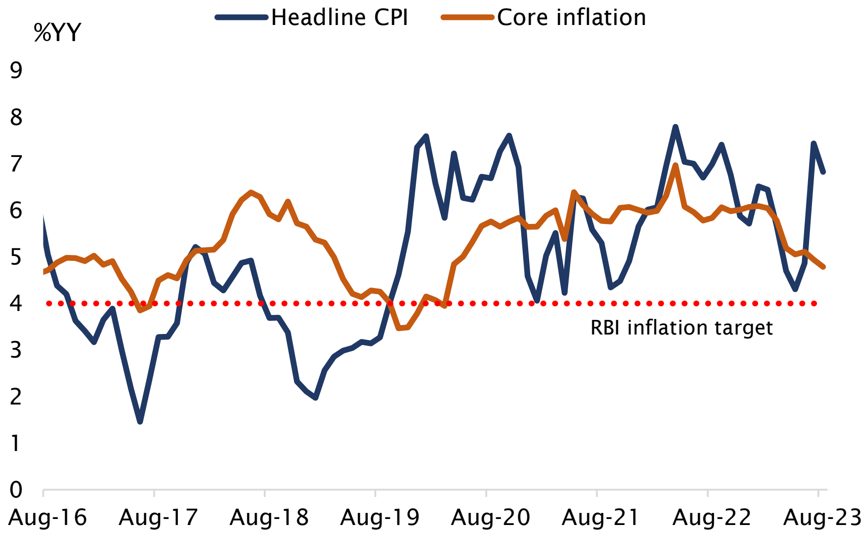
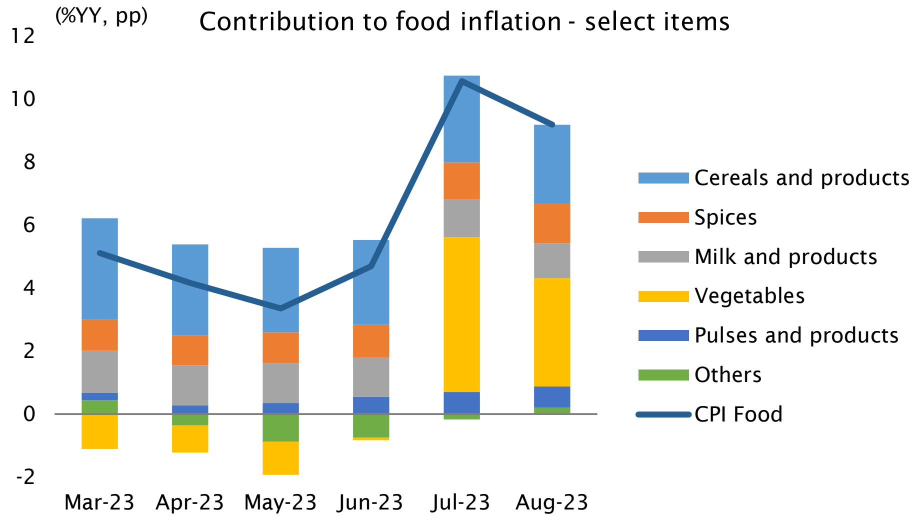
Headline CPI inflation moderates in August but food inflation remains a cause of concern; easing core inflation remains a bright spot

Key takeaways: Headline inflation moderated in August, largely aided by softening in prices of vegetables, but remained above RBI's upper tolerance limit for the second straight month. Even as seasonal effects roil recent inflation prints, policy makers and investors can seek solace in the fact that various core measures, which strip out the volatile food and fuel components, continue to moderate. A muted monsoon, El Nino prospects, and rising global crude prices pose upside risks to inflation, while deflation in wholesale prices could cushion the impact from these risks to some extent, albeit with a lag. Based on the latest inflation data, the RBI MPC is likely to maintain the policy pause at its upcoming October policy meeting, as awaits the transient price pressures to fade away.

Summary. Headline inflation moderated to 6.8%YY in August from the 15-month high of 7.4% in July, largely aided by softening in food inflation, particularly vegetables, though there remain pockets of concern within the food basket. Inflation also eased in categories of clothing, housing, and miscellaneous items (particularly, personal care and effects, and household goods and services). There was an uptick in inflation in the categories of fuel and light; and pan, tobacco and intoxicants. Core inflation, excluding the volatile food and fuel group, eased to 4.8% from 4.9% in July, marking the second consecutive month of sub-5% print.





Respite lies at the core. Despite the moderation in headline inflation in August, the underlying momentum, measured by the 3-month annualized rate, increased, as inflation stayed above the RBI's upper tolerance limit of 6% for two straight months (Table 1). However, the silver lining remains the core measure(s) of inflation where the underlying momentum continues to moderate (Table 2). The softening price pressures are also evident when we filter data into sticky versus flexible components, and into goods versus services. The headline inflation continues to track changes in the flexible component of CPI, which is more vulnerable to price changes, but the bright spot is the sticky component, which remains well behaved. The sticky component within the food basket has been actually contributing negatively to overall food inflation due to a decline in prices of edible oils in recent months. Splitting CPI components into goods and services reveals that the core measures within these categories also continue to ease. This should come as a respite as core services can add to the stickiness in overall inflation. Despite these positive aspects, concerns linger that the recent food price spikes might spill over to other components and high inflation could become more generalized. To evaluate such possibilities, we examine some of the details of food inflation.

