Press Release

CPI-Oct'21: Favourable base masks incremental price pressures

Spike in vegetable prices drives sequential increase in food inflation

13 November 2021

India's retail inflation reported a marginal uptick of 4.48% YoY in Oct-21 from 4.35% in Sep-21, remaining close to the mid-point of RBI's inflation targeting band of 2-6% for the second consecutive month. The comfort in the inflation print is largely derived from continued supportive base of the last year, nearly masking the rise in sequential price pressures recorded in the categories of food, fuel, miscellaneous and housing inflation. Sequentially, the headline CPI inflation rose to a 5-month high of 1.41% MoM in Oct-21 from 0.18% in Sep-21.

After peaking out in May-21, food inflation (until Sep-21) had been in a moderation mode primarily on account of less severity in the summer seasonality (which typically impacts vegetable prices) along with positive supply side interventions taken by the government through custom duty cuts in the case of pulses and edible oils. However, sequential price pressures for Food and Beverages (F&B) surged from 0.06% in Sep-21 to 2.26% MoM in Oct-21 which is the highest sequential spike since Apr-20. This is predominantly led by vegetable prices which rose by 14.24% MoM in Oct-21 from a decline of 1.58% in Sep-21 followed by pulses (0.73% MoM), sugar (1.84% MoM) and oils and fats (1.33% MoM). The emergence of food price pressures in Oct-21 was led by a combination of elevated fuel prices that pushed up transportation costs of perishables from wholesale to the retail markets along with erratic rains in certain parts of India damaging certain crops. Nevertheless, we believe a strong backloaded monsoon performance along with healthy reservoir levels that is set to aid rabi sowing activity, adequate buffer stock of food grains and onset of winter season would help in keeping a lid on food inflation pressures going forward.

Fuel inflation momentum rose to 0.98% MoM in Oct-21 from 0.74% in Aug-21, led by price of Coal, Diesel and Kerosene. As such, annualized fuel inflation climbed further up to 14.35% - yet another series high amidst the run up in global fuel prices. India Crude Basket hardened significantly by 16.4% MoM with oil prices averaging at USD 82 pb in Oct-21. Encouragingly, government's recent move to cut excise duties on petrol and diesel by Rs. 5 and Rs. 10 respectively has effectively lowered domestic pump prices by 5-10%. The central government's move was also complemented by some of the states reducing their Value Added Tax (VAT) on petrol and diesel. As per our analysis, the direct impact of the move is expected to soften headline inflation by around 10-15 bps and moderately improve household savings, boding well for overall consumption. However, the actual impact of excise duty cut could be lower if global crude oil prices continue their upward momentum.

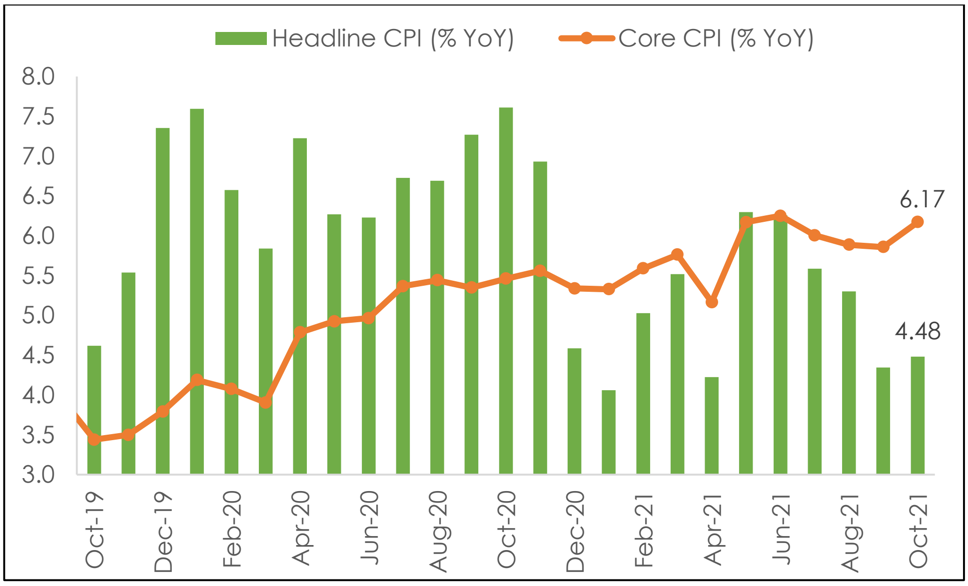
Looking ahead, amidst favorable base factor at play, the ongoing comfort on inflation is likely to persist well into Q3 FY22. However, inflation trajectory is set to firm up in Q4 FY22 hovering close to upper tolerance threshold of RBI's inflation targeting band on narrowing output gap and imported price pressures. Additionally, an improvement in consumer sentiment supported by steady vaccination progress could fan some demand side price pressures and facilitate higher pass through of input price pressures in manufacturing sector thereby keeping core inflation sticky at elevated levels. Core inflation excluding food, fuel & light and pan tobacco and intoxicants) rose to 6.17% YoY in Oct-21 after trailing below 6% for two consecutive months (Chart 1). The increase in core inflation was primarily led by uptick in transport and communication costs amidst elevated petrol and diesel prices. Overall, while we continue to maintain our FY22 CPI inflation forecast at 5.5%, there could be some upside risks to that figure if high commodity prices and raw material shortages persist.

