

Inflation Watch: Headline CPI inflation slipped below 4% in July due to favorable base effects

16 August, 2024

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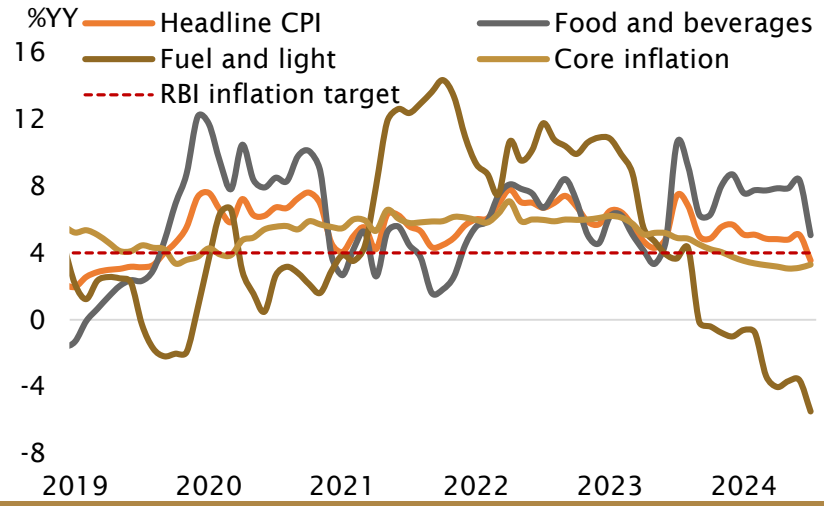
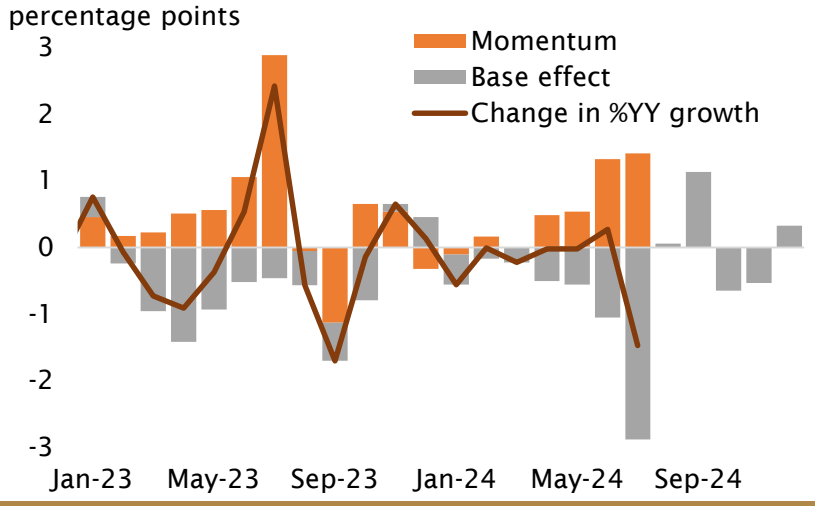
Key takeaways

- Headline CPI inflation reached an almost five-year low (59 months, to be precise) at 3.5%YY in July from 5.1% in June due to favorable base effects that particularly dragged down food inflation. The month-on-month momentum in headline inflation was stronger in July compared to June, and also above the long-term average for the month.
- After easing for more than a year and reaching fresh lows, core inflation rose marginally to 3.4% from 3.1% in June, mainly reflecting the impact of tariff rate hikes by telecom companies and also higher global prices of precious metals that trickle down to the personal care category.
- The fuel and light index remained in deflation and reached a fresh low, aided by the ongoing deflation in LPG and diesel, and also easing in some of the other categories during the month.
- Even as core inflation is expected to gradually increase, the upside from the current rates of sub-4% is unlikely to be worrisome in the near term. Going forward, the trajectory of headline CPI will largely hinge on food inflation which, in turn, will depend on the ongoing progress in monsoon, sowing and reservoir levels. Latest data on these metrics, along with high frequency data on food prices, and the long-term trends in the prices of vegetables suggest low inflation pressures in the month of August. The MPC will have another month of inflation data, and the Fed policy decision to account for before it meets again in the first week of October.

