

Inflation Watch: Headline CPI eased due to favorable base effects, monthly fall in prices

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Key takeaways

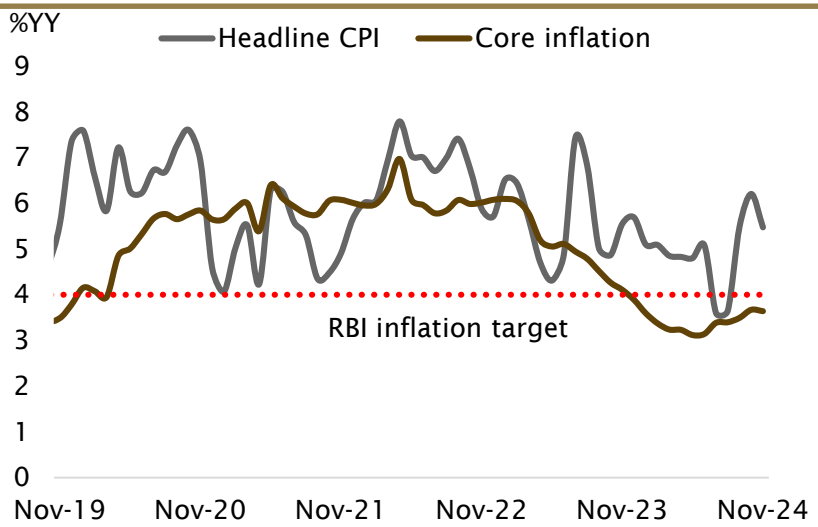
- Headline CPI inflation eased to 5.48% in November after hitting 14-month high of 6.21% in October. The print was in line with expectations (Bloomberg survey: 5.50%), with the moderation supported by base effects and month-on-month decline On a fiscal year-to-date basis, inflation has averaged 4.9%, lower than 5.4% in Apr-Nov FY24.

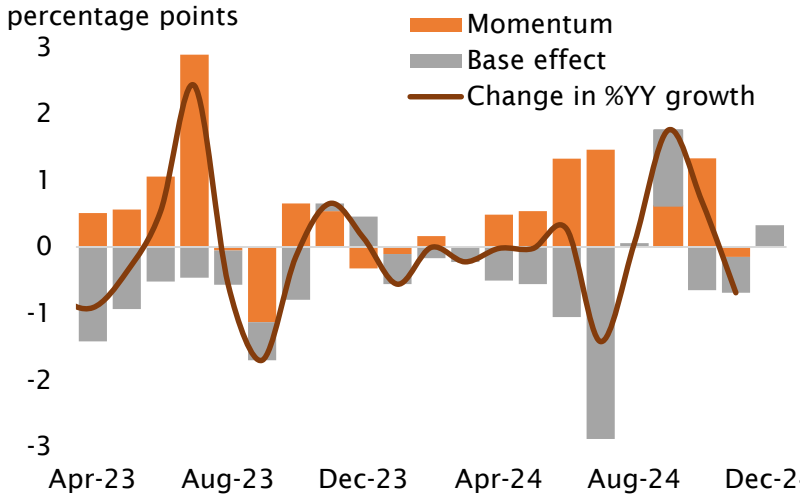
- Food inflation eased but remained elevated at 8.2% in November, compared to 9.7% in October. Despite the drop in vegetable prices in November and the recent softening in pulses and spices inflation, pockets of concern within the food basket have shifted that continues to prolong the disinflation process.

- Core inflation (ex-food and fuel) was largely stable, and in fact, eased marginally to 3.64% from 3.67% in October. Various metrics of core inflation have been gradually rising, but continue to remain benign at sub-4%.

- However, as some of the underlying measures of inflation rise, partly as spill overs from high primary food inflation, these could eventually impinge on the headline inflation trajectory in the next fiscal year, and add to the complex balancing act for the RBI MPC in terms of growth-inflation dynamics, particularly after the latest growth print surprised on the downside. Thus, even as recent CRR cut paves the way for start of policy repo rate easing at the upcoming meeting in February, the easing cycle is likely to be a shallow one.

