Press Release

CPI touches upper tolerance band of MPC; WPI eases marginally

Sequential moderation in food prices provide short term comfort

14 February 2022

Headline inflation at wholesale and retail level showed divergent trends in Jan-22. While WPI inflation eased marginally to 12.96% YoY in Jan-22 from 13.56% YoY in Dec-21, CPI inflation crossed the upper band of RBI's inflation target band after a hiatus of seven months coming in at 6.01% YoY from 5.59% YoY, primarily led by unfavourable base at play. On a sequential basis, however, CPI inflation contracted for the second consecutive month by 0.3% while WPI inflation increasing marginally by 0.4% MoM from a contraction of 0.3% MoM.

The comfort on sequential basis was driven by retail food and beverages inflation which declined further by 1.07% MoM in Jan-22 from 0.88% in Dec-21 led by continued seasonal factors at play. Within food and beverages, the decline was primarily led by contraction in the prices of vegetables followed by oil & fats, sugar, fruits, and pulses.

Going forward, food inflation is likely to remain the biggest source of comfort on the CPI front and has been the factor behind MPC's dovish stance on inflation. Prospects of robust rabi arrival backed by strong rabi sowing acreage (at 700 lakh hectares) along with policy interventions in case of edible oils and pulses will continue to keep food prices moderate in the near term.

On the other hand, overall fuel & light inflation registered only a marginal expansion of 0.6% MoM from an increase of 0.12% in Dec-21. Encouragingly, annualized fuel inflation eased to a 9-month low of 9.32% YoY. However, this comfort is expected to be short lived as we expect the impact of significant jump in crude oil prices to start reflecting within the next 2-3 months.

Rise in clothing & footwear followed by housing and miscellaneous category led core inflation (inflation ex. fuel and food) to rise by 0.56% MoM in Jan-22 from 0.23% MoM in Dec-21. Within miscellaneous (a proxy for services inflation), central and state government's move to cut excise duties and VAT on petrol and diesel has helped transportation charges to decline to an extent but the staggered impact of hike in telecom tariffs announced in Nov-21 has offset that relief, leading overall price of transport and communication to increase further by 0.58% MoM in Jan-22.

On the other hand, WPI inflation eased to 12.96% YoY in Jan-22 from 13.56% in Jan-21 with a mild sequential expansion of 0.4% thereby bringing partial relief to the WPI inflation trajectory. The common thread emerging from both CPI and WPI inflation is the comfort derived from sequential moderation in food prices particularly that of vegetables. As such consolidated wholesale food inflation (comprising of manufactured and primary food prices) contracted by 1.6% MoM in Jan-22 from 0.8% MoM in Dec-21.

The significant jump in crude oil prices during Jan-22 has started to reflect as the incremental price pressure was visible in consolidated fuel inflation which rose by

2.62% MoM in Jan-22 from -2.73% in Dec-21. This upward momentum is expected to continue going forward as the crude oil prices have further increased by 9% in Feb-22 so far and is currently hovering close to USD 95 pb. The impact of the recent rise in crude oil prices would likely be higher 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) further moderated to 9.7% YoY in Jan-22 from 11.0% YoY in Dec-21, with a sequential rise of 0.56% vs 0.31% in the previous month. Going forward, if consumption demand improves on a durable basis a further pass-through of input costs to manufactured products is expected to keep core WPI inflation near double digits.

So far, the relatively weak domestic consumption demand has led only to a partial pass through of high input price pressures to end consumers. However, increasing compression in firms' profit margins due to elevated commodity prices and the expected improvement in demand scenario, may lead to increased pass-through over the next few quarters, keeping CPI core inflation sticky at elevated levels. As such, we expect headline CPI inflation to average at 5.5% in FY22 and 5.0% for FY23, marginally higher than RBI's estimate of 5.3% in FY22 and 4.5% in FY23 and also with moderate upside risks.

From monetary policy perspective, RBI in the recent MPC review opted to remain steadfast on its accommodative policy stance and postponed the initiation of any formal monetary policy normalization process with the continuous focus on supporting the uncertain growth revival trajectory. Going forward, as the recovery turns more sustainable given strong progress in vaccination, decline in COVID caseloads along with gradual unwinding of lockdown restrictions by states we expect the RBI to gradually revert to its pre-pandemic policy corridor by hiking the reverse repo rate between Apr-22 and Jun-22 policy meeting. However, the timing on the upward adjustment in the repo rate is difficult to comment on, given RBI's thrust on growth facilitation vs the timeliness of monetary policy normalization.

