# Press Release

## Base factor puts CPI inflation on an upward trajectory

**Sequential comfort derived from the decline in food and housing inflation**

***12 January 2022***

India's retail inflation closed 2021 on a sombre note rising to a 5-month high of 5.59% YoY in Dec-21 from 4.91% in Nov-21, primarily on account of an unfavorable statistical base. After bottoming out at 4.35% in Sep-21, CPI has been gradually inching up with Dec-21 print standing close to the upper end of RBI's inflation targeting band of 2-6%. Taking into consideration today's print, average inflation for Q3 FY22 stands at 4.99% YoY marginally lower than 5.08% recorded in Q2 FY22. Sequentially, the momentum however declined by 0.36% in Dec-21, the first such decline MoM since Jan-21, from +0.73% in Nov-21 driven by the categories of food and beverages, housing and pan tobacco and intoxicants (PTI).

The seasonal normalization amid winter arrivals in the market expectedly, led food inflation to decline by 0.88% MoM in Dec-21 from an increase of +1.19% in Nov-21. The decline was primarily led by vegetables, meat & fish, oils & fats, and fruits. Although, winter seasonality has helped in the moderation of food price pressures, the sequential decline has been visibly lower than the average decline of ~1.5% MoM (average of last three years) usually recorded in the month of December.

Going forward, food inflation to likely to remain the biggest source of comfort on the CPI front. Expectation of a record Kharif output, healthy traction of acreage in the ongoing Rabi season along with policy interventions in case of edible oils and pulses will continue to provide comfort. Further, the second order impact of the downward revision in domestic petrol and diesel prices, should provide additional comfort to transportation costs thereby taming food price pressures.

On the other hand, overall fuel & light inflation registered a marginal expansion of +0.12% MoM after declining by 0.18% in Nov-21 with price of diesel contracting for the second consecutive month by -1.56% MoM amid excise duty cut by the government. As such, annualized fuel inflation modestly eased further from 13.35% to an eight-month low of 10.95% YoY in Dec-21. Crude oil prices after correcting by ~9% MoM at USD 73.3 pb in Dec-21 has again started inching up and currently tracking close to USD 80 pb. This is likely to put upward renewed pressures on fuel inflation in the coming months.

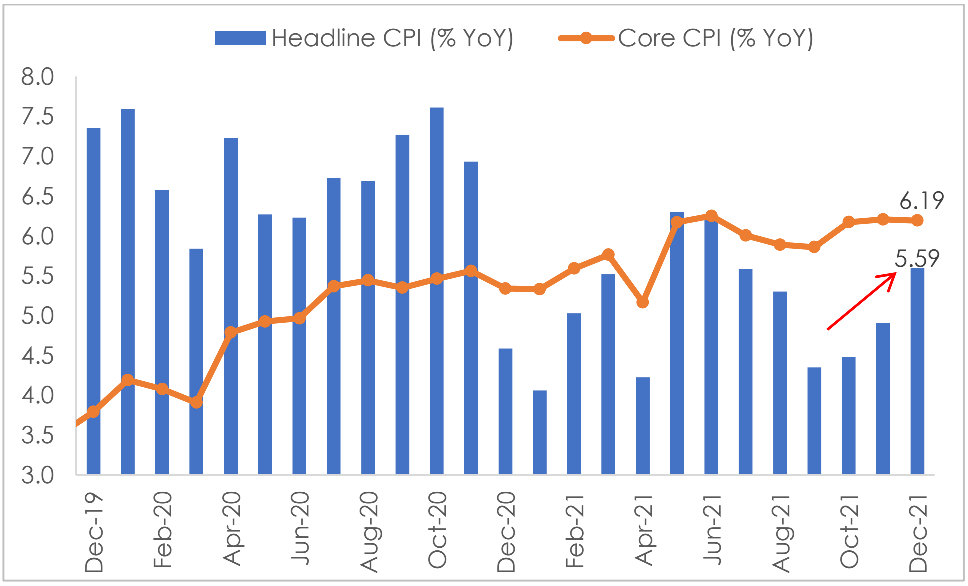
Within miscellaneous category (a proxy for services inflation), central and state government's move to cut excise duties and VAT on petrol and diesel has helped transportation charges to decline to an extent but the recent hike in telecom tariffs more than offset that relief, leading overall price of transport and communication to increase by 0.52% MoM in Dec-21 from -0.58% in Nov-21.

However, seasonal decline in housing inflation led core inflation (ex. Food & Bev, Fuel & light and PTI) to rise at a slower pace of 0.23% MoM in Dec-21 from 0.37% in Nov-21. Nevertheless, we expect core inflation to remain sticky at around 6.2% as several sectors such as autos, electronics, textiles among others are seeing pass-through of higher inputs costs in a calibrated manner, which could continue into 2022 along with still persistent supply disruptions. Additionally, the recent surge in Covid infections amid the spread of new Omicron variant has started to lead to re-imposition of state-level restrictions. Though the impact of such lockdowns on economic activity is expected to be milder, it could nevertheless induce short term supply disruptions and in turn enhance the inflationary pressures.

From perspective of CPI trajectory, we expect subsequent inflation readings to trend higher amidst the waning of a favorable base. In Q4 FY22, CPI inflation could remain above 6.0% until the end of the fiscal year. Overall, we continue to maintain our FY22 CPI inflation forecast at 5.5% with moderately upside risks from any increase in supply side constraints.

Globally, inflation has become a major cause of concern amid surge in commodity and raw material prices, persistence of supply bottlenecks and demand push inflation thereby persuading many central banks to start normalizing pandemic era accommodative policies. However, from domestic standpoint the focus of the RBI has consistently been on ensuring a durable economic recovery. Consequently, from monetary policy perspective, while the calibration of the surplus system liquidity will continue till the next policy meeting, it is difficult to comment on the timing of the reverse repo rate hike or any subsequent repo rate hike. There may be a possibility of such an increase in Feb-22 provided the high frequency economic indicators continue to remain robust. However, the recent surge in infections has started to build up a case of another pandemic wave in the country leading many states to impose moderate mobility restrictions. Continuing uncertainty on the residual risks of the pandemic can thus further reinforce the 'wait and watch' approach of RBI, thereby slowing down the progress on the policy normalization path.

**Chart 1: CPI inflation further ticks up in Dec-21**



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