

RETAIL INFLATION

13 January 2020

A big negative surprise

CPI rose to more than 5-year high of 7.4% in Dec'19 led by food inflation at 14.1%. Within food, vegetable inflation rose to 60.5% and pulses to 15.4%. Core also increased a bit to 3.8% in Dec'19 from 3.5% in Nov'19 on the back of higher telecom and fuel prices. However, most components of core decelerated in-line with muted demand. We do foresee inflation easing to 6% in Mar'20 and then to 4% in Q3FY21 because of which RBI will see through the current inflation spike and look at easing rates closer to Oct'20.

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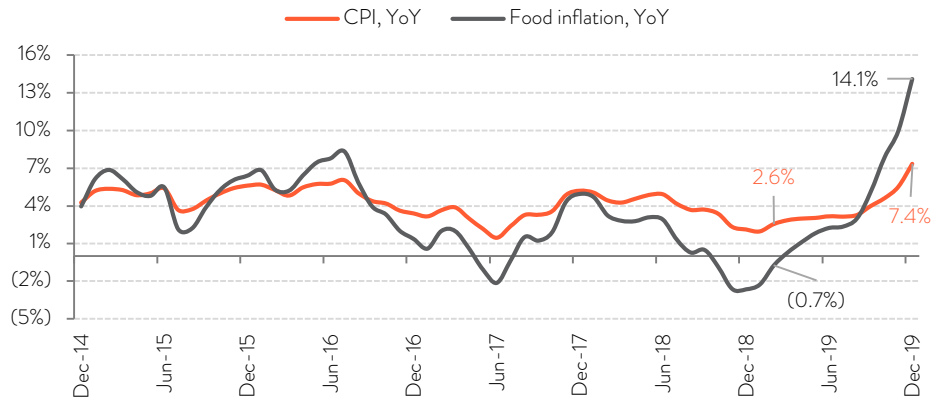
Food inflation at 6-year high: Headline CPI spiked to 7.4% in Dec'19 from 5.5% in Nov'19 led by sharp acceleration in food prices. The increase in food prices was quite widespread. Food inflation rose to 6-year high of 14.1% in Dec'19 from 10% in Nov'19. Within the food index, vegetable prices increased the most at 60.5% in Dec'19 versus 36.1% in Nov'19. In addition, prices of fruits too increased at a 17-month high of 4.4% compared with 3.2% in Nov'19. Prices of pulses too rose at a 40-month high of 15.4% in Dec'19 versus 13.9% in Nov'19. Prices of egg, milk, meat and fish too noted an uptick.

Core rose by 30bps: CPI inflation excluding food and fuel increased to 3.8% in Dec'19 compared with 3.5% in Nov'19. The increase in core was driven by transport and communication category which reported a 4.8% increase in Dec'19 vs 0.9% in Nov'19. While a part of this was on the back of higher retail prices of petrol and diesel, a larger part can be explained by increase in telecom tariffs which are more structural in nature. At the same time, certain components of core such as health at 3.8% vs 5.5% in Nov'19, education at 3.7% vs 5.2% in Nov'19 and housing at 4.3% vs 4.5% in Nov'19 showed deceleration.

Rate cut on hold till H1FY21: Such high food inflation level was last seen in FY14 when India had CPI inflation level of 9.4%. It has coincided with uptick in global food prices which are now at 5-year high. However, India does have surplus food stock in rice and wheat and this should put a cap on food inflation. Thus as vegetable inflation eases in the next few months, CPI inflation should decelerate as core inflation is likely to remain anchored around 4% in H1FY21 before inching up to 4.3% in H2FY21. However, in H2FY21 food inflation will be benign which opens up room for rate cuts by RBI as growth will remain below potential even in FY21.

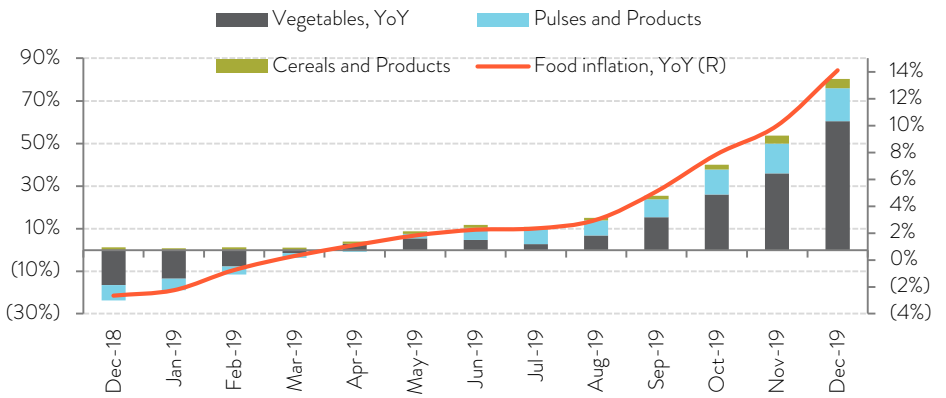


FIG 1 – FOOD INFLATION INCHES UP TO 6-YEAR HIGH



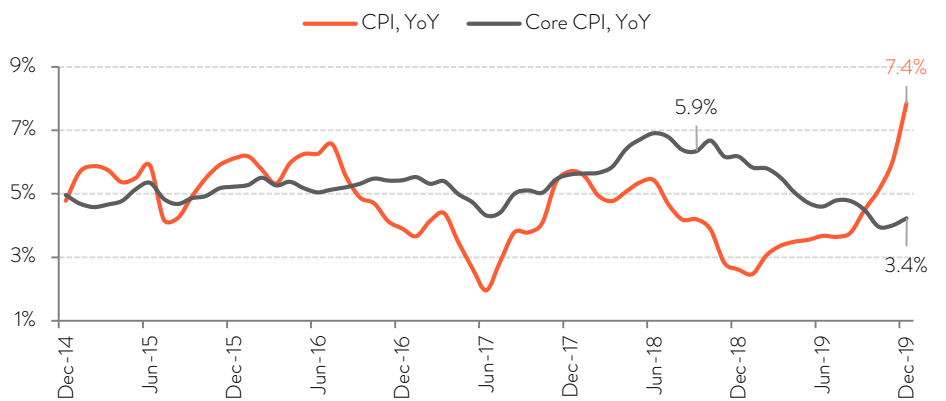
Source: CEIC, Bank of Baroda Research

FIG 2 – LED BY HIGHER VEGETABLE PRICES



Source: CEIC, Bank of Baroda Research

FIG 3 – CORE CPI REMAINS ELEVATED



Source: CEIC, Bank of Baroda Research

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