

## CPI

13 September 2021

**Food inflation drives CPI lower**

**CPI inflation moderated to 5.3% in Aug'21 led by food inflation which softened to 3.1% (4% in Jul'21). Core inflation eased by 10bps to 5.9%. A favourable base and uptick in rains in Sep'21 bodes well for inflation outlook. We expect CPI inflation to average 5.5% in FY22 (RBI: 5.7%). However, core inflation is likely to remain sticky with an impending increase when contact intensive services sector opens up. We expect RBI to remain on hold this year and raise reverse repo rate in Q4FY22.**

**Sameer Narang**

+91 22 6698 5713

chief.economist@bankofbaroda.com

**Dipanwita Mazumdar**

dipanwita.mazumdar@bankofbaroda.com

**Jahnavi**

jahnavi@bankofbaroda.com

**Key highlights**

- CPI edged down to 5.3% from 5.6% in Jul'21.
- Food inflation softened to 3.1% from 4%, led by vegetables.
- Core inflation remained sticky at 5.9% against 6% in Jul'21.

**CPI moderated led by food:** CPI inflation eased to 5.3% in Aug'21 from 5.6% in Jul'21 led by moderation in food inflation to 3.1% in Aug'21 compared with 4% in Jul'21. This was led by sharp drop in vegetable prices which declined by -11.7% (-7.8% in Jul'21). Inflation in eggs moderated to 16.3% (from 20.8% in Jul'21), fruits to 6.7% (from 9% in Jul'21) pulses to 8.8% (from 9% in Jul'21) and sugar to -0.6% (-0.5% in Jul'21). However, inflation in milk rose marginally to 2.9% (2.7% in Jul'21) and oils and fats to 33% (from 32.5% in Jul'21).

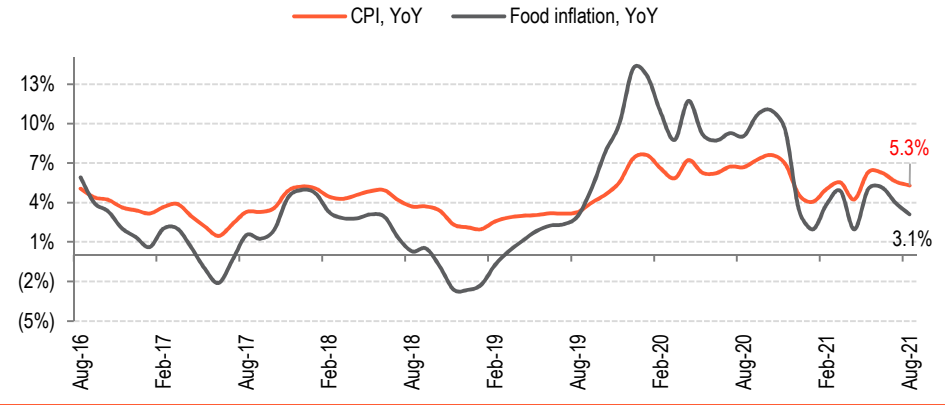
**Core inflation softens a bit:** CPI excluding food and fuel edged down by 10bps to 5.9% in Aug'21 (6% in Jul'21). This was led by 30bps drop in transport and communication index to 10.2% (from 10.5% in Jul'21). Personal care and effects inflation also softened by 275bps to 1% from 3.8% due to decline in gold prices. Inflation in Pan, tobacco etc. also moderated to 4% from 4.7% in Jul'21. However, other components of core showed an increase led by education at 3.8% (from 3% in Jul'21), household goods and services at 5.4% (from 5.0% in Jul'21) and clothing and footwear at 6.8% (from 6.4% in Jul'21). Housing inflation was stable at 3.9%. Fuel and light index has now risen to a high of 12.9% from 12.4% in Jul'21.

**CPI Inflation estimated at 5.5%:** The uptick in rainfall in Sep'21 is positive for sustaining the current trend of decline in food inflation. Reduction in customs duties on edible oils is also a positive. Base effect for vegetables is also favourable till Nov'21 after which food inflation is likely to edge upwards. Notably, vegetable inflation during Apr-Nov'20 was 14.3% before falling to -9.4% in the remaining four months of the previous financial year.

While core inflation has softened a tad in Aug'21, elevated crude oil prices and impending pass-through when services economy opens up implies core inflation is likely to remain elevated in coming months and quarters. For now, this inflation print sets the background for RBI to maintain its policy rate at current levels in FY22 and look at gradually reducing excess liquidity in the coming months. We do see RBI reducing the gap between repo and reverse repo rate in Q4FY22 unless growth disappoints from our current projection of 9.7% (RBI: 9.5%).

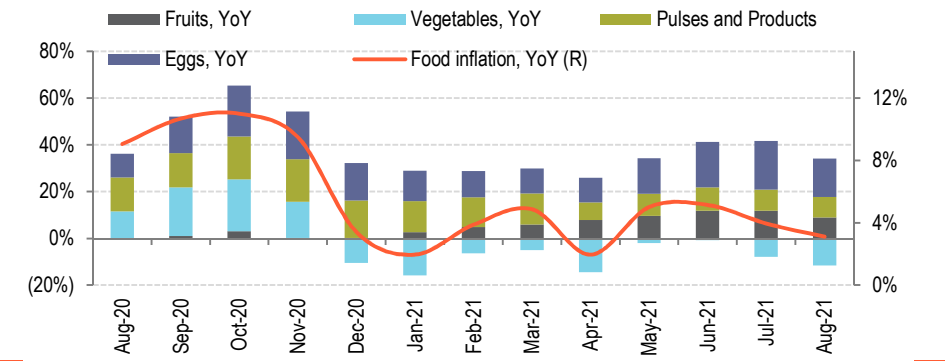


**Fig 1 – CPI edged down to 5.3% in Aug'21, led by food**



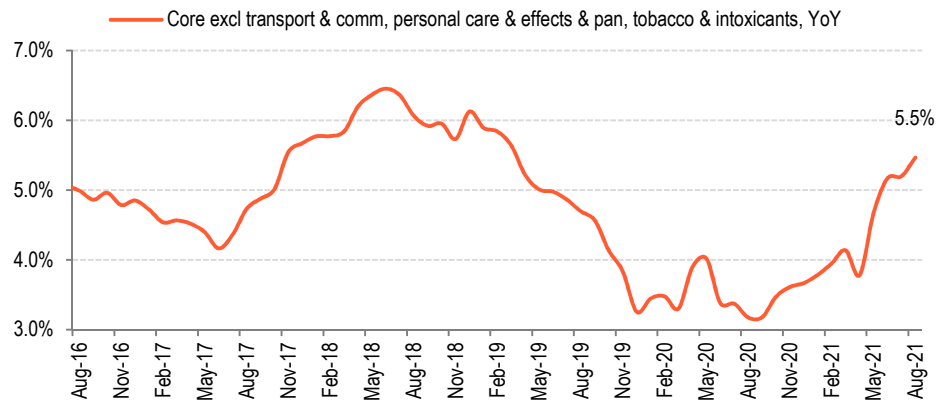
Source: CEIC, Bank of Baroda Research

**Fig 2 – ... vegetables, fruits and eggs dropped the most**



Source: CEIC, Bank of Baroda Research

**Fig 3 – Core excl. volatile components shoot up**



Source: CEIC, Bank of Baroda Research

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For further details about this publication, please contact:

**Economics Research Department**

Bank of Baroda

+91 22 6698 5713

[chief.economist@bankofbaroda.com](mailto:chief.economist@bankofbaroda.com)