Headline CPI inflation within RBI's tolerance band in September, core inflation eased to pre-pandemic levels

Key takeaways: After hovering above RBI's upper tolerance band of 6% for two straight months, headline consumer inflation moderated to 5.0%YY in September. This easing was due to lower food and fuel inflation, aided by a decline in overall vegetable prices and the effect of LPG subsidy. However, inflation remains elevated in certain pockets of the food basket such as cereals, pulses and spices, which could prolong the time for food inflation to soften further from the prevailing rate. CPI inflation averaged 6.4% in Q2-FY2024, which is in line with RBI's quarterly projection. Core inflation slipped to 4.5%, the lowest rate since March 2020, due to broad-based moderation in inflation across major categories. Details of various measures of core prices indicate further softening is likely. However, amid the various push and pull factors, inflation is likely to remain range-bound between 5.0-5.5% in the coming months. Even as the headline CPI nudges closer to the RBI MPC's target of 4%, the last leg of the journey could be a protracted one. Among external factors, volatility in global commodity prices will remain the wildcard in the backdrop of escalating geopolitical tensions and an expected slowdown in global growth in H2-FY2024. The RBI MPC is likely to remain in a wait-and-watch mode, as it awaits validation in the coming months that headline inflation is easing to its 4% target on a durable basis.

Summary. Headline inflation moderated to 5.0%YY in September after remaining above RBI's upper tolerance band of 6% for two consecutive months. Core inflation also softened to 4.5%, the lowest point since March 2020 (Figure 1). Below are some of the factors that contributed to easing price pressures in the latest print (Figure 2).

- Food inflation moderated to 6.3%, as seasonal price shocks in vegetables reversed, particularly in case of tomatoes.
- Fuel prices fell, aided by the decline in LPG cylinder prices due to government policy measures announced in late August.
- Price pressures softened across categories of core inflation such as pan and tobacco, clothing, housing, and miscellaneous items.
- Both core goods and services inflation moderated in September, with core services inflation remaining below core goods inflation.
- The housing index declined compared to the previous month.

However, there are also areas of distress within the consumer basket.

- Within food, inflation in cereals, pulses, and spices remained in double-digits. Also, within vegetables, onion prices continued to soar.
- Within the miscellaneous category, inflation in personal care items has been high, with gold contributing more than half of price changes since May.
- Volatility in global commodity prices is likely to add to the uncertainties to the future trajectory of domestic inflation.

The net impact of these opposite forces is likely to keep inflation range-bound within 5.0-5.5% in the coming months. The RBI's MPC is likely to keep its policy stance and key rates unchanged, unless it garners evidence of headline inflation moderating to its 4% target on a durable basis.

Figure 1: Core inflation eased to the lowest level since March 2020.