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

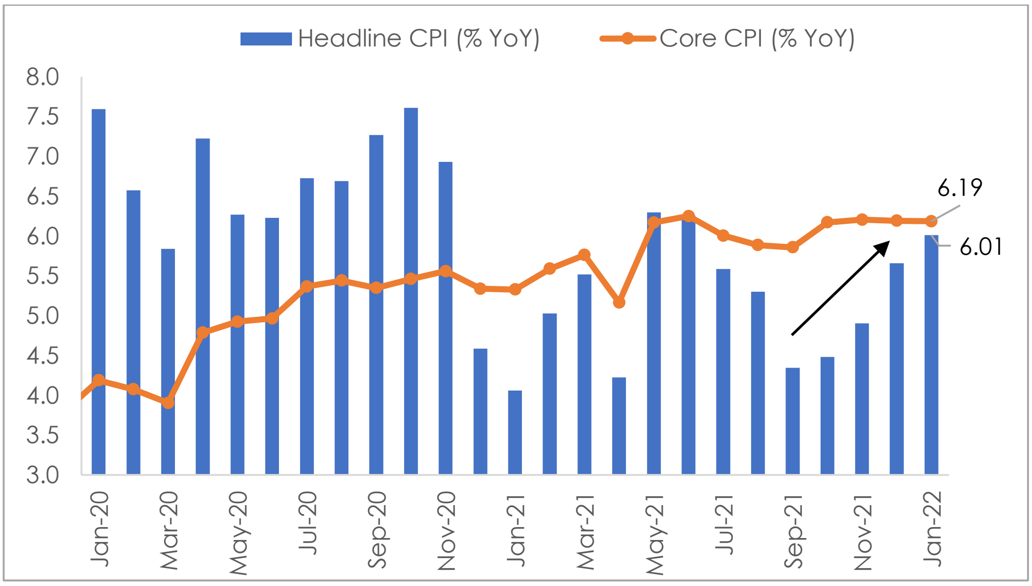
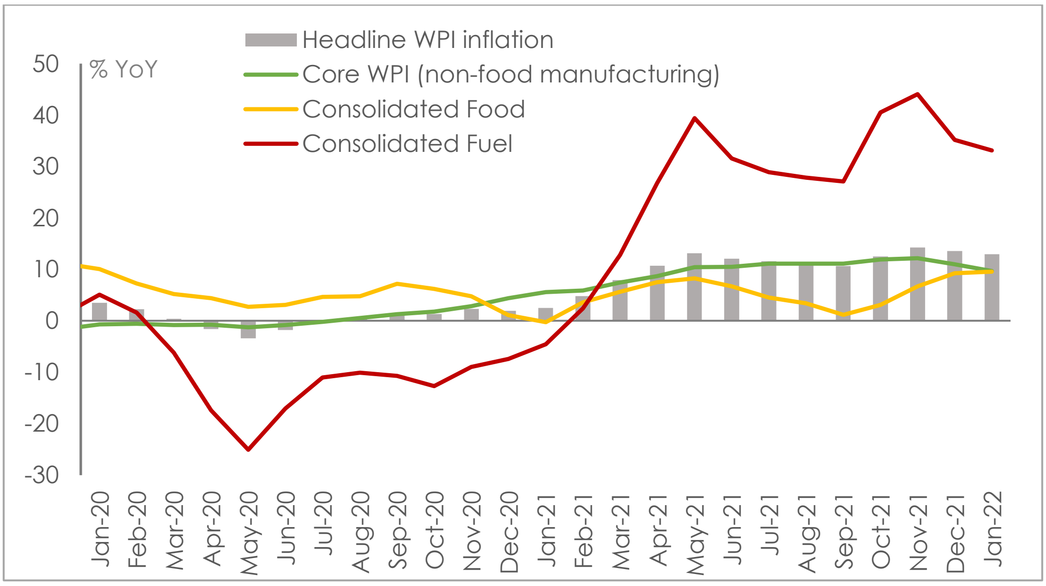


Chart 2: WPI inflation eases in Jan-22, but the comfort likely to be transient



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