Press Release

Higher food prices continue to hold up CPI inflation over 7.0%

35-40 bps rate hike on the cards in the Dec-22 MPC meeting

12-Oct-2022

India's CPI inflation in Sep-22 rose to a five-month high of 7.41% from 7.00% recorded in Aug-22, with the print remaining well above the upper tolerance level of RBI's inflation targeting framework for the ninth consecutive month. The marginally higher than expected print was primarily on the back of rise in food prices especially that of cereals and vegetables followed by rise in clothing and footwear. Sequentially, the pace of build-up in consumer prices that eased for three months in a row till Jul-22, has been once again gaining momentum with the month of Sep-22 recording an increase of +0.57% from an increase of +0.52% in Aug-22. Taking into consideration today's print, the Q2 FY23 inflation has settled above the 7.0% mark at 7.04% for the second consecutive quarter with persistent pressure seen in food & beverages and clothing & footwear.

Sequentially, food and beverages index rose significantly by 0.85% MoM in Sep-22 from an increase of 0.74% in Aug-22 led by an increase in price of vegetables, cereals, meat & fish, and spices. However, some offsetting impact emerged from fruits and edible oils. It's interesting to note that edible oil prices have been contracting sequentially for four consecutive months now, in tandem with decline seen in global edible oil prices and supported by the steps taken earlier by the government. The UN Food Price registered its sixth consecutive monthly decline on the back of significant drop in edible oil prices, of which India is a major importer.

While easing of supply chain bottlenecks have led the food price pressures at the global level to ease, the food prices on the domestic front have been playing spoil sport amid uneven rainfall distribution and in anticipation of a material drop in kharif foodgrain output. Although monsoon performance picked up post a sluggish start recording a cumulative surplus rainfall of 6.6% above the long period average (as of Sep-22), the lower acreage for rice and wheat and an anticipated decline in production (6% as per the first advance estimate of Kharif production), has led to an upward pressure on domestic prices. Additionally, speculative trading and festive season demand are also conjectured to be weighing on prices. Nevertheless, government's efforts to tame supply side inflation in the form of export ban on broken rice and the imposition of a 20% export duty on non-basmati rice exports along with export restrictions on wheat and atta is likely to offer some reprieve.

On the other hand, while annualized fuel and light inflation eased marginally in Sep-22 to 10.39% YoY vs. 10.78% in Aug-22, sequentially it inched up by +0.39% MoM from a contraction of 0.45% in Aug-22. The uptick in sequential momentum was on account of rise in the price of electricity, coke, coal, charcoal, and dung cake. Post a significant correction in oil prices to USD 85 pb in the month of Sep-22, the prices are once again hovering at USD 90+ pb levels with OPEC+ countries opting for 2 million barrels per day cut in oil production. Notwithstanding this marginal rise in crude oil, renewed recession fears in the key developed economies coupled with Zero Covid policy in China, is expected to keep the crude oil prices capped at ~USD 100 pb in FY23 from USD 105 pb expected earlier.

Core (i.e., CPI ex indices of Food & Beverages, Fuel and Light) inflation momentum rose by 0.41% MoM in Sep-22 from an increase of 0.51% in the previous month. On an annualized level, the core print stood at 6.33% vs 6.11% in Aug-22. While housing and miscellaneous category registered a moderation, clothing & footwear recorded an increase in prices. Going forward, we expect the sticky core inflation to persist with a strong pick-up in retail, lagged pass-through of elevated input prices to end consumers to recoup the profit margins and impact of GST rate hike on certain household consumption items.

In terms of trajectory, after averaging at 7.16% in H1 FY23, H2 FY23 is likely to see a more favorable retail inflation outturn with Kharif harvest coming onboard, winter seasonality in perishables kicking-in and a slower pass-through of commodity price that is showing a moderating trajectory. 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, the risks to our FY23 CPI inflation estimate of 6.7% appear to be somewhat well balanced at the current juncture.

From monetary policy perspective, the response from the RBI is unlikely to exhibit the high degree of hawkishness currently displayed by most DM and few EM central banks given India's inflation divergence from its target is materially lower as compared to the other economies. Accordingly, going forward, we expect the central bank to balance the growth-inflation dynamics in a nuanced manner. As such, we expect the RBI to slow down the pace of interest rates hike with a likelihood of 35 bps rate hike in the Dec-22 policy review and decide on the next steps depending on the incoming inflation data.

