

## India Watch

## RBI MPC Preview: Going tomatoes!

**A hawkish hold on Aug 10<sup>th</sup>, see one more hike in 2023**

When the RBI MPC persisted with a pause on Jun 8<sup>th</sup>, they were faced with a 4.7% yoy CPI inflation for April. Post that, CPI inflation for May and Jun stayed benign at 4.3% and 4.8% yoy respectively, coming in-line with RBI's 1QFY24 estimate. However, between June 1<sup>st</sup> and now, retail price of tomatoes has shot up ~5x. Accordingly, we see Jul CPI inflation rise to 6.6% yoy. As inflation is once again set to breach the upper limit of MPC's tolerance band, concerns surrounding their stance and action on Aug 10<sup>th</sup> have resurfaced. In June, the RBI forecasted 2QFY24 CPI at 5.2% yoy, the upcoming July CPI print (out on Aug 14<sup>th</sup>) and still elevated tomato prices in Aug pose upside risks to this estimate. Will this push the MPC to preemptively hike policy repo rate on Aug 10<sup>th</sup>? To answer this question, we looked at RBI's policy response to such episodes in the past and conclude that the RBI MPC would likely deliver a hawkish hold this time and retain the stance as withdrawal of accommodation. That said, we are looking at another 25bp repo rate hike in the remainder of CY23 as the 4% CPI inflation target is still elusive and agree that the inflation battle is only half won. So, it's not the fleeting tomato price spike that may result in another hike but the protracted journey to the target.

**MPC members caution: Not a permanent pause**

We highlight Gov Das' remark "Let me re-emphasize that headline inflation still remains above target and being within the tolerance band is not enough. Our goal is to achieve the target of 4%, going forward. Other MPC members echoed, Dr. Patra: "Holding the rate unchanged should not be interpreted as the interest rate cycle having peaked." Dr. Goyal: "The pause is only for the current meeting." Dr. Ranjan: "Time is opportune to emphasize the distinction between the inflation target and tolerance of deviations from the target." These excerpts from minutes of the Jun MPC meeting reinforce our view.

**The tomato trouble- we have been here before**

Between Jun 1<sup>st</sup> – Aug 5<sup>th</sup> retail tomato prices have shot up 444% (Exhibit 2). Although its weight in CPI is only 0.6, this increase is likely to add 120bp to headline. Tomato, onion and potato together account for only 2.2% of headline CPI but contribute nearly 50% to the variance in headline inflation. The usual drivers of such spikes are - deficient or excess rainfall, heatwaves or strikes in mandi, speculation and hoarding. Since the demand for them is relatively inelastic, inflation becomes a serious problem. A recent RBI paper finds that tomato prices increase almost every Jun-July. Potato prices increase after every two years and onion prices rise after every 2.5 years. A vegetable price shock is thus not new to India. In Exhibit 1, we analyze about 12 episodes of vegetable price fluctuation since FY2010. Exhibits 3,4 & 5 indicate that these price spikes fizzle out within a few months, though duration of each cycle differs ranging from 61 days in 2010-11 to 142 days in 2016-17 (both in tomatoes.)

In Exhibit 6, we enlist RBI's policy response in each of these episodes and observe that the RBI has mostly refrained from acting on such events, given its seasonal nature. 6 out of 12 times, RBI has kept the policy rate unchanged even in the face of record high food inflation. Twice they reduced the repo rate by 25bp (including the 2019 onion price peak) and only 4/11 times the RBI increased the repo rate.

07 August 2023

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**Glossary**

RBI: Reserve Bank of India  
MPC: Monetary policy committee  
CPI: Consumer Price Index

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Timestamp: 06 August 2023 05:00PM EDT

**Exhibit 1: TOP (Tomato, Onion, Potato) price cycles in the past**

Barring 2010, episodes of horizontal spillover amongst these vegetables were not seen. TOP are susceptible to weather fluctuations and have seen frequent spikes

