in the current month in line with our expectations. However, the likelihood of a pause hereafter has reduced due to the hawkish tone of the MPC and its stated stance to continue with the “withdrawal of accommodation” mode for now. RBI has particularly voiced its concerns on the sticky core inflation which has held up above 6.0% for more than a year. While MPC will closely look at the upcoming macro data prints before Feb-22 meet, we believe there is still a significant likelihood that there will be another round of a moderate rate hike of 25 bps before any change in the stance to ‘neutral’.

Says Suman Chowdhury, Chief Analytical Officer, Acuité Ratings & Research “It is a pleasant surprise to see the headline CPI inflation print at 5.88% in Nov-22 since most market participants estimated it to be above 6.0%. This is an eleven month low figure and is clearly driven by the faster than expected decline in food inflation which stood at 5.07% in the previous month due to the quick drop in vegetable prices. Nevertheless, the core inflation figure remains high for RBI's comfort and has in fact moved up further to 6.29% in Nov-22; on a MoM basis, the core inflation went up by 0.43%, highlighting the embedded nature of the current inflationary environment. The moderately healthy, if not strong, momentum in domestic demand clearly, is the driver of high core inflation. Also, the base factor was relatively an advantage for the Nov-22 headline print which may not be the case for Dec-22. Therefore, we don't expect any significant trend downwards for the CPI inflation for the next few months and continue to forecast an average figure of 6.7% for CPI inflation in FY23. Given the latest narrative from RBI MPC, we also expect another round of modest hike in Feb-23 which will take the terminal rate to 6.5% or higher."

Annexure

Chart 1: While headline CPI moderates slightly, Core CPI inflation consistently >6.0%



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