Press Release

Feb-22 Inflation: Risks getting entrenched

Geopolitical risks to weigh on India's inflation trajectory

14 March 2022

Headline inflation at both wholesale and retail level surprised negatively coming in slightly above the market estimates. **As such, WPI inflation rose to 13.11% YoY in Feb-22 from 12.96% in Jan-22 while CPI inflation rose to 6.07% YoY in Feb-22 from 6.01% in Jan-22**, thereby staying above the upper tolerance threshold of RBI's inflation targeting band for the second consecutive month. On sequential basis, after two consecutive months of contraction, WPI as well as CPI inflation rose in Feb-22 by 1.40% and 0.24% respectively, reflecting the inflationary pressures although it doesn't yet factor in the impact of the geo-political conflict between Russia and Ukraine and the incremental effect of crude oil beyond USD 100 per barrel.

Sequentially, food and beverage inflation in CPI remained the only category to have recorded a contraction of 0.12% MoM in Feb-22 from 1.07% in Jan-22 led by seasonal factors at play. Within food and beverages, the decline was primarily led by contraction in the prices of vegetables, sugar, pulses, and eggs.

Going forward, food inflation is expected to remain a major source of comfort on the CPI front with prospects of robust rabi arrival backed by strong rabi sowing acreage (at 700 lakh hectares), adequate buffer stocks along with supply-side interventions taken by the government in case of edible oil and pulses. However, the geopolitical concerns emerging out of the conflicts between Russia and Ukraine may lead prices of certain commodities such as edible oils (particularly sunflower oil where imports are largely from Russia and Ukraine), fertilizers and certain cereals to increase thereby impacting the existing benign food inflation trajectory in FY23.

Expectedly, overall fuel & light inflation rose significantly by 0.91% MoM in Feb-22 from 0.06% in Jan-22 led by a significant jump in kerosene prices. However, on account of favourable base, annualized fuel inflation eased to a 10-month low of 8.73% YoY. Nevertheless, this comfort is expected to be short lived as there has been a sharp jump in crude oil prices from end Feb-22 which is currently hovering at around USD 110 pb after reaching a high of USD 130 pb. With conclusion of several state elections, we expect the oil manufacturing companies to gradually start revising their retail fuel prices upwards after a hiatus of four months which would gradually feed into headline CPI inflation. According to past trends, a 10% increase in petrol and diesel prices leads to around 50-60 bps rise in retail inflation.

Sequential moderation in the prices of clothing & footwear and housing led core inflation (inflation ex. fuel and food) to rise marginally by 0.50% MoM in Feb-22 from 0.56% in Jan-22. Moderation in transport & communication (pending the hike in fuel prices) was offset by surge in personal care & effects amidst increase in gold and silver prices, leading inflation in the miscellaneous category (a proxy for services inflation) to remain unchanged at 0.43% in Feb-22 as compared to the previous month.

On the other hand, WPI inflation rose by 1.4% MoM in Feb-22 from -0.3% in the previous month. The common thread emerging from both CPI and WPI inflation is the comfort derived from moderation in food prices particularly that of vegetables. As such consolidated wholesale food inflation (comprising of manufactured and primary food prices) eased to 8.47% YoY in Feb-22 from 9.55% in Jan-22, while sequentially it recorded a marginal uptick of 0.06% from -1.71% in Jan-22.

The significant jump in crude oil prices during Jan-22 has clearly been reflected in consolidated fuel inflation which rose by 5.65% MoM in Feb-22 from -0.37% in Jan-22. The headline index for crude petroleum as well as mineral oil surged to their respective record high levels with Aviation turbine fuel (ATF), Kerosene, Naphtha and Bitumen, recording double-digit sequential expansion. This upward momentum is expected to intensify going forward as the crude oil prices have surged significantly to around USD 110 pb amidst intensifying geopolitical risks. The direct impact of rise in oil prices would likely be greater in WPI as compared to CPI given higher weightage of crude oil and its derivatives in the WPI basket.