Headline CPI slipped below 4%, core inflation rose in Jul



Favorable base effect contributed strongly to low CPI



Headline CPI inflation slipped below 4% due to favorable base effects

- In July, headline CPI inflation slipped below the RBI's 4% target and moderated to 3.5%YY, the lowest rate since August 2019. The print was also below most market expectations with Bloomberg survey estimate at 3.6%. The easing was due to a favorable base effect that enabled sharper disinflation in the food basket, particularly vegetables. In July 2023, food inflation reached double-digits due to over 200% surge in tomato prices. In July 2024, food inflation slipped below 6% for the first time in a year, during which it had averaged 8%. Food contributed 66% to the latest headline print after adding around 75% each in the months of May and June.
- The fuel index remained in deflation for the eleventh consecutive month and reached a fresh low in the series at -5.5%YY, aided by the ongoing deflation in LPG and diesel, and also easing in the categories of electricity, firewood and chips, coal, and other fuel during the month.
- Inflation in other major categories of CPI inflation was also lower in July compared to the previous month, except for the miscellaneous group that saw an uptick, mainly because of the impact of increase in telecom tariffs and the pass-through of higher global prices of gold and silver in the personal care and effects group. As a result, there was a marginal rise in various measures of core inflation that had been moderating for more than a year, but remained benign below 4%.
- In non-seasonally adjusted terms, the month-on-month momentum in headline inflation strengthened to 1.42% from 1.33% in June, and was above the long-term average for the month at 1.28%. The momentum in food items eased from the previous month, but remained the highest among major CPI categories at 2.47% and above the long-term average of 1.96% for the month. Compared to June, momentum rose in case of housing and miscellaneous groups, as compared to the previous month, while it eased for other categories.

Inflation eased across groups except for miscellaneous

%YY	Weight	May-24	Jun-24	Jul-24
Headline CPI	100.0	4.80	5.08	3.54
Food	45.9	7.87	8.36	5.06
Intoxicants, etc.	2.4	3.03	3.08	3.02
Clothing	6.5	2.74	2.73	2.67
Housing	10.1	2.56	2.69	2.68
Fuel and light	6.8	-3.67	-3.61	-5.48
Miscellaneous	28.3	3.41	3.41	3.79

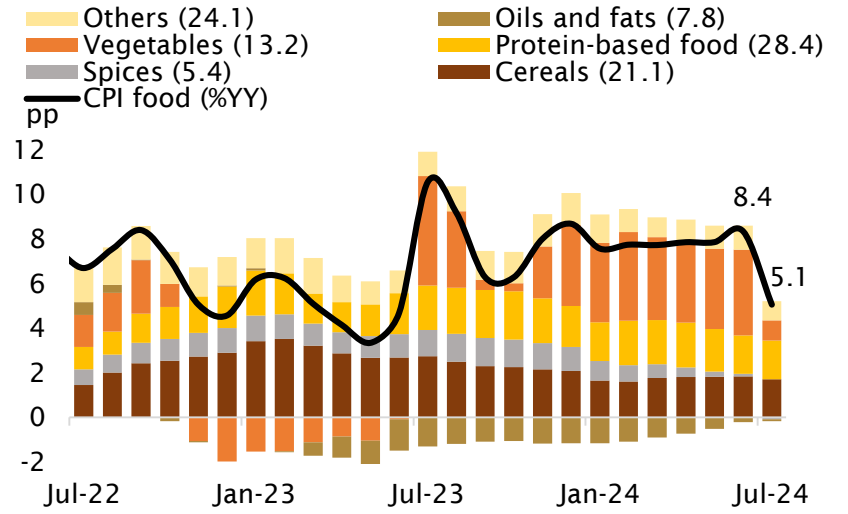
Monthly momentum in headline CPI increased in July