Headline CPI eased in line with expectations in November due to favorable base effects and month-on-month fall in prices





Inflation eased due to favorable base effects, monthly fall in prices

- Headline CPI inflation eased to 5.48% in November after hitting 14-month high of 6.21% in October. The print was in line with expectations (Bloomberg survey: 5.50%), with the moderation supported by base effects and month-on-month decline of 0.15%, compared to historical median increase of 0.42% (FY12-24) for November. On a fiscal year-to-date basis, inflation has averaged 4.9%, lower than 5.4% in April-November FY24.

- Prices either eased or fell month-on-month across all major groups. A similar trend held in case of year-on-year change, except for clothing and housing, though inflation in these categories was benign at sub-4%. The fuel index remained in deflation for the fifteenth straight month, with the extent deepening slightly in November. The miscellaneous and food groups were the only ones where, despite easing, inflation stayed above 4%.

- Food contributed an average of about 70% to headline CPI in the past three months. Despite lower vegetable prices in November, categories such as edible oils, meat and fish, and prepared meals added more to inflation. Though CPI was lower FYTD, food inflation rose to 7.6% average from 6.6% in April-November FY24.

- Though core inflation (ex-food and fuel) bottomed out in May, it has continued to remain sub-4% for twelve successive months now and, in fact, eased a tad in November to 3.64% from 3.67% in October. Despite easing in November, inflation in the miscellaneous group has been above 4% for three consecutive months now, reflecting not only the trend in global prices of gold and silver, and the telecom tariff hike, but also price increases in certain services such as health and household goods and services that need to be watched out for, as part of second round effects of persistently high food inflation.

Headline CPI inflation eased below 6% in November

%YY	Weight	Sep-24	Oct-24	Nov-24
Headline CPI	100.0	5.49	6.21	5.48
Food	45.9	8.36	9.69	8.20
Intoxicants, etc.	2.4	2.51	2.50	2.35
Clothing	6.5	2.71	2.70	2.75
Housing	10.1	2.72	2.81	2.87
Fuel and light	6.8	-1.34	-1.67	-1.83
Miscellaneous	28.3	4.05	4.32	4.26

Monthly momentum eased or fell across major groups

%MM, NSA	Weight	Sep-24	Oct-24	Nov-24
Headline CPI	100.0	0.62	1.34	-0.15
Food	45.9	1.04	2.25	-0.48
Intoxicants, etc.	2.4	0.05	0.19	0.10
Clothing	6.5	0.21	0.36	0.26
Housing	10.1	-0.06	0.94	0.16
Fuel and light	6.8	0.11	-0.06	-0.11
Miscellaneous	28.3	0.38	0.43	0.22

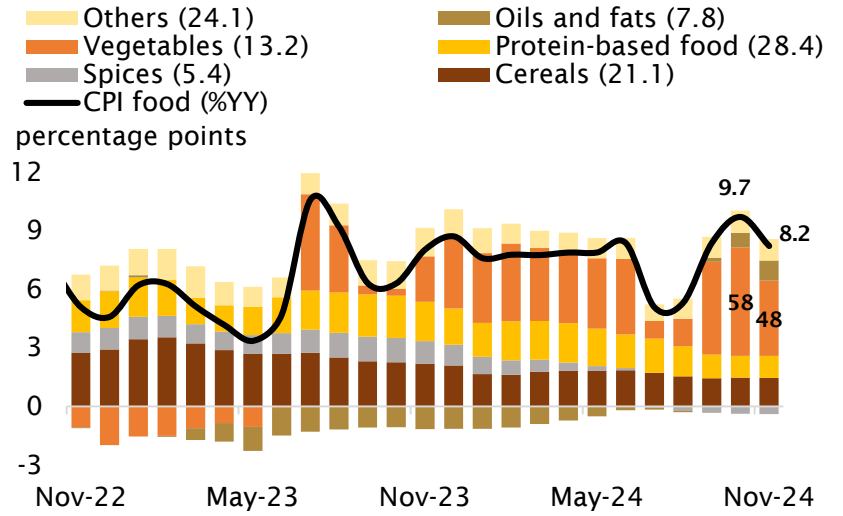
Despite correction in vegetable prices, food inflation remained high

