

## INFLATION

13 July 2020

**CPI surprises negatively led by core**

**NSO released CPI inflation for Apr'20 and May'20 along with Jun'20 data. CPI inflation in Q1 is at 6.5% (6.7% in Q4) and in Jun'20 at 6.1%. The negative surprise came from core inflation at 5.1% in Q1 from 4.1% in Q4. While core and food inflation will moderate going ahead, the trajectory for H2 is now higher than earlier estimated. MPC members may still go for a 25bps rate cut to support growth but room is limited and most of policy rate cuts are behind us. Focus will be on transmission, financial stability and yield curve.**

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**CPI surprises negatively:** As against our forecast of 5.1% (consensus of 5.3%) for Jun'20, actual CPI inflation was 6.1%. Data released for Apr'20 and May'20 shows CPI inflation at 7.2% and 6.3% respectively. While food inflation has come down in the last three months from 11.7% in Apr'20 to 7.9% in Jun'20, core inflation has increased from 4.9% in Apr'20 to 5.3% in Jun'20. In Mar'20 core was 4.0% which shows a significant increase during the lockdown period.

**Food inflation falls:** Food inflation fell to 7.9% in Jun'20 from 9.2% in May'20 led by moderation in vegetable prices to 15-month low of 1.9% in Jun'20 (5.5% in May'20). CPI (ex-vegetables) moderated to 6.2% in Jun'20 from 6.4% in May'20. Given the abundant rainfall and sowing pattern, food inflation is expected to moderate in coming months.

**Core inflation rose:** NSO released core inflation for Apr'20 and May'20 along with Jun'20. Notably, core inflation has accelerated in lockdown period led by personal care (12.4% in Jun'20 vs 8.8% in Mar'20), education (5.5% vs 3.9%), and transport and communication (7.1% vs 4.3%). On the other hand, categories such as housing (3.7% vs 3.5%) and recreation (4.4% vs 3%) have seen a deceleration. Rising core inflation is due to higher gold prices, taxes on fuel and underlying change in consumer behaviour.

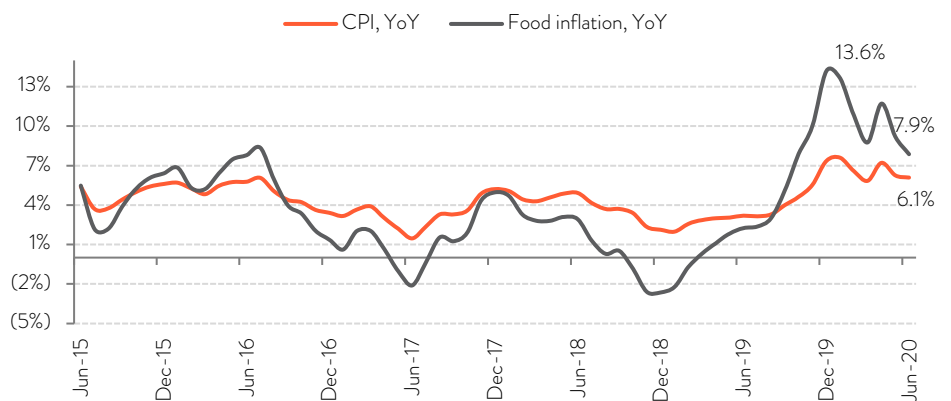
**RBI to focus on growth:** We now expect CPI inflation to average 3.4% in H2FY21 as against 5.7% in H1FY21. Our GDP growth forecast remains at (-) 4.7% for FY21. Given the growth inflation dynamics, MPC may focus on growth for now and deliver a 25bps rate cut in August policy. However, some MPC members may vote for a pause to see the impact of negative GDP growth on inflation before cutting rates further. RBI's focus is likely to be on financial stability and transmission as most of monetary easing is behind us.

**KEY HIGHLIGHTS**

- NSO has released headline CPI print for Apr, May & Jun'20.
- Food inflation has moderated to 7.9% in Jun'20 from 11.7% in Apr'20.
- Core inflation accelerated significantly to 5.3% in Jun'20 from 4% in Mar'20.

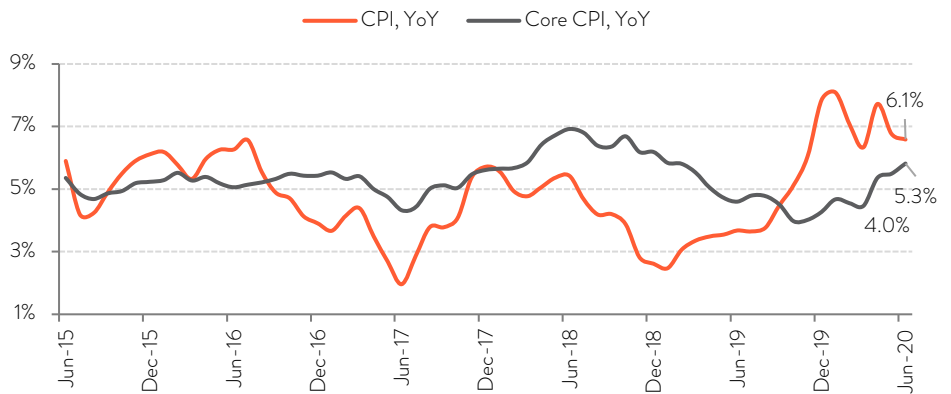


**FIG 1 – CPI PRINT FOR JUN'20 WAS AT 6.1% AGAINST 6.3% IN MAY'20 & 7.2% IN APR'20**



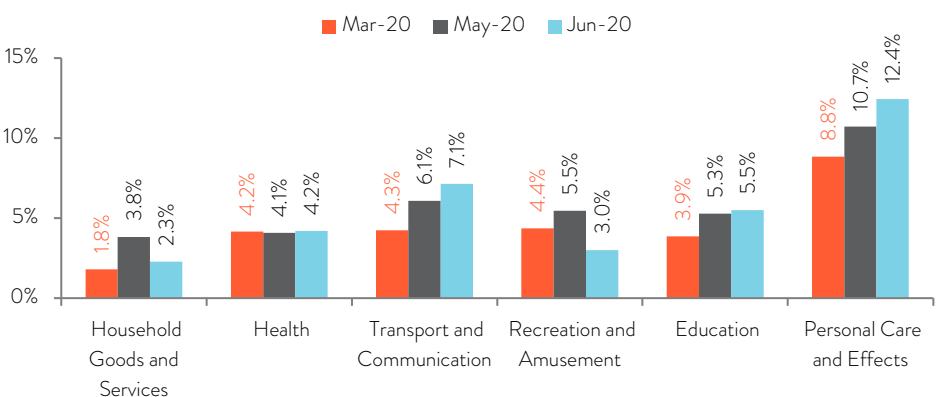
Source: CEIC, Bank of Baroda Research

**FIG 2 – CORE ACCELERATED SIGNIFICANTLY TO 5.3% FROM 4% IN MAR'20**



Source: CEIC, Bank of Baroda Research

**FIG 3 – ...LED BY TRANSPORT AND COMMUNICATION, EDUCATION AND PERSONAL CARE ITEMS**



Source: CEIC, Bank of Baroda Research

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