%MM, NSA	Weight	May-24	Jun-24	Jul-24
Headline CPI	100.0	0.54	1.33	1.42
Food	45.9	0.68	2.69	2.47
Intoxicants, etc.	2.4	0.24	0.29	0.24
Clothing	6.5	0.16	0.31	0.21
Housing	10.1	0.11	-0.56	0.50
Fuel and light	6.8	0.97	0.11	-0.17
Miscellaneous	28.3	0.28	0.28	0.77

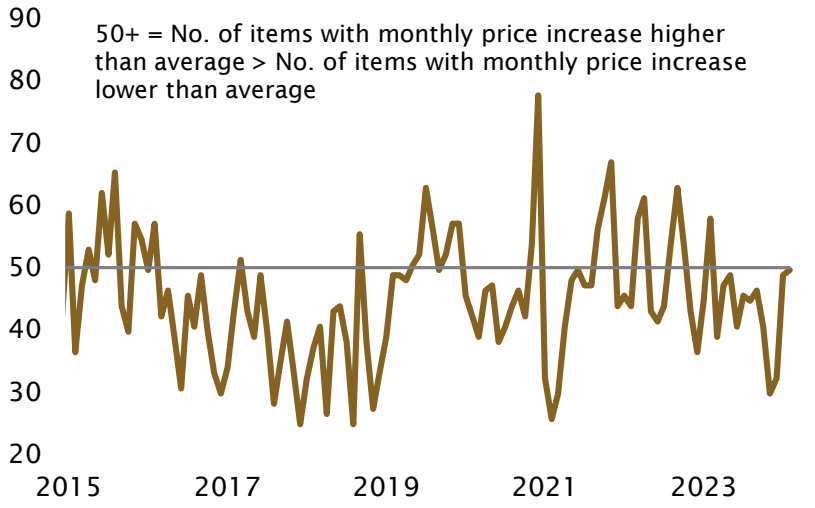
Sharp disinflation in vegetables enabled lower food price pressures

- Inflation in the food and beverages category moderated to 5.1%YY in July from an eight-month high of 8.4% in June. Vegetables, with a weight of around 13% in the food basket, contributed 18% to food inflation in July, down from over 40% in the past seven months when inflation in this group was over 20%. However, month-on-month momentum (non-seasonally adjusted) was strong at 14.1%, mildly lower than in June but higher than the long-term average (FY12-24) of around 11.2% for the month. The other food groups where monthly momentum was higher than the long-term average for July were cereals, eggs, oils and fats, and pulses.
- The diffusion index, which captures monthly prices changes across food items, edged closer to the neutral zone in the months of June and July after remaining benign for almost ten months.
- The other categories where year-on-year price gains had been elevated and sticky over the past few months were cereals, pulses and spices. Of these, spices slipped into deflation in July, the first time since March 2018, while inflation in the cereals group moderated to a five-month low but stayed slightly over 8%. Inflation in pulses eased but remained in double digits. Apart from pulses, inflation in other protein-based items stayed firm; increasing in case of meat, fish, and eggs; while remaining unchanged from June in case of milk.
- The deflation in oils and fats index sustained for the eighteenth successive month but the degree continued to dwindle, largely tracing the trend in global prices. Sugar prices continued to ease for the six straight month.

Contribution to food inflation - select items



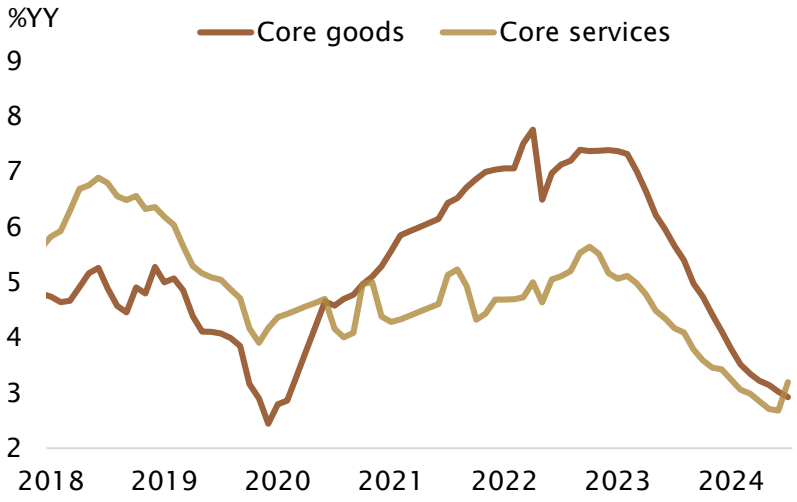
Food diffusion index closer to neutral zone in June-July