- Food inflation eased to 8.2% in November from 9.7% in October, aided by favorable base effect and month-on-month fall in prices. Among 12 major food sub-groups, the monthly change was below the historical median for the month (FY12-24) across categories, except for edible oil, eggs and cereals.

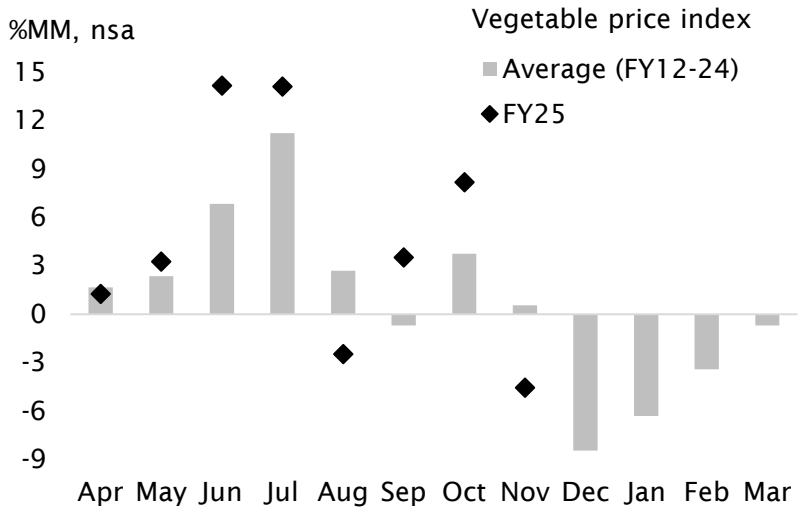
- Despite sharp month-on-month seasonal correction in prices, vegetables continued to add the most to food inflation at 48%, though it was lower than 58% in October. The contribution of major vegetables – tomato, onion, potato – eased to 39% from 65%. Inflation in tomatoes moderated to 42% from over 160%, and in onions to 6% from 52%, while it rose and stayed elevated in potatoes at over 65%. Apart from these, the contribution of garlic to vegetables inflation has been 12% on average in the past six months.
  - Fiscal year-to-date inflation in vegetables has surged to 26.2% from 9% in April-November FY24. A similar trend holds for fruits, though in single digits (6.6% vs 4.9%).

- In addition to fruits and vegetables, the sub-groups that contributed the most to food inflation in November were cereals, edible oils, and prepared meals. Inflation in protein-based food remained benign but rose mildly due to the meat and fish category, even as inflation eased in eggs, milk and pulses groups.

Food inflation eased but stayed elevated in November..