WPI core inflation (non-food manufacturing inflation) is estimated to have increased to 10.0% YoY in Feb-22 from 9.7% YoY in Jan-22, with a sequential rise of 0.79% vs 0.48% in the previous month. Amidst increasing pressures on the profit margins of manufacturing companies and a pickup in consumption demand, Acuité expects a further pass through of input costs.

Going forward, we expect a potential increase in oil production from other OPEC+ countries and the US along with probability of easing sanctions on Iran, to help rein in spiralling crude oil prices and ease supply shortages. However, it would take some time for the prices to moderate on the back of escalating tensions with US and UK banning oil imports from Russia. As such, while the import dependency on Russian energy is limited, many allies of Russia could join the bandwagon thereby affecting supplies and keeping oil prices elevated. Additionally, existing low levels of oil inventories which had been depleted due to the pandemic and limited ability of some oil producing countries to ramp-up production due to years of underinvestment could further hamper the oil supplies. Overall, in our base case we expect oil price to average in the range of USD 85-90 pb in FY23 higher than USD 70-75 pb pegged in the Union Budget FY23 and in the inflation forecasts of RBI.

Along with crude, price of aluminium, nickel, steel and coal among other commodities have also surged significantly thereby building a case for further increase in input price pressures for the manufacturing sector. With declining intensity of the pandemic and pressure on the operating margins of the companies, a further pass through of higher input costs in manufacturing is much likely translating to a material upside risk for our CPI print forecast of 5.0% (RBI: 4.5%) in FY23.

The geopolitical strife between Russia and Ukraine may leave little scope for the RBI to tighten monetary policy in the upcoming Apr-22 policy review amid a deteriorating global growth outlook and its cascading impact on India's nascent growth recovery. Nevertheless, given the significant risks to the inflation outlook and tighter global financial conditions, we expect the central bank to revise its inflation forecast higher and lay the ground for a gradual exit from the prolonged accommodative stance.

Chart 1: CPI inflation stays above upper tolerance band of RBI's inflation framework