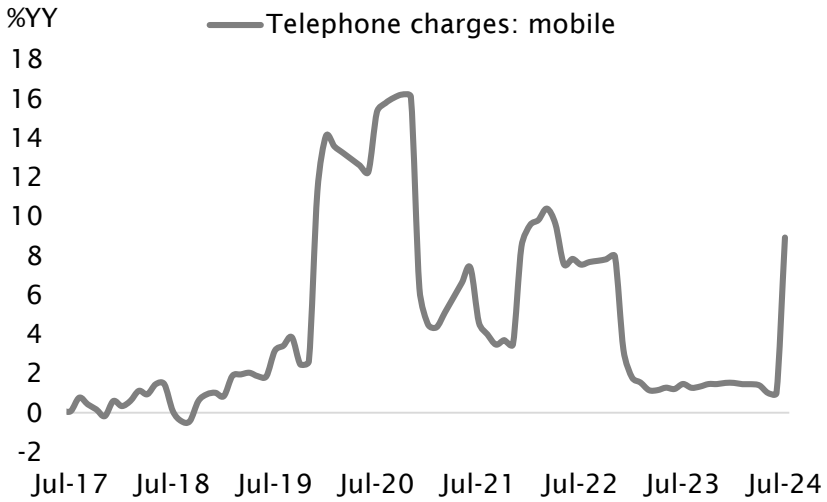
Hike in telecom tariffs lifted core inflation from record low levels

- In July, core inflation (ex-food and fuel) increased to 3.4%YY from 3.1% in the previous month. After easing for more than a year and reaching fresh lows, various measures of core inflation ticked up, mainly reflecting the pass-through of tariff hikes (of up to 25%) by telecom companies that were effective starting July. Mobile phone charges account for 21% of the transport and communication sub-index that has a weight of 8.6% in the CPI index. As a result, core services inflation rose to 3.2% from 2.7% in June, even as core goods inflation continued to ease, albeit fractionally.
- In addition to transport and communication, the contribution of personal care and effects group to core inflation increased marginally in July, reflecting higher global prices of gold and silver.
- As per a survey by the RBI, households' inflation expectations (both three-month and one-year ahead) rose for the second consecutive round in July. In terms of products, the proportion of respondents expecting prices to increase one year-ahead has been the highest in case of housing since March 2023, even as the near-term expectations tend to be led by food. Housing inflation remains low (at sub-3% for six months now), contrary to anecdotal evidence and could require an update in calculation methodology to reflect market conditions.
- According to the RBI's latest Survey of Professional Forecasters, core inflation (ex-food and beverages; pan, tobacco, and intoxicants; fuel and light) that had averaged 3.2% in Q1 is expected to gradually increase in the coming quarters with median forecasts at Q2: 3.5%, Q3: 4.0%, Q4: 4.3% and Q1:FY26: 4.5%.