.. amid sharp seasonal correction in vegetable prices



Shifting pockets of concern within food are keeping inflation elevated

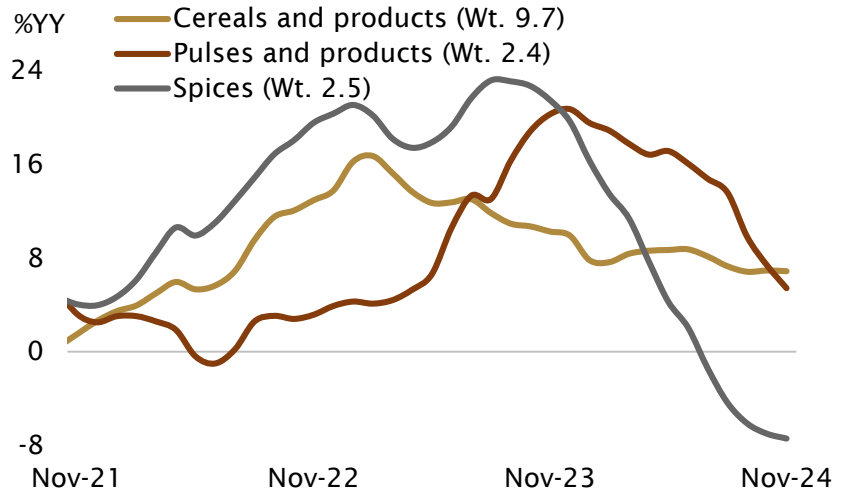
- Apart from volatile vegetable prices, double-digit inflation in cereals, pulses and spices was a major concern for most of FY24. But the trends have shifted, with the spices sub-index in deflation for the past five months. Inflation in pulses has been in single digits for three straight months, and slipped below that of cereals in November. The disinflation in cereals continues to be tardy despite favorable base effects, as month-on-month momentum has been strong, which has eased in case of pulses and spices in recent months.

- The edible oils sub-index was in deflation from February 2023 to August 2024. However, post the import duty hike, effective mid-September, there has been a quick uptick in edible oils inflation to 13.3% in November from 2.5% in September. In addition to the duty hike, rise in global prices has also contributed to inflation.

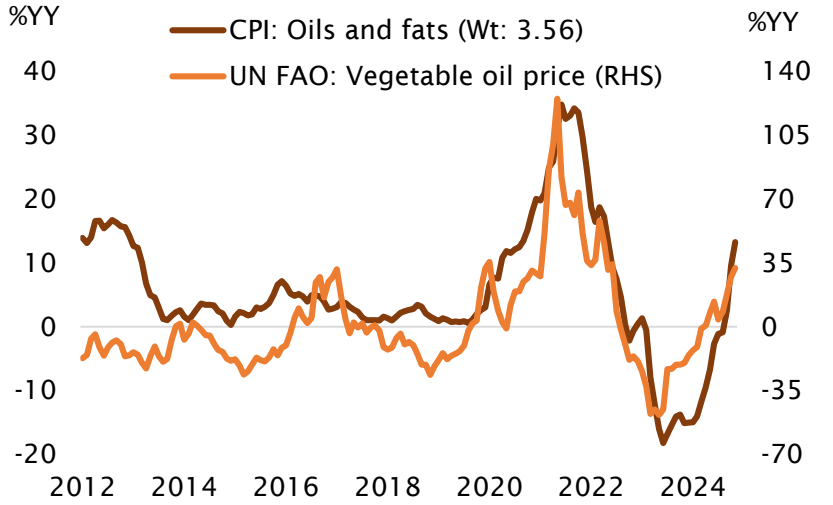
- The contribution of prepared meals to food inflation rose slightly in November, though inflation in the sub-index remained sub-4%. Higher inflation in prepared meals is attributable to the festive season and second round effects of persistently high food inflation and the recent rise in categories such as edible oil prices.

- Thus, despite the drop in vegetable prices in November and the recent softening in pulses and spices inflation, pockets of concern within the food basket have shifted that continues to prolong the disinflation process.