Food in focus. Recent inflation prints have been driven higher by prices of vegetables (6% weight in CPI), which is seasonal in nature, and therefore, expected to be transient. With a shorter crop cycle and timely government intervention, the spike in vegetable prices is likely to reverse and take some pressure off the headline print in coming months. For instance, tomato prices fell around 22% month-on-month in August after increasing 214% and 66% respectively, in July and June. Prices of potatoes and onions also moderated in sequential terms in August, though the price increase remained in double digits in case of onions. Recent policy measures to release buffer stocks of onions in the wholesale market and imposition of 40% export tax are likely to improve supply and tame price pressures. However, government intervention is likely to play a larger role in case of other items in the food basket such as cereals and pulses, where inflation remains in double-digits, and the crop cycle is longer and more vulnerable to vagaries of the monsoon.

Inflation in cereals moderated to 11.9%YY in August from the recent peak of 16.7% in February. During the corresponding period, inflation in rice (other sources) and wheat (other sources), the heavyweights within cereals, moved in opposite directions. While inflation in wheat (other sources) moderated to 9.3%YY in August from 25.4% in February, inflation in rice (other sources) peaked at 13.1% in July. To keep prices in check and ensure adequate domestic supply of rice, the government banned exports of non-basmati white rice in July and more recently, imposed 20% export duty on parboiled rice. Other policy measures undertaken include imposing stock limits on wheat, and offloading rice and wheat stocks under open market sale scheme (OMSS). There could also be additional respite to cereal inflation based on recent sowing data (as on September 8) on Kharif crops, which suggests that sowing in case of rice and cereals has exceeded last year's sown area. However, sown area remains lower in case of pulses and this could remain an area of pressure for future inflation prints, unless managed by policy intervention. Inflation in pulses has hovered around 13%YY in July-August, with the prices of arhar (tur) being the largest contributor. Government intervention via imposition of stock limits and release of buffer stocks are yet to bear fruit.

Apart from sowing, data on rainfall and reservoir levels also indicate certain areas of concern. Latest data (as on September 13) suggests that the country as a whole received 10% below normal rainfall. The departure from normal was across the four major regions, with the largest discrepancy in case of east and north-east regions (-19%) and the least in case of the north-west region (-1%). Further risks remain due to El Nino conditions that could intensify and continue up to early next year, likely affecting Rabi crops as well. Due to low rainfall, the major reservoirs in the country were at 62% of their storage capacity (as of September 6), compared to 84% in the corresponding period last year.

In a nutshell, below normal monsoon, low reservoir levels, and El Nino conditions could remain a challenge for the trajectory of food inflation, and timely government and other policy intervention could be crucial to prevent food inflation from spilling over to other components. Despite these challenges, the average year-to-date inflation in food and beverages for FY24 currently stands at 6.4% compared to 6.7% for the entire FY23. If the latest trends in food prices indeed turn out to be transient, there is still hope that price pressures might not become generalized across categories of the consumer index.

The wildcards. Wholesale prices have remained in deflation in India for five straight months now, which could ease pressures in consumer prices, albeit with a lag. However, trend in global food and energy prices is mixed. In terms of year-on-year change, the UN FAO food price index remained in contraction for the tenth consecutive month in August, but in terms of levels, the index remains above the pre-pandemic numbers. Also, Brent crude price breaching $90/barrel does not bode well for global inflation outlook, and could thwart the relentless efforts by central banks to keep inflation in check.

Outlook. The year-to-date average headline inflation currently stands at 5.6%, which remains higher than the latest RBI forecast of 5.4% for the entire FY24. Though there is scope for the headline inflation to moderate from current levels, the central bank assumptions of a normal monsoon and crude oil prices at $85/barrel are currently under challenge. In the near term though, the transient price pressures are expected to fade away, so that the RBI MPC is likely to maintain the policy pause at its October meeting.

<u>Annexure:</u>

Table 1

India headline CPI and main sub-indices						
%YY	Mar-23	Apr-23	May-23	Jun-23	Jul-23	Aug-23
Headline CPI	5.7	4.7	4.3	4.9	7.4	6.8
Food and beverages	5.1	4.2	3.3	4.7	10.6	9.2
Pan; tobacco; intoxicants	3.0	3.5	3.6	3.7	3.9	4.1
Clothing and footwear	8.2	7.5	6.6	6.1	5.6	5.2
Housing	5.0	4.9	4.8	4.6	4.5	4.4
Fuel and light	8.8	5.5	4.7	3.9	3.7	4.3
Miscellaneous	5.8	4.9	4.9	5.2	5.0	4.9
Note: Color code is based on %3m3m, SAAR data						

Table 2:

India headline CPI and additional measures of inflation						
%YY	Mar-23	Apr-23	May-23	Jun-23	Jul-23	Aug-23
Headline CPI	5.7	4.7	4.3	4.9	7.4	6.8
Core	5.8	5.2	5.1	5.1	4.9	4.8
Core-core	6.0	5.8	5.6	5.4	5.2	5.0
Super core	5.9	5.6	5.3	5.1	4.9	4.7
Sticky CPI	4.3	3.7	3.0	2.6	2.7	2.7
Flexible CPI	6.5	5.2	4.9	6.1	10.4	9.3
Goods	5.7	4.6	4.0	4.8	8.2	7.4
Services	5.0	4.8	4.5	4.3	4.2	4.1
Core goods	7.0	6.6	6.2	6.0	5.7	5.4
Core services	5.0	4.8	4.5	4.3	4.2	4.1
CPI ex-vegetables	6.6	5.5	5.1	5.2	5.4	5.5
Note: Color code is based on %3m3m, SAAR data						