The uptick in core inflation was driven by services…



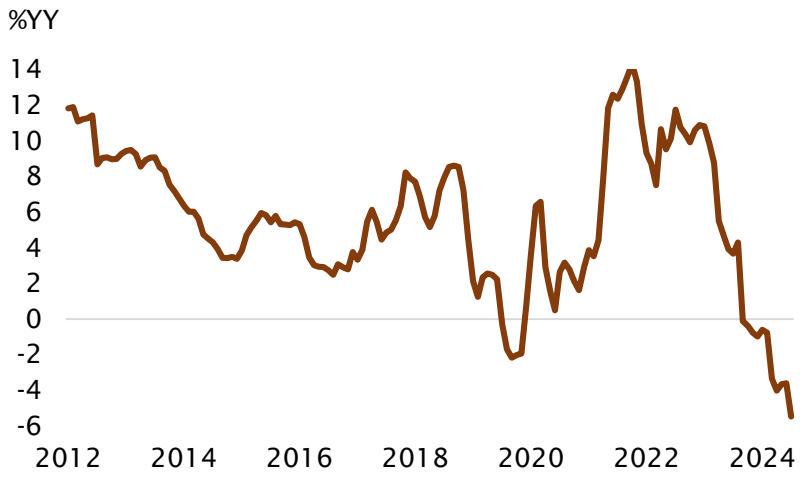
… largely reflecting the impact of telecom tariff hike



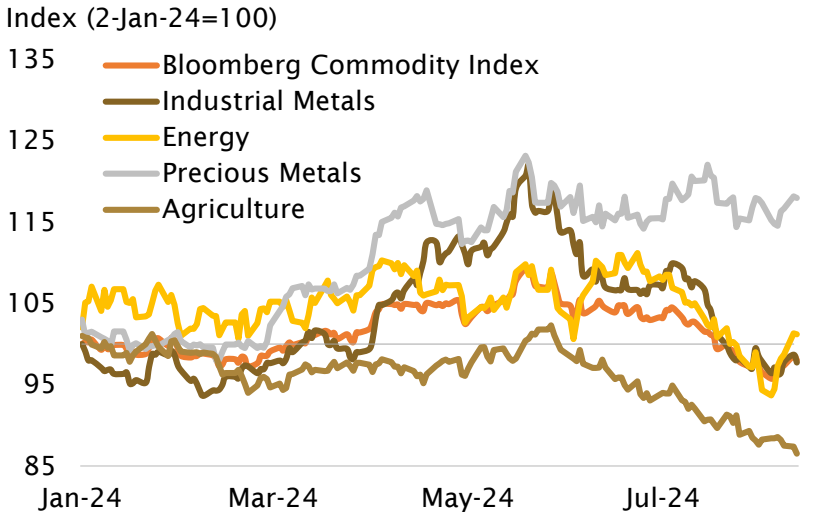
Fuel deflation at a fresh low, global commodity prices volatile

- The fuel and light index, with a weight of 6.84% in CPI inflation, remained in deflation for the eleventh consecutive month, and touched a fresh series low of -5.5% in July. The decline was supported by the impact of price cuts in LPG, petrol and diesel announced in the previous and this year. Inflation in electricity also eased to a 15-month low after hovering in double digits for almost a year till May 2024. There was also easing of inflation in other sub-groups such as firewood and chips, and coal, with the other fuel index posting deflation.
- Most of the global commodity prices have eased since the beginning of the year but remain volatile. Crude oil prices remain vulnerable to tensions in the Middle East, and are expected to return to between $85/b and $90/b by the end of the year despite easing in July (as per latest EIA outlook note), mainly due to extended production cuts by the OPEC+. The upside is likely to be capped due to lower consumption expected in China.
- The headline Bloomberg commodity index is currently below the levels seen at the beginning of the year, and so is the industrial metals sub-index that had increased over 20% in May. Copper and nickel prices fell in June and July amid reports of exports from China due to muted domestic demand. Concerns of a sharper-than-expected slowdown in the US further drove industrial commodity prices lower in July. On the flip side, precious metal prices, particularly gold, have surged on safe haven demand.
- Global food prices have remained in deflation since December 2022, as per the UN FAO. In terms of month-on-month change, global food prices fell in July after increasing for four months, with cereals as the main drag.

