Core inflation inched closer to 4% in October; food inflation woes likely to remain

Key takeaways: Headline inflation moderated mildly in October and remained within RBI's upper tolerance band of 6% for the second straight month. Core inflation nudged closer to 4%, and various measures of core inflation remained benign. However, despite slight easing in food inflation, details remained worrisome amid persistent double-digit inflation in certain pockets of the food basket and rising onion prices. Under these circumstances, the RBI MPC is likely to maintain its vigilance to ensure that the recurring and overlapping food price shocks do not translate into generalized price pressures. Though it is unlikely to tweak its policy rates or stance at its upcoming December policy meeting, intervention via liquidity management tools or updates to its inflation forecasts could be on the cards, particularly up until or at its February MPC, when the central bank will have more data at its disposal for assessment.

Summary: Headline inflation eased slightly to 4.9%YY in October from 5.0% in September, marginally above the Bloomberg survey estimate of 4.8% but within RBI's upper tolerance band of 6% for the second straight month. Core inflation moderated to 4.2% from 4.5% in the previous month. Below are some of the factors that enabled easing of price pressures in October:

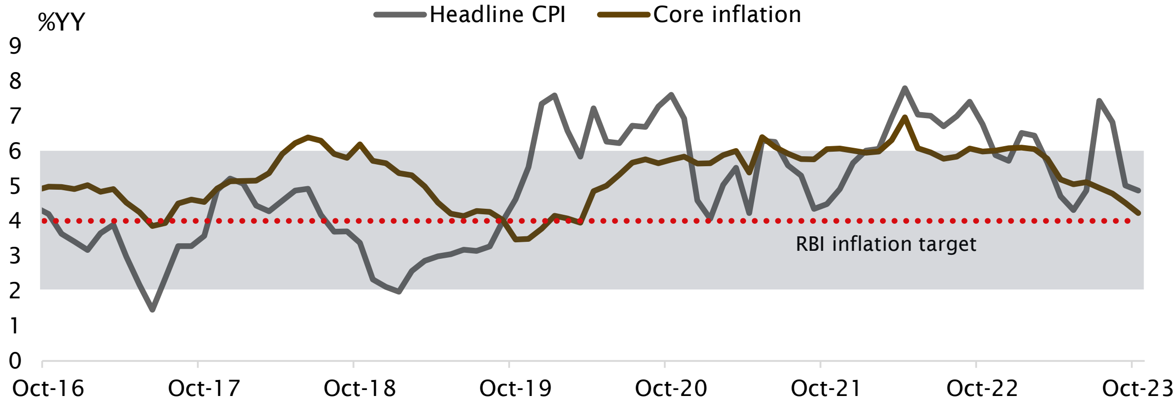
- There was a broad-based moderation in inflation across most major categories.
- The **fuel and light category stayed in deflation for the second straight month.**
- Among major categories, the contribution of miscellaneous items (weight: 28.3%) to headline inflation eased marginally, compared to September, though the category continued to contribute over one-fourth to headline inflation.
- **Various measures of core inflation continued to ease**, including both core goods and services inflation. Core services inflation remained below core goods inflation.
- The momentum in headline inflation, measured by 3-month seasonally adjusted annualized rate (SAAR), moderated sharply from the previous month.
- The headline number was supported by a **favorable base effect.** In October last year, headline inflation was elevated at 6.8%.

We also note the factors that contributed to price pressures during the month and could weigh on the headline number in the coming months.

- **Majority of the items where inflation continues to persist above RBI's upper tolerance band of 6% belong to the food basket.**
    - Inflation in case of pulses, cereals and spices remained in double-digits.
    - While tomato prices (weight: 0.57) drove headline inflation high in July and August, and have retreated thereafter, **onion prices (weight: 0.64) are rising and could add to food inflation woes in the coming months.**
- In terms of monthly change, headline inflation rose in October after declining for two straight months.
    - Prices rose for the categories of food and beverages, housing, and fuel and light, after contracting in the previous month.
- Base effect is unlikely to be supportive in the months of November and December.
- The volatility in global commodity prices remains a wildcard amid an uncertain geopolitical backdrop that could turn the tables in either direction for policymakers.