Says Suman Chowdhury, Chief Analytical Officer, Acuité Ratings & Research "The retail inflation print has been higher than expectations, driven by food inflation which has increased sequentially by 0.9%, leading to the overall inflation to go up by 0.6% over the index in the previous month. Irregular rainfall in Sep-22 has been the primary reason behind higher inflation in vegetables and cereals, which we believe is temporary in nature. What, however, will remain a worry is the rise in core inflation to 6.3% from 6.1% in Aug-22, highlighting that the price pressures have started to get embedded due to demand recovery. Going forward, we expect the average inflation in H2FY23 to moderate, given the correction in commodity prices and the slowdown in global economic activity although such moderation will be gradual. In our opinion, the likelihood of a moderate hike of 35-40 bps in the repo rate in Dec-22 is high given not only the inflation print but also the pressure on the currency. The systemic liquidity will also get tighter and will start getting reflected through a rise in bank deposit rates to the extent of 100-150 bps over the next few months."

Annexure

Chart 1: CPI inflation above tolerance for the ninth consecutive month in Sep-22

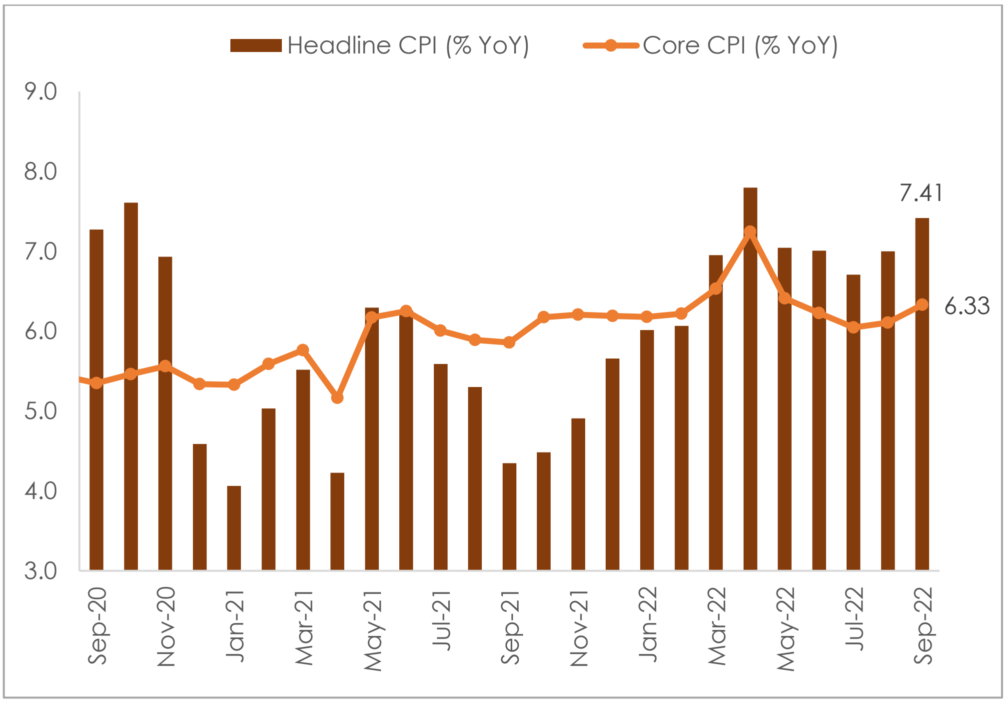


Chart 2: UN FAO price index eased further in Sep-22 led by drop in edible oil prices