Inflation in cereals inflation remains sticky



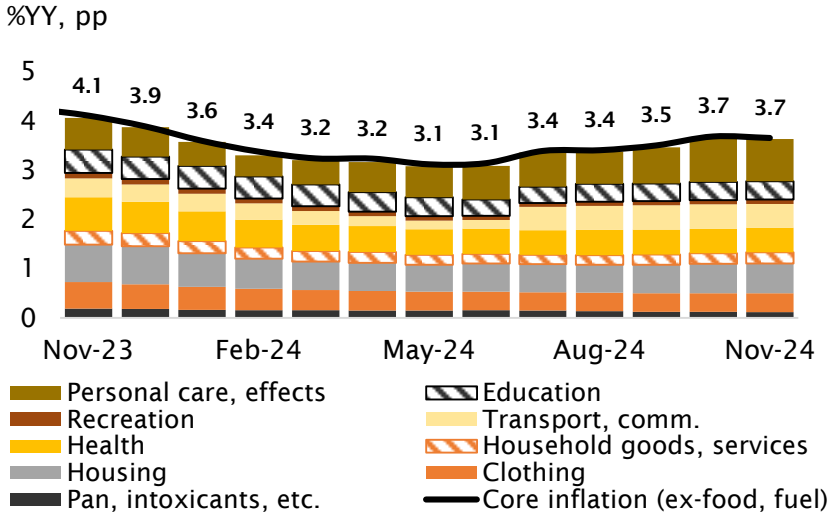
Rapid rise in edible oils inflation



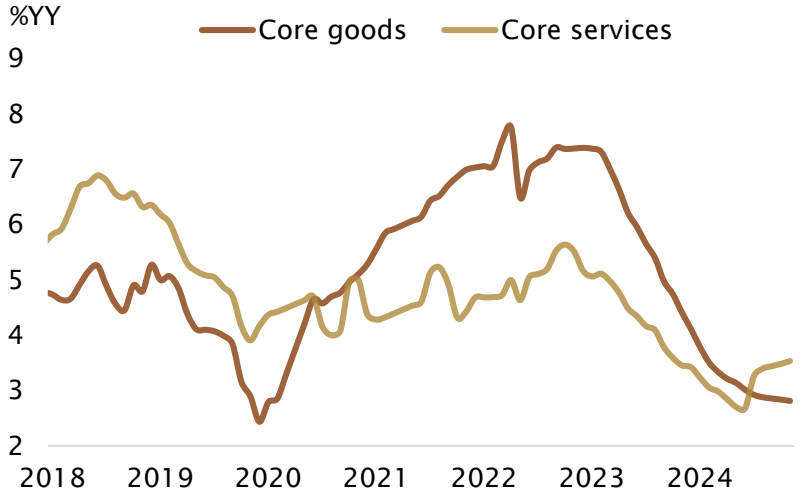
Core inflation remained largely stable amid mild rise in services

- Core inflation (ex-food and fuel) was largely stable in November, and in fact, eased marginally to 3.64% from 3.67% in October. The categories that contributed less to core inflation compared to October were personal care and effects; transport and communication; and pan, tobacco, and intoxicants.
  - In case of personal care and effects, the contribution of gold and silver moderated, reflecting softening in global prices of precious metals during the month. Within transport and communication, the decline in bus fare (including that of school) more than offset the increase in telephone charges that continue to reflect the telecom tariff hike, effective July. In case of intoxicants, cigarettes recorded deflation for first time in the series for data available since January 2015.
- The groups that added more to core inflation were housing, clothing, health, household goods and services.
  - Housing inflation has been rising fractionally for seven straight months now, though it remains benign at sub-4%. Higher inflation in clothing, and household goods and services indicates the impact of weather and festive season on not only goods such as winter wear and fresh flowers, but also services such as laundry and tailoring, domestic servant/cook, and monthly maintenance charges.
- In addition to housing, higher inflation in some segments of health such as hospital and testing charges, and consultation fees, are impinging on core services inflation that rose to 3.5% in November after bottoming out at sub-3% in mid-2024. Core goods inflation continues to remain relatively soft.