While the continued softening in core inflation is heartening, food inflation is likely to remain a cause of concern. Nonetheless, **the latest print is unlikely to move the needle for the RBI MPC at its upcoming policy meeting in December in terms of policy rates and stance.** However, intervention via liquidity management tools or inflation forecast updates cannot be ruled out.

Figure 1: Core inflation moderated further in October

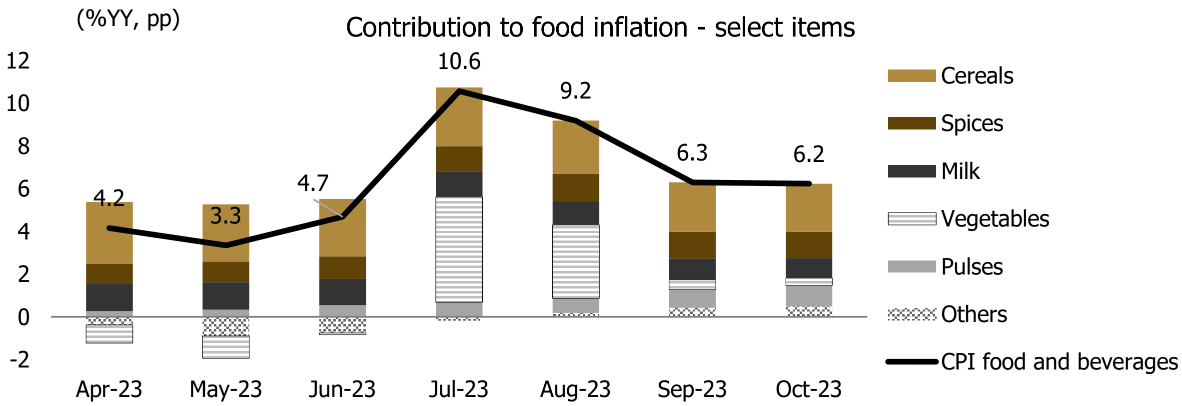


Note: Shaded area denotes RBI's tolerance band of 4%+/-2%. Source: MoSPI

Figure 2: Inflation eased in most major categories in October; fuel and light remained in deflation

India headline CPI and main sub-indices							
%YY	Weight	May-23	Jun-23	Jul-23	Aug-23	Sep-23	Oct-23
Headline CPI	100.0	4.3	4.9	7.4	6.8	5.0	4.9
Food	45.9	3.3	4.7	10.6	9.2	6.3	6.2
Intoxicants, etc.	2.4	3.6	3.7	3.9	4.1	3.9	3.9
Clothing	6.5	6.6	6.1	5.6	5.2	4.6	4.3
Housing	10.1	4.8	4.6	4.5	4.4	4.0	3.8
Fuel and light	6.8	4.7	3.9	3.7	4.3	-0.1	-0.4
Miscellaneous	28.3	4.9	5.2	5.0	4.9	4.8	4.4
Note: Color code is based on %3m3m, SAAR data							

Figure 3: Cereals, weighing one-fifth of the food basket, continue to add over one-third of food inflation