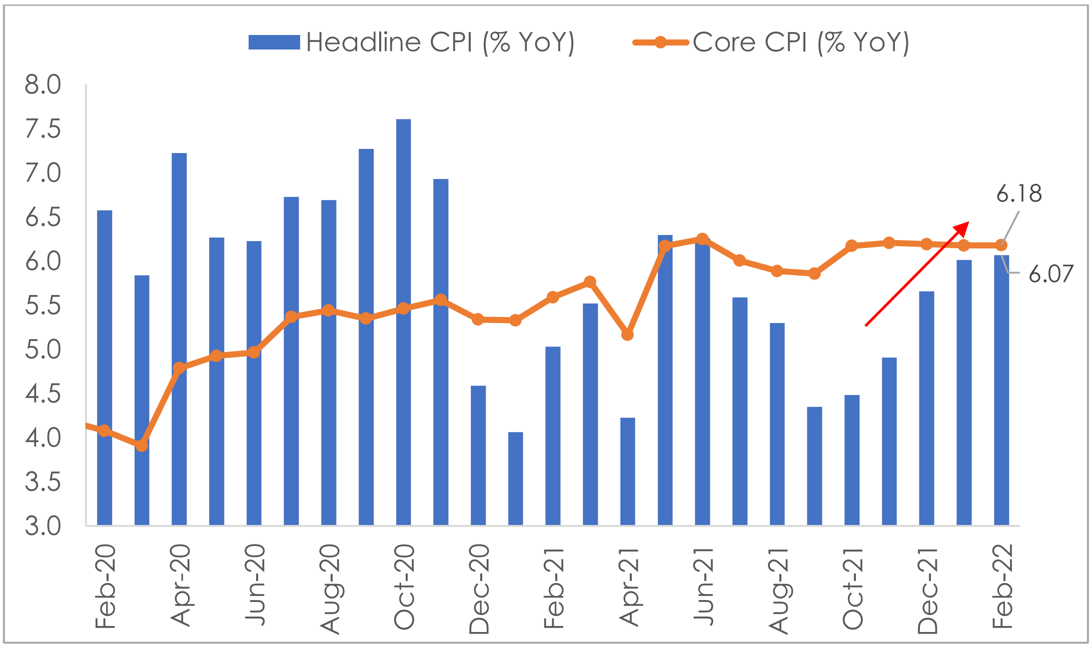
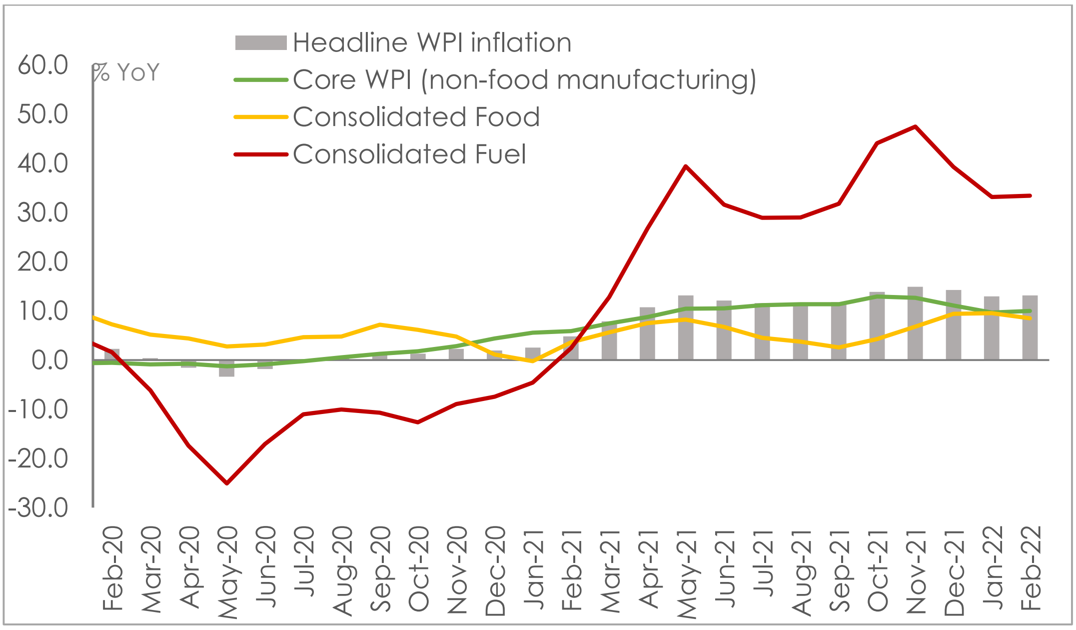


Chart 2: Fuel inflation leads WPI inflation to rise in Feb-22



About Acuité Ratings & Research Limited:

Acuité Ratings & Research Limited is a full-service Credit Rating Agency registered with the Securities and Exchange Board of India (SEBI). The company received RBI Accreditation as an External Credit Assessment Institution (ECAI), for Bank Loan Ratings under BASEL-II norms in the year 2012. Since then, it has assigned more than 9,000 credit ratings to various securities, debt instruments and bank facilities of entities spread across the country and across a wide cross section of industries. It has its Registered and Head Office in Kanjurmarg, Mumbai.

Media Contacts:

Roshni Rohira Ph: + 91-9769383310 roshnirohira@eminenceonline.in	Sahban Kohari Ph: + 91-9890318722 sahban@eminenceonline.in

Investor Outreach: **Analytical Contact:**

Rituparna Roy Deputy Vice President Ph: + 91-7506948108 rituparna.roy@acuite.in	Suman Chowdhury Chief Analytical Officer Ph: + 91-9930831560 suman.chowdhury@acuite.in