Core inflation remained largely stable in November



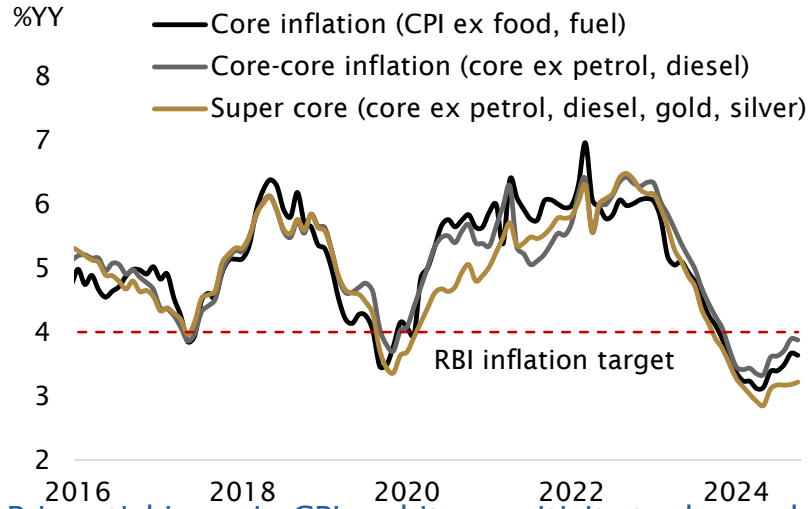
Details show mild uptick in core services inflation



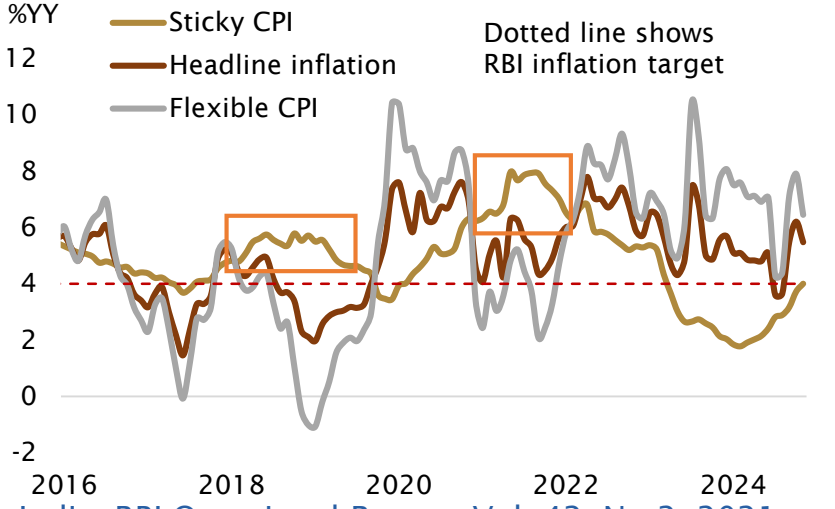
Persistent food inflation warrants caution on second order effects

- Even as various measures of core inflation bottomed out in mid-2024 and have started to rise, most of them remain sub-4%. However, as noted in the 'state of the economy' article of the RBI's monthly bulletin for November, second order effects or spill overs of high primary food prices have started to trickle to certain segments of the CPI basket such as processed food, and household services like those of domestic help/cook. These effects need to be watched out for, particularly, as core inflation is likely to rise above headline inflation by Q2-FY26, as per median estimate in the latest survey of professional forecasters (SPF) by the RBI.
- In addition to various metrics of core inflation increasing marginally in recent months, one of the measures of sticky price inflation, constructed on the basis of a paper by the RBI*, is also starting to rise. As noted by the paper,"…in a situation when the sticky price inflation turn upwards, it may remain elevated for a considerable period of time because of its high intrinsic persistence, thus, posing risks for inflation turning generalised. Therefore, monetary policy should remain wary of the underlying inflationary pressures which may be observed by a careful monitoring of the sticky price index." A simple chart of the index suggests that headline inflation tends to rise when sticky inflation peaks, and remains high on a rather durable basis before starting to ease. Thus, even as the debate on higher potential GDP raising the neutral rate of interest has subsided amid the recent weakness in economic activity, rise in sticky price inflation, albeit gradual, could warrant that the upcoming policy rate easing cycle be a shallow one.

Various measures of core inflation remain benign



Inflation measures based on RBI paper