On global front, continued surge in commodity and raw material prices, persistence of supply bottlenecks, along with demand push inflation following the easing of Covid lockdowns worldwide have remained the major cause of concern causing inflation rates in many countries to go up sharply (Chart 2). Inflation rate in the US surged to a 31-year high of 6.2% YoY in Oct-21. Similarly, in China, the producer price index rose to 13.5% YoY, the fastest pace in 26 years, amidst shortages of coal, electricity and other raw materials. With rising inflationary pressure in most DMs and EMs many central banks have started to reconsider their earlier belief of inflation being 'transitory' and are now coalescing around higher inflation rate to be enduring. This has forced few central banks to start considering normalization of pandemic era accommodative policies. To recall, the Fed in its last meeting announced tapering of monthly pace of net asset purchases by USD 15 bn per month from current USD 120 bn per month. Further, given high inflationary pressures, it appears that Bank of England (BoE) is also on course to become the first major central bank to hike interest rate, though considerable difference in opinions with respect to timing of the hike remains.

From India's monetary policy perspective, taking comfort from the current moderation in CPI inflation, the RBI in its last MPC meeting continued to advocate the need for nurturing the nascent growth recovery thereby maintaining its accommodative stance. However, the central bank did make an attempt to nudge short term money market rates in upward direction (towards the LAF corridor) by calibrating the liquidity surplus through the expansion of the scope of VRRR auctions along with discontinuation of G-SAP operations. In our opinion, this is a precursor to interest rate normalization that we envisage to happen by Dec-21. However, given RBI's approach of 'gradualism' and continuation of benign inflationary trajectory in Q3 FY22 the likelihood of the postponement onto next quarter is on the rise.

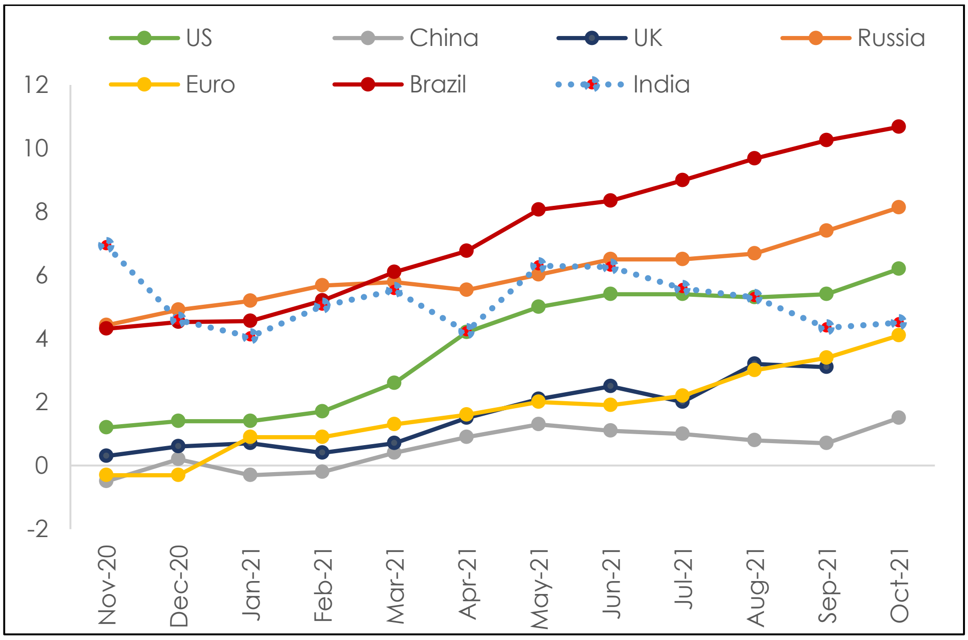
Annexure

Chart 1: Core inflation expected to remain sticky at elevated levels



Core Inflation – Excludes food, fuel & light and pan tobacco and intoxicants

Chart 2: High inflationary pressures has spread across DM's and EM's (CPI YoY%)



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