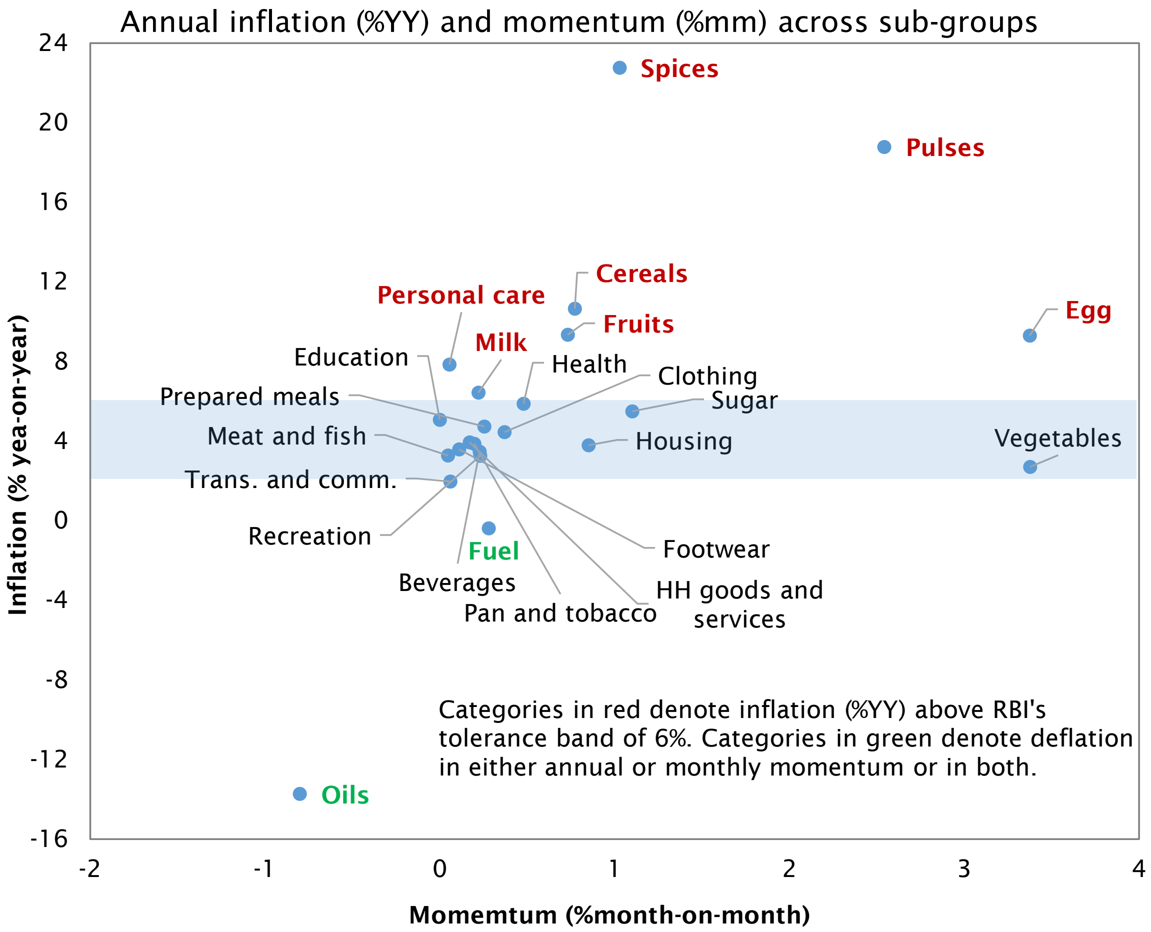


Source: MoSPI

Food prices likely to weigh on headline inflation in coming months. Food inflation remains elevated, whether measured by the food and beverages index (figure 3) or the official consumer food price index (CFPI). In fact, CFPI inflation remained higher and was at 6.6% for both September and October.

Inflation remained in double digits in case of cereals, pulses and spices, though it moderated slightly in case of cereals and spices. Within pulses, prices of arhar or tur dal (weight: 0.80) were up over 40%. Inflation rose above 9% in case of eggs and fruits, and remained elevated in case of milk and related products. Though the increase in vegetable prices has moderated, **a worrisome trend has emerged with onion inflation surging by double-digits over the past three months.** In its earlier research, the central bank has noted the risks from high inflation in select vegetable prices such as onions, tomatoes and potatoes, which have a tendency to percolate to other items in the consumer basket.

Figure 4: Most items where inflation is above RBI's upper tolerance band of 6% are in the food basket



Source: MoSPI

Latest high frequency data (until mid-November) suggests that high inflation is likely to persist in case of cereals and pulses. The outlook for food inflation is further clouded by the **first advance estimate of Kharif produce that is lower** than target and below last year's output across major foodgrains. Though the Kharif output estimates are subject to revisions and could possibly move up, **hopes hinge on a good Rabi output and timely**

government intervention to keep a lid on food price pressures. For FY24 Rabi season, higher production targets and minimum support prices could provide the necessary boost to output. So far, the government has also implemented a host of measures to tame food price shocks such as open market sales of rice and wheat, release of onion buffer stock into the market and imposition of minimum export price, extension of restrictions on sugar exports, sale of wheat flour and chana dal at subsidized rates, etc.