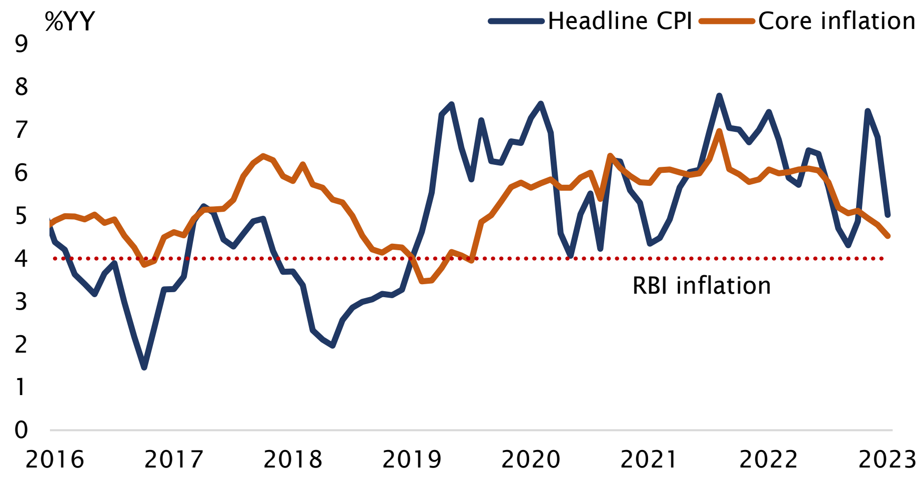


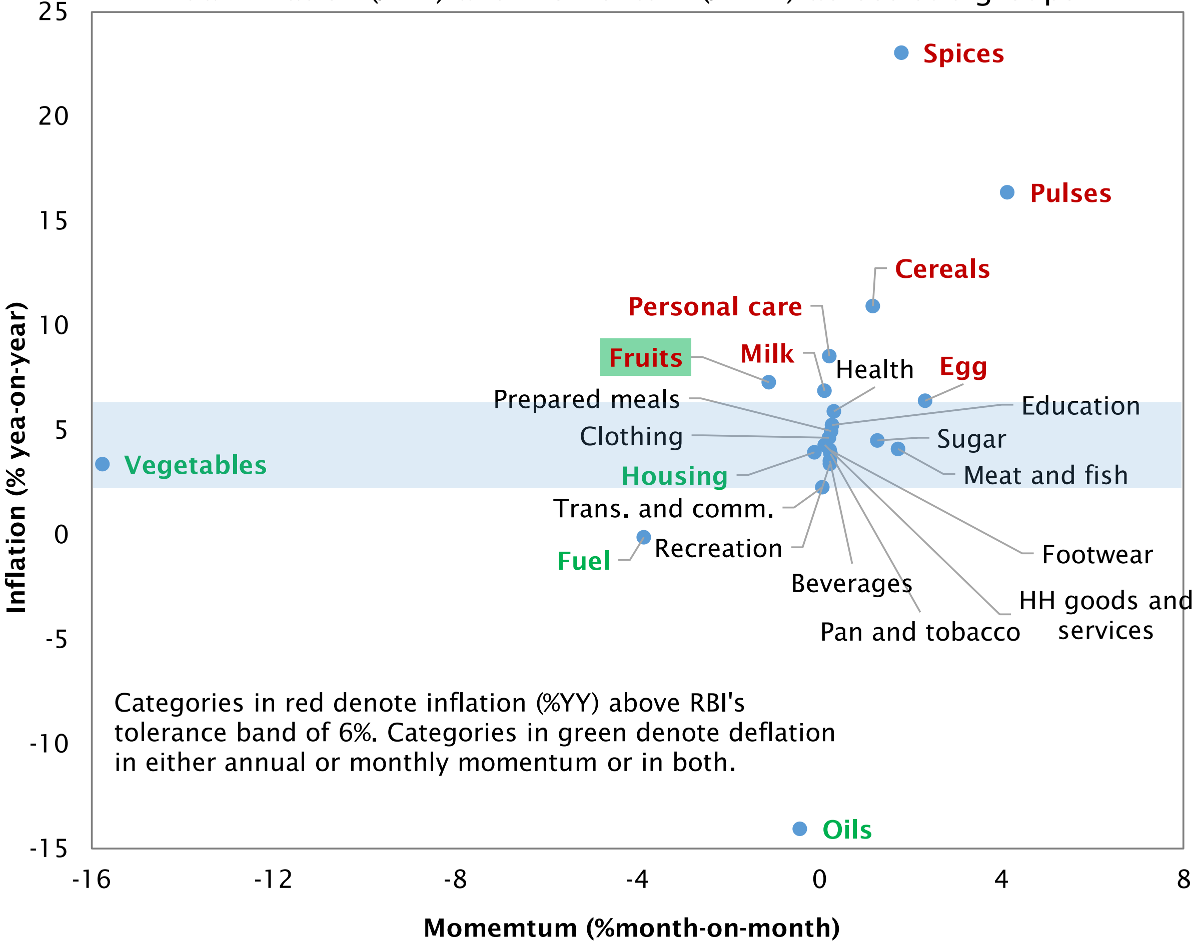
Figure 2: Inflation moderated across categories in September.

India headline CPI and main sub-indices						
%YY	Apr-23	May-23	Jun-23	Jul-23	Aug-23	Sep-23
Headline CPI	4.7	4.3	4.9	7.4	6.8	5.0
Food	4.2	3.3	4.7	10.6	9.2	6.3
Intoxicants, etc.	3.5	3.6	3.7	3.9	4.1	3.9
Clothing	7.5	6.6	6.1	5.6	5.2	4.6
Housing	4.9	4.8	4.6	4.5	4.4	4.0
Fuel and light	5.5	4.7	3.9	3.7	4.3	-0.1
Miscellaneous	4.9	4.9	5.2	5.0	4.9	4.8
Note: Color code is based on %3m3m, SAAR data						

Source: MoSPI.

Details suggest moderation in food and fuel inflation amid scope for further easing. Food inflation moderated in September, as vegetable prices, particularly tomatoes, reversed the seasonal shocks observed in the months of July and August. Overall vegetable prices fell 15.8% from the previous month (Figure 3). In terms of annual change, vegetable prices moderated to 3.4% year-on-year (%YY), down from 37.4% and 26.1%, respectively in July and August. Edible oils remained in deflation for the seventh consecutive month in September. This was due to soft global vegetable oil prices and lower domestic import duty that enabled high imports of edible oils at low prices. In order to ensure availability of edible oil to consumers at affordable prices, the government, in June, cut the basic import duty on edible oils (refined sunflower and soybean) to 12.5% from 17.5% effective until March 2024. This was in addition to the reduction in import duty from 32.5% implemented in October 2021.