Fuel and light deflation slipped to fresh low in July



Bloomberg commodity index below Jan-2024 levels

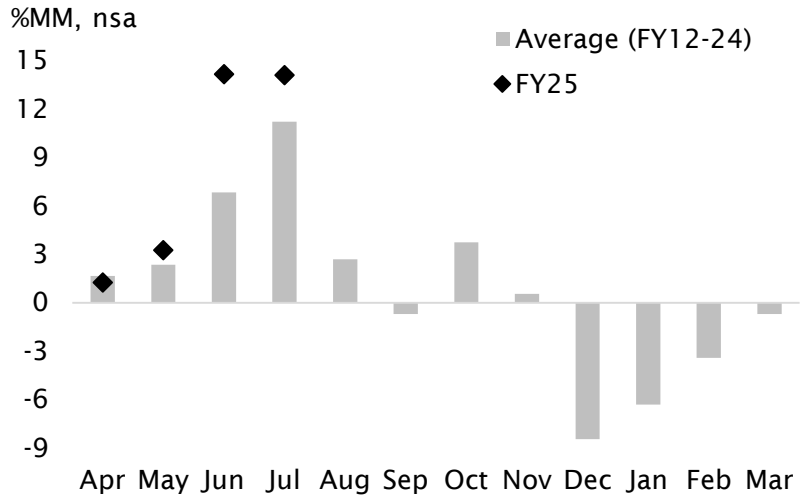


Outlook and policy implications

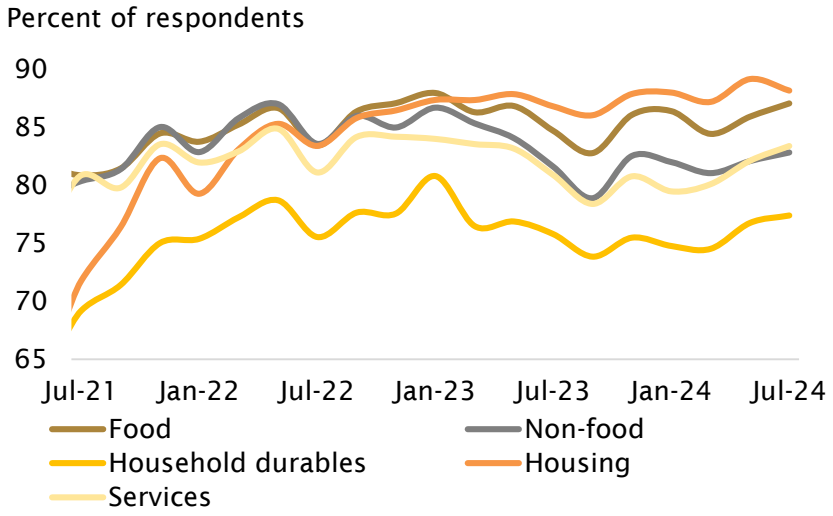
- In the latest policy meeting, the RBI MPC raised Q2 inflation forecast by 60bps to 4.4% due to concerns over spillovers from food inflation to other components. The upward revision was also on the back of hikes in milk prices and mobile tariffs, and bottoming out of core inflation. However, high frequency data (till 14-August) shows that compared to July, inflation has eased in case of major pulses, cereals, sugar, and key vegetables (tomatoes, potatoes, and onions). Also, price pressures in vegetables tend to be lower in the months of August and September. These factors could provide cushion against the slightly negative base effect in August, which is expected to worsen in September, before turning favorable again for the months of October and November.
- Even as core inflation is expected to gradually increase, the upside from the current rates of sub-4% is unlikely to be worrisome in the near term. With the fuel index plunged in deflation, the onus of aligning headline inflation to the central bank's 4% target largely hinges on the trajectory of food inflation, which, in turn, depends on the ongoing progress in monsoon, sowing and reservoir levels.
- **Monsoon:** As of August 7, rainfall in the country as a whole was 7% above long-period average (LPA), though the distribution remained skewed with the southern (+25%) and central regions (+19%) receiving excess rains. The east and north-east regions (-12%) and the north-west area (-5%) recorded deficient rains. The forecast of La Nina that is likely to develop towards end-August bodes well for farm output prospects, including Rabi crop.
- **Sowing:** As of August 9, area sown under Kharif crops exceeded last year's levels across major food grains. However, in 2023, sowing progress was slow due to the impact of El Nino. In that context, comparison with earlier years suggests that pulses sowing, while higher than last year's levels, is lagging.
- **Reservoir levels:** As on August 8, reservoir storage in the country as a whole was at 65% of total storage capacity, higher than 61% in the corresponding period a year ago, and above the average of the last ten years. Except for the northern region, reservoir levels in other areas were above their long-term average.
- Food grain stocks of major cereals (rice and wheat) remained above the stocking norms in August. In fact, recently, the government announced that States could buy rice from FCI directly under the open market sale scheme as a step to reduce surplus stocks prior to the start of the new procurement season. The government continues to actively address supply-side constraints to keep prices in check and this will be required going ahead in the advent of any climate-related setbacks to farm output. Some of the recent public measures include sales of tomatoes at subsidized rates, and imposing stocks limits on certain pulses.
- The latest print was in line with expectations and unlikely to induce changes to monetary policy. The progress in monsoon and sowing, latest high frequency data on food prices, along with the long-term trends in the prices of vegetables suggest low inflation pressures in the month of August. The MPC will have another month of inflation data, and the Fed policy decision to account for before it meets again in the first week of October.