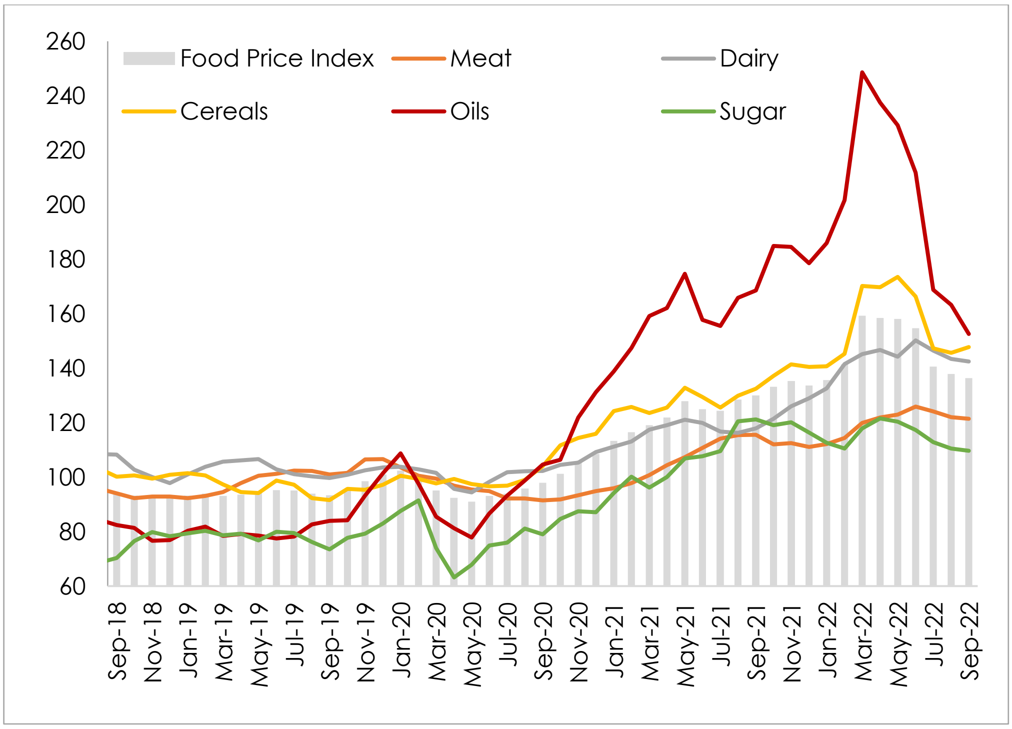
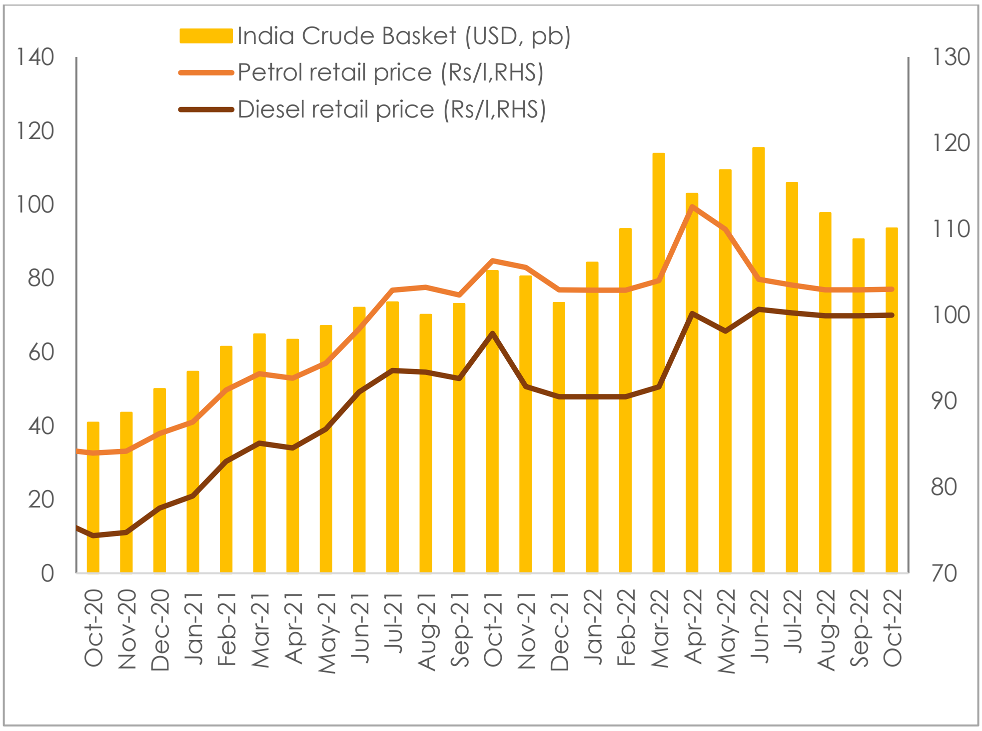


Chart 3: Production cuts lead the crude oil prices to rise to USD 90+ bp in Oct-22 so far



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