Though food price shocks are expected to be transitory, risks remain that these could translate into generalized price pressures and prolong the time for headline inflation to move closer to the central bank's target in a sustained manner.

Various measures of core inflation, particularly services, remain benign. Excluding volatile food and energy prices, inflation has been moderating over the past few months (Figure 5). The trend holds true from the perspective of goods versus services inflation as well. In fact, **core services inflation has slipped and been below 4% for the past two months and has continued to remain below core goods inflation. The underlying monthly momentum has also been soft across various core measures.**

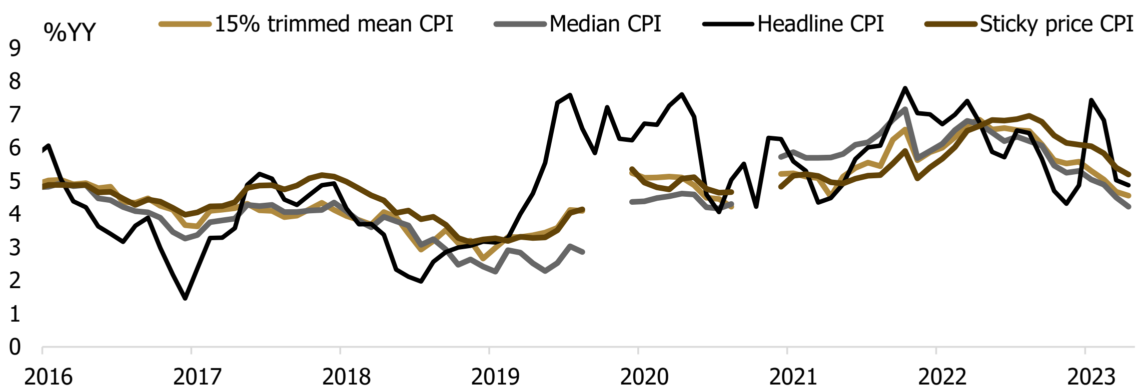
Figure 5: Various measures of core inflation continue to decelerate, core services slips below 4%

India headline CPI and core measures of inflation						
%YY	May-23	Jun-23	Jul-23	Aug-23	Sep-23	Oct-23
Headline CPI	4.3	4.9	7.4	6.8	5.0	4.9
Core	5.1	5.1	4.9	4.8	4.5	4.2
Core-core (core, ex petrol, diesel)	5.6	5.4	5.2	5.0	4.7	4.4
Super core (core, ex petrol, diesel, gold, silver)	5.3	5.1	4.9	4.7	4.3	4.1
Core goods	6.2	6.0	5.7	5.4	5.0	4.7
Core services	4.5	4.3	4.2	4.1	3.8	3.6
Note: Color code is based on %3m3m, SAAR data						

Source: MoSPI

However, sticky price inflation, constructed using items from the consumer basket exhibiting lower standard deviation over the long run, remains slightly above 5%, though it has been easing after peaking at 7% in February (Figure 6).