Appendix

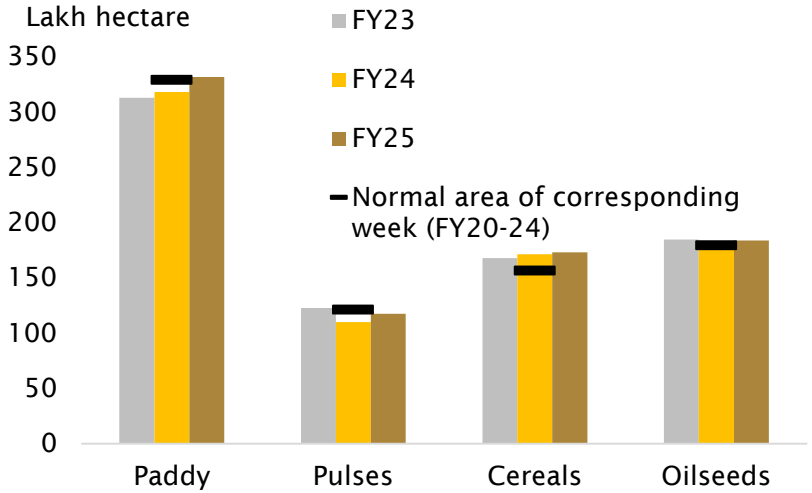
Monthly price pressure in vegetables tends ease in Aug-Sep



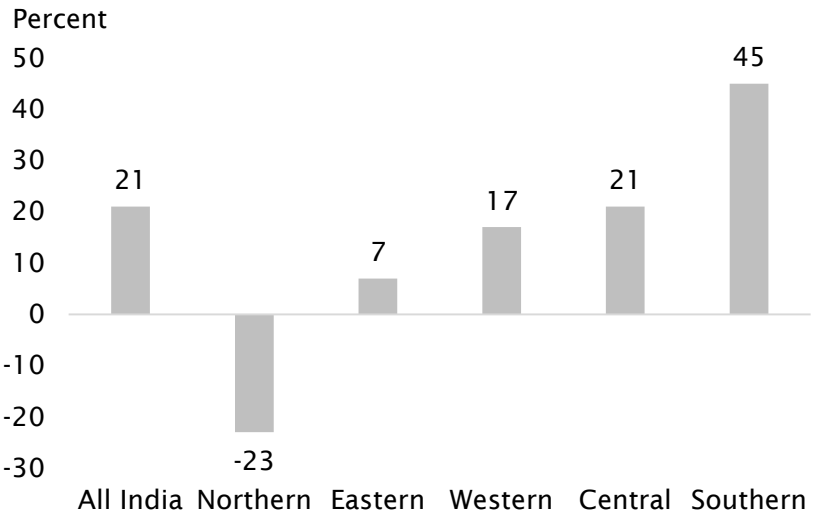
Households' expectations of year-ahead inflation by product



Kharif sowing (as on August 9)



Reservoir level (departure from normal) as on August 8



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