Annual inflation (%YY) and momentum (%mm) across sub-groups



Among major vegetables, despite the deflation in tomato and potato prices, onion prices continued to surge. Inflation in cereals, pulses, and spices remained in double digits. Eggs and milk registered price increases of over 6%. Prices of fruits fell month-on-month (%MM) but rose over 7% in annual terms. Additionally, the area sown under pulses and oilseeds in the Kharif season this year is less than previous year, which does not augur well for food price prospects, though the first advance estimate of Kharif output will clear the air on the supply side aspect to some extent. However, with demand likely to firm due to the festive season, food inflation is unlikely to moderate on a sustained basis in Q3-FY24, thereby prolonging the period for headline inflation to reach RBI's inflation target of 4%.

Among other categories that contributed to lowering inflation in September, the housing index surprisingly fell 0.1% month-on-month, but based on past data, this is unlikely to be a trend in the coming months. The fuel sub-index fell 0.1%YY and 3.9%MM. In terms of annual change, fuel prices slipped into deflation for the first time in almost four years, aided by the decline in LPG prices due to some of the recent public policy measures. Ahead of the festive season this year, the government slashed LPG prices by Rs.200 per cylinder across all consumers effective August 30. This was in addition to the targeted subsidy of Rs.200 per cylinder to the beneficiaries of Pradhan Mantri Ujjwala Yojana (PMUY) effective since May 2022 for FY23 and FY24. In October, the government raised this subsidy under the PMUY scheme by Rs.100 to Rs.300 per cylinder for low-income households. These measures are likely to cushion domestic inflation from the volatility in global energy prices, at least to some extent.

Under miscellaneous items that constitute over 28% of the CPI basket, inflation in the personal care category has been consistently above 6% since August 2022, and in recent months, more than half of these increases have been due to higher prices of gold. Interestingly, in recent weeks, the Israel-Hamas conflict triggered an increase in gold prices as investors rushed towards safe haven assets, even as global crude prices remain volatile.

Various measures of core inflation, constructed by excluding different items exhibiting volatile price trends (particularly in the food and fuel categories), remained benign in September (Table 1 in the annexure). A key feature across various core measures is that the monthly momentum has been softer than the annual rate of change. Additionally, core services inflation, which tends to be sticky in nature, slipped below 4%YY in September and stayed below core goods inflation. These trends augur well for the way forward, suggesting scope for further easing.

Outlook. Inflation is likely to remain within the range of 5.0-5.5% in the coming months. Despite lower prices of vegetables that dragged down food inflation in September, certain items in the food basket such as cereals and pulses are likely to remain a pain point. A patchy and muted monsoon, low reservoir levels, below normal Kharif sowing of certain crops, and El Nino conditions cloud the outlook for food inflation. The festive season is likely to keep demand high for goods and services. The volatility in international commodity prices will add to the existing uncertainties for future inflation trajectory. These challenges could prolong the time for headline inflation to move towards RBI’s target of 4% on a sustained basis. In the meantime, the MPC is likely to continue leaning on its liquidity operations to manage inflation in the economy.

Annexure:

Table 1: Various measures of core inflation remained benign in September.

India headline CPI and additional measures of inflation						
%YY	Apr-23	May-23	Jun-23	Jul-23	Aug-23	Sep-23
Headline CPI	4.7	4.3	4.9	7.4	6.8	5.0
Core	5.2	5.1	5.1	4.9	4.8	4.5
Core-core	5.8	5.6	5.4	5.2	5.0	4.7
Super core	5.6	5.3	5.1	4.9	4.7	4.4
Sticky CPI	3.7	3.0	2.6	2.7	2.7	2.6
Flexible CPI	5.2	4.9	6.1	10.4	9.2	6.4
Goods	4.6	4.0	4.8	8.2	7.4	5.2
Services	4.8	4.5	4.3	4.2	4.1	3.8
Core goods	6.6	6.2	6.0	5.7	5.4	5.0
Core services	4.8	4.5	4.3	4.2	4.1	3.8
CPI ex-vegetables	5.5	5.1	5.2	5.4	5.5	5.1
Note: Color code is based on %3m3m, SAAR data						

Source: MoSPI