

RETAIL INFLATION

14 January 2019

Food deflation continues; core inflation a worry

Retail inflation at 2.19% eases to its 18-month low on the back of continued deflation seen in food prices (-2.5% in Dec'18) While overall core inflation was stable, health, education and household and personal goods are showing an uptick. Even so, a domestic cyclical slowdown is converging with loss of global growth momentum. With CPI inflation significantly undershooting RBI's trajectory as laid out in Oct'18, we believe RBI is likely to change its stance next month. However, room to cut rates is limited for now.

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Core inflation stable: Headline CPI inflation fell to 2.19% from 2.33% in Nov'18 on the back of lower food inflation. Core inflation, on the other hand, was unchanged at 5.7% in Dec'18. However, core (excluding transport and communication) increased to 6% in Dec'18 from 5.6% in Nov'18. This increase is led by higher inflation in health, education, household and personal goods. Notably, health inflation is now at 9% (7.2% in Nov'18) and education inflation is at 8.4% (6.6% in Nov'18). Even so, core inflation was stable as lower crude prices ensured that retail prices of petrol and diesel fell. Housing also helped at the margin as impact of HRA on the index is moderating.

KEY HIGHLIGHTS

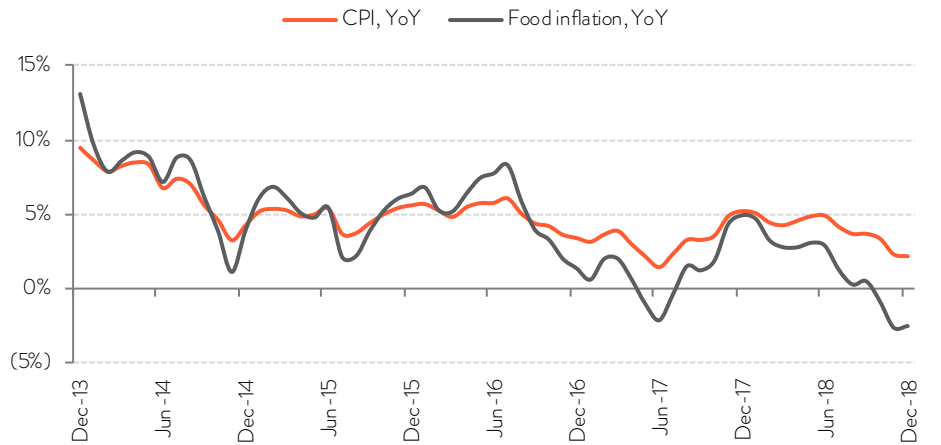
- CPI inflation falls to 2.2% in Dec'18 led by food.
- Food deflation drops to (-) 2.5% in Dec'18.
- Core inflation unchanged at 5.7%.

Food deflation continues: Food deflation continued for third month in a row now at (-) 2.5% from (-) 2.6% in Nov'18. The decline is attributable to vegetable prices which fell by (-) 16.1% in Dec'18 compared with (-) 15.6% in Nov'18. Even on a MoM basis vegetable prices fell by (-) 7.5% in Dec'18 (-1.8% in Nov'18). Deflation in fruits and sugar intensified. Pulses deflation moderated a bit to (-) 7.1% from (-) 9.2% in Nov'18. Inflation in cereals category was at the same level as Nov'18 at 1.3% despite the MSP hike by government. Outlook on food inflation is relatively benign for now as pass-through of higher MSPs is likely to take some more time.

Neutral stance on the horizon: CPI inflation yet again edged down in Dec'18. With this print, CPI inflation during Q3FY19 stands at 2.6% versus RBI's projected trajectory of 3.8% (released in Oct'18). Given the significant undershoot and now the narrative of a global slowdown, CPI inflation is expected to remain below RBI's target of 4% in FY19 (at 3.8% in 9MFY19) and FY20. This gives RBI room to change its monetary policy stance. However, the elevated level of core components such as health, education, household and personal goods suggests that room to cut rates is limited for now.

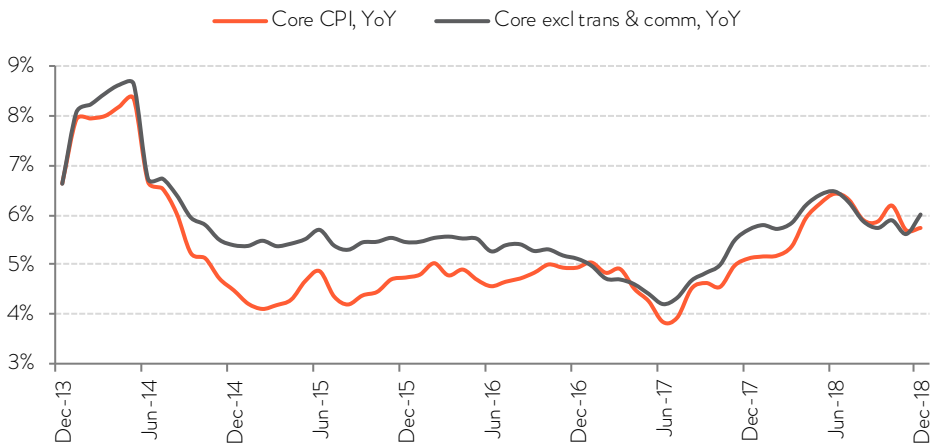


FIG 1 – CPI SOFTENED TO 2.2% LED BY FOOD



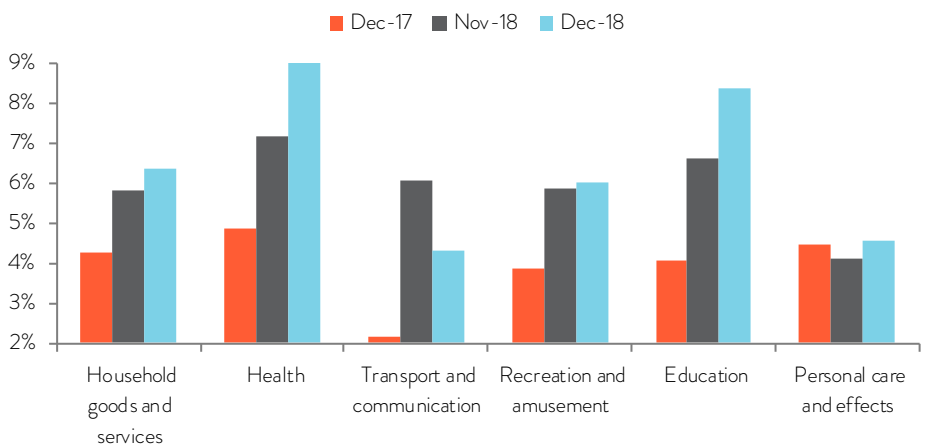
Source: CEIC, Bank of Baroda Research

FIG 2 – CORE STABLE; CORE EXCL-TRANSPORT & COMM INCHED UP



Source: CEIC, Bank of Baroda Research

FIG 3 – BROAD BASED ITEMS OF CORE PICKING UP



Source: CEIC, Bank of Baroda Research

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