

CPI Inflation Moderates Sharply on a Favourable Base

August 12, 2024 | Economics

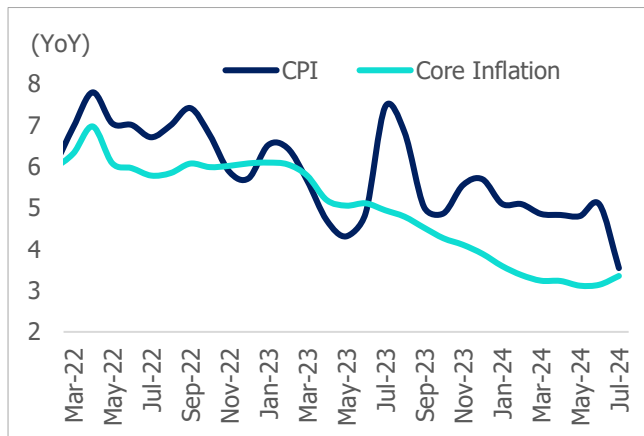
Headline Inflation Moderates to a Multi-Year Low Due to Favourable Base Effect

In line with expectations, the CPI inflation moderated sharply to 3.5% in July from 5.1% in June, largely on account of a favourable base of last year. The inflation has moderated across all the major heads except telecommunications and personal care. Core inflation remained largely benign, rising marginally to 3.4% in July, up from 3.1% in June, reflecting recent hikes in telecom tariffs and the upward revision of fuel prices in certain states. Notably, inflation in telecommunications surged to 2.5% in July, up from 1% in the previous month, while inflation in personal care items remained elevated at 8.4%. Recently, telecom tariffs were hiked by major mobile service providers, ranging from 10-25%. Additionally, certain states have hiked sales tax on fuel prices which also marginally impacted inflation.

Food and Beverages inflation moderated to 5.1% in July, down from 8.4% the previous month. Notably, inflation in the spices category, which had seen a steep decline over the past couple of months, has now entered negative territory. Oils and fats continued to remain in deflation, while inflation in vegetable prices dropped significantly to 6.8% in July, down from 29.3% last month.

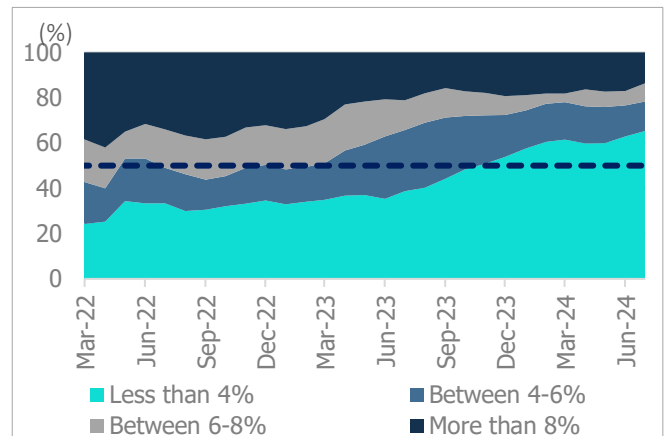
Despite the moderation in the inflation of the food and beverage basket when compared to last year, the sequential momentum remains strong, with a 2.5% MoM increase in prices, higher than an average sequential growth of 1.3% MoM in Q1 FY25. Much of the sequential increase in food prices is due to a sharp rise in vegetable prices which rose 14.1% MoM. The early arrival of Kharif harvests in the second half of September is expected to cool this sequential momentum in food prices. However, it will be crucial to monitor the temporal and spatial distribution of the monsoon and the progress of Kharif sowing. Although all-India rainfall is currently about 6% above normal, key agrarian regions such as Punjab, Haryana, and the eastern Gangetic Plains are experiencing double-digit rainfall deficits. This is concerning, as reservoir levels especially in northern India remain below both normal and last year's levels.

CPI: Headline vs. Core Inflation



Source: MOSPI, CareEdge; Note: Core index is calculated excluding food, fuel and light

Share of items in different inflation buckets



Source: MOSPI, CareEdge

Overall, the sowing of foodgrains in the Kharif season remains robust, with a 6% increase compared to last year. However, this growth is inflated by the low base of last year when El Nino-induced disruptions negatively impacted sowing. A concerning aspect is the lagged sowing of pulses this time, which is down by 6.2% compared to 2022. This is particularly worrisome, as inflation in pulses has remained in double digits for the past 14 months. Controlling price pressures in the food basket is essential, as they can significantly influence households' inflationary expectations.

Globally, commodity prices, which had been rising through the first half of CY 2024, have eased over the past couple of months. Brent crude prices have eased by approximately 3% over the past six months, reaching around USD 80 per barrel in the first week of August due to global demand concerns. However, the EIA projects that Brent will rebound to a level between USD 85-90 per barrel by the end of CY 2024, driven by falling global crude oil inventories amid ongoing OPEC+ production cuts. External risks arising from ongoing geopolitical tensions need to be closely monitored, as they could pose significant risks to supply chains and commodity prices.

Component-Wise Retail Inflation (% y-o-y)

	Food & Beverages	Pan, Tobacco & Intoxicants	Clothing & Footwear	Housing	Fuel & Light	Miscellaneous	Headline Inflation
Weight	45.86	2.38	6.53	10.07	6.84	28.32	100
Jul-23	10.6	3.9	5.6	4.5	3.7	5.0	7.4
Aug-23	9.2	4.1	5.2	4.4	4.3	4.9	6.8
Sep-23	6.3	3.9	4.6	4.0	-0.1	4.8	5.0
Oct-23	6.3	3.9	4.3	3.8	-0.4	4.5	4.9
Nov-23	8.0	3.8	3.9	3.6	-0.8	4.4	5.6
Dec-23	8.7	3.6	3.6	3.6	-1.0	4.1	5.7
Jan-24	7.6	3.3	3.4	3.2	-0.6	3.8	5.1
Feb-24	7.8	3.1	3.1	2.9	-0.8	3.6	5.1
Mar-24	7.7	3.1	3.0	2.7	-3.4	3.5	4.9
Apr-24	7.9	3.0	2.9	2.7	-4.0	3.5	4.8
May-24	7.9	3.0	2.7	2.6	-3.7	3.4	4.8
Jun-24	8.4	3.1	2.7	2.7	-3.7	3.4	5.1
Jul-24	5.1	3.0	2.7	2.7	-5.5	3.8	3.5

Source: MOSPI

Way Forward

Looking ahead, the base effect will turn unfavourable in both August and September which may lead to a reversal of the trend witnessed this month. A benign core inflation underscores the fact that the healthy growth momentum has largely been disinflationary. However, the risks to food inflation remain elevated. Early arrival of Kharif harvests from mid-September can help in moderating food prices. However, it will be crucial to monitor the distribution of rainfall and the progress of the Kharif sowing. Despite a pick-up in monsoon, key agrarian regions in North and Eastern India continue to face significant deficits in rainfall.

Additionally, it's also important to monitor the external risks to the inflationary outlook stemming from geopolitical uncertainties. For FY25, we expect inflation to average 4.8%. If food inflation moderates, we anticipate that the RBI may initiate a shallow rate-cut cycle in the second half of the fiscal year.

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