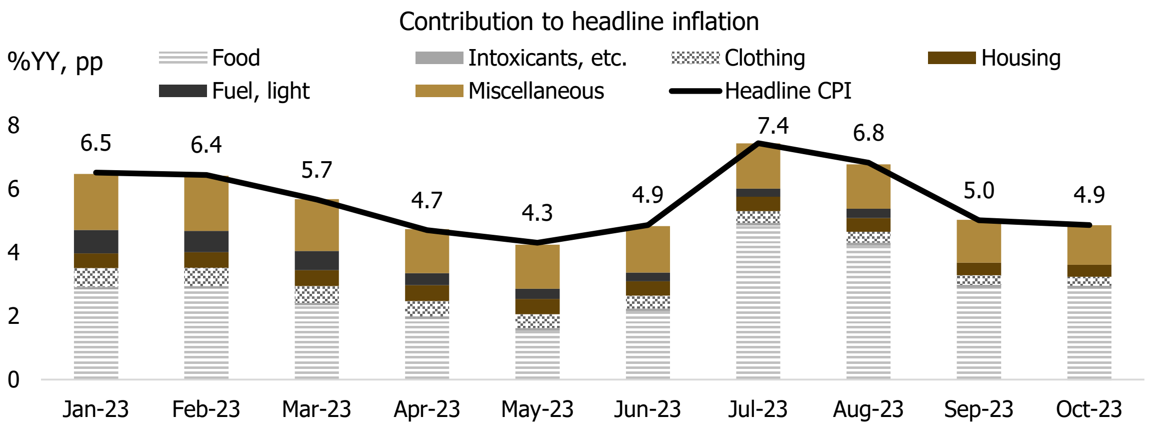
Figure 6: Both median and 15% trimmed mean CPI continue to ease even as sticky CPI is slightly high



Source: MoSPI

By major categories, the contribution of miscellaneous items to headline inflation moderated in October compared to the previous month, though the category continued to contribute to more than one-fourth of headline inflation. Softer inflation readings were also recorded for the categories of clothing and housing, though their contribution to the headline number remain largely unchanged and relatively lower. The moderation in the miscellaneous category was aided by softer prints for the sub-categories of transport and communication, and household goods and services. Though inflation in personal care and effects moderated, it continued to contribute to around one-fourth of inflation in the miscellaneous category due to higher contribution from gold prices.

Figure 7: Despite easing, miscellaneous items added to over one-fourth of headline inflation in October



Source: MoSPI

Fuel and light remained in deflation for the second straight month due to LPG subsidy. In addition to slashing LPG prices in August, the government raised subsidy per cylinder under the Pradhan Mantri Ujjwala Yojana (PMUY) scheme for low-income households in October. This aided the continued decline in fuel prices over the previous year, even as electricity prices remained in double-digit inflation for the fourth consecutive month.

Though global crude oil prices have somewhat retreated in November, the underlying volatility due to geopolitical tensions continue to add to existing uncertainties to the inflation trajectory. However, in the event where oil prices start rising again, **the pass through from higher oil prices to domestic inflation, if any, is likely to be capped or modest, at best, in the context of the election cycle and imports from alternative sources such as Russia and Venezuela.**

Outlook: Despite slight easing in headline inflation in October, overall prices rose compared to the previous month, after declining for two consecutive months. The monthly rise was mainly due to increases in the prices of food and fuel. The food basket was driven higher by prices of vegetables, fruits and eggs. Within the fuel category, the impact of LPG subsidy faded from the previous month.

Fiscal year-to-date headline inflation stands at 5.4%YY for April-October compared to 7.1% during the same period a year ago. Though the October print at 4.9% is well below the RBI MPC's inflation forecast for Q3:FY24 at 5.6%, inflation is likely to trend higher in the months of November and December as support from favorable base effects fades away and food price shocks continue to remain a challenge. Rabi output and government intervention measures will be crucial to keep food price pressures contained. However, moderating core inflation is likely to cap the upside for headline inflation. Global commodity prices, particularly crude oil, will remain a wildcard, though the pass-through could be limited ahead of the general elections in 2024. Under these circumstances, inflation is likely to remain range-bound between 5.0-6.0% for the remainder of the fiscal year.

The latest inflation print is unlikely to move the needle for the RBI MPC at its policy meeting in December in terms of policy rates and stance. However, persistent double-digit inflation in certain items of the food basket and the recent rise in onion prices are likely to add to central bank woes in the context of recurring and overlapping food price shocks that it hopes to be transient and not translate into generalized price pressures. With the MPC's inclination for intervention via liquidity tools, and management of expectations via updates to its inflation forecasts, a move in either or both these directions cannot be ruled out, particularly up until or at its February MPC, when the central bank will have more data at its disposal for assessment.

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