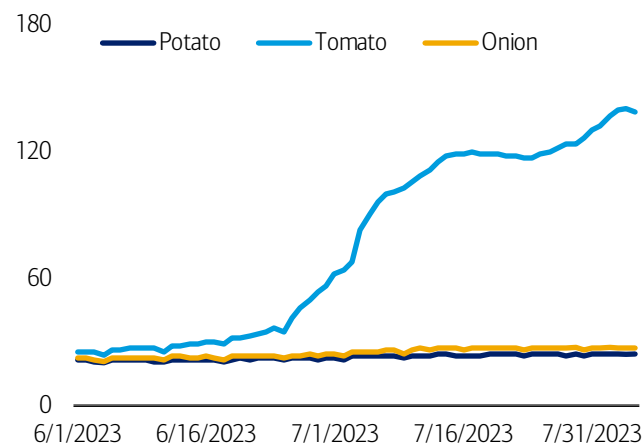
	CPI	Tomato			Onion			Potato		
		Min price	Max price	% Increase over min price	Min price	Max price	% Increase over min price	Min price	Max price	% Increase over min price
2009	10.9%	27.0	28.3	5%	15.26	22.19	45%	7.56	19.52	158%
2010	12.0%	9.4	35.9	282%	10.56	51.4	387%	7.73	16.22	110%
2011	8.9%	11.9	31.3	162%	11.54	47.05	308%	8.67	24.68	185%
2012	9.5%	11.0	33.0	199%	10.86	22.44	107%	8.5	19.56	130%
2013	10.0%	13.5	46.5	243%	18.43	63.96	247%	12.98	27.1	109%
2014	6.7%	14.5	56.4	290%	16.15	29.81	85%	14.51	31.57	118%
2015	4.9%	19.0	57.8	205%	21.25	57.82	172%	12.87	21.47	67%
2016	4.9%	12.0	49.0	308%	14.36	24.04	67%	14.09	23.38	66%
2017	3.3%	13.8	69.7	404%	13.29	45.54	243%	12.26	17.06	39%
2018	3.9%	13.8	31.7	130%	15.24	44.5	192%	11.82	23.35	98%
2019	3.7%	18.2	43.0	137%	15.13	103.67	585%	13.6	27.27	101%
2020	6.6%	18.0	54.9	205%	19.33	89.76	364%	20.77	46.31	123%
2021	5.1%	16.6	67.1	304%	22.57	47.91	112%	16.35	30.19	85%
2022	6.7%	21.4	53.8	151%	21.72	36.63	69%	18.88	30.25	60%
2023	5.4%	20.2	120.3	494%	20.15	27.52	37%	17.25	24.65	43%

Source: MOSPI, CEIC

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**Exhibit 2: Current retail price of TOP (in Rs/kg)**

Since June tomato prices are up 5x, no spillover to onion and potato prices yet

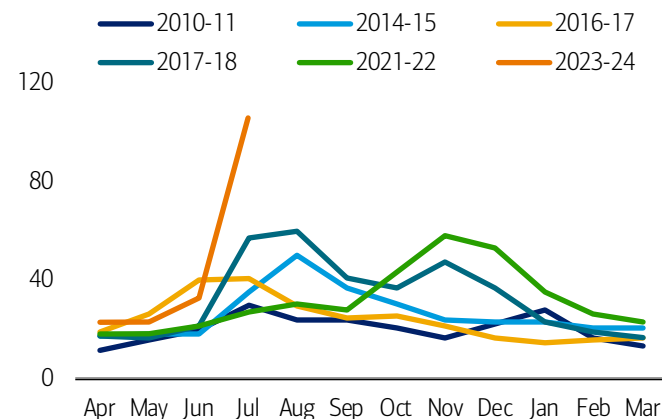


Source: CEIC

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**Exhibit 3: Tomato historical price fluctuation (retail price in Rs/kg)**

The price increase in 2023 so far has been the steepest

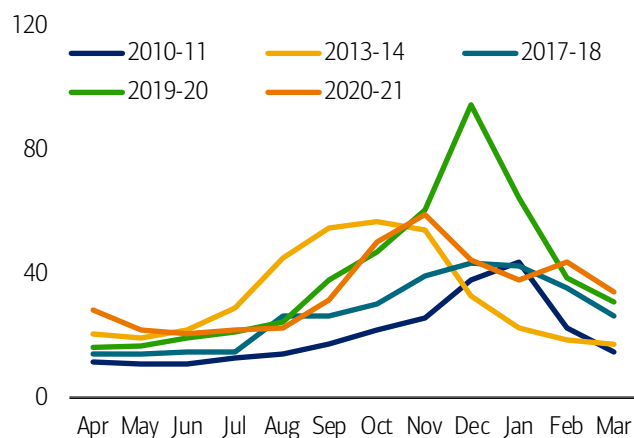


Source: CEIC

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**Exhibit 4: Onion historical price fluctuation (retail price/kg)**

2019 saw similar spike in onion prices

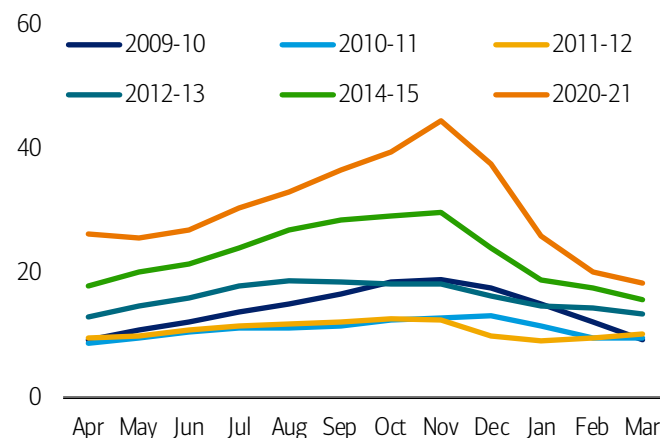


Source: CEIC

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**Exhibit 5: Potato historical price fluctuation (retail price in Rs/kg)**

Potato prices have been relatively stable, the amplitude is much lower



Source: CEIC

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**Exhibit 6: Previous price cycles and RBI response in the past**

In the past 12 episodes, 6 times RBI policy rate was unchanged, 4 times repo rate was raised (primarily on non-food WPI concerns) and twice policy rate was cut

	Vegetable experiencing high prices	High price cycle	No of days in a cycle	RBI monetary policy decision	Rationale
2010-11	Tomato	Jun to Aug	51	Repo rate raised from 5.5% to 5.75%	Despite better monsoon WPI inflation in double digits, broad based inflation with non-food contributing 70% to WPI inflation. But food prices important for softening of inflation.
2010-11	Tomato and onion	Nov to Feb	55	Repo rate raised twice - in Sep and in Nov by 25 basis points each, reaching to 6.25%	WPI non-food inflation main concern. WPI inflation above 10%. Prices of food articles added pressure to WPI inflation. Inflation plateaued but expected to stay there for months.
2013-14	Onion	July to Dec	108	Repo rate increased by 25 basis points to 7.75%	WPI high in food but deflationary pressures in non-food inflation. CPI high in both food and non food subgroups.
2014-15	Tomato and potato	Jun to Oct, followed by Oct to Dec for potato	76 followed by 46	Repo rate kept unchanged at 8%	CPI inflation came off the spike in July 2014 driven by vegetable prices. Non-food inflation moderated. Food inflation contributed 60% to headline inflation
2016-17	Tomato	Apr to Sep	142	August - repo rate unchanged at 6.5%	Retail inflation rose to 22-month high owing to high vegetable prices, but non-food inflation eased.
2017-18	Tomato	Jun to Sep	87	August - repo rate reduced by 25 basis points to 6%	Apart from seasonal spikes in tomato, onion and milk, rest of the food and non food inflation recorded lowest reading.
2017-18	Tomato and onion	Oct to Dec	56	Oct and Dec- repo rate remained unchanged at 6%	Inflation in vegetables went up and down but overall inflation remained high.
2019-20	Onion	Oct to Feb	130	Oct -repo rate reduced by 25 basis points to 5.15% from 5.40%, kept unchanged in Dec and Feb	Food inflation was high mainly owing to high onion prices, but other subgroups reflected deflationary pressures.
2020-21	Potato	Sept to Dec	101	keep repo rate unchanged at 4%	Headline inflation increased mainly on account of supply side disruptions across food, fuel and core. But firm's selling prices remain muted due to low demand.
2021-22	Tomato, onion	Sept to Jan	121	repo rate unchanged at 4%	Food inflation moderated, core inflation remained sticky, crude oil prices remained high and volatile
2023	Tomato	June to ?	43 till today	June repo rate stands at 6.5%	

Source: CEIC, RBI, WPI is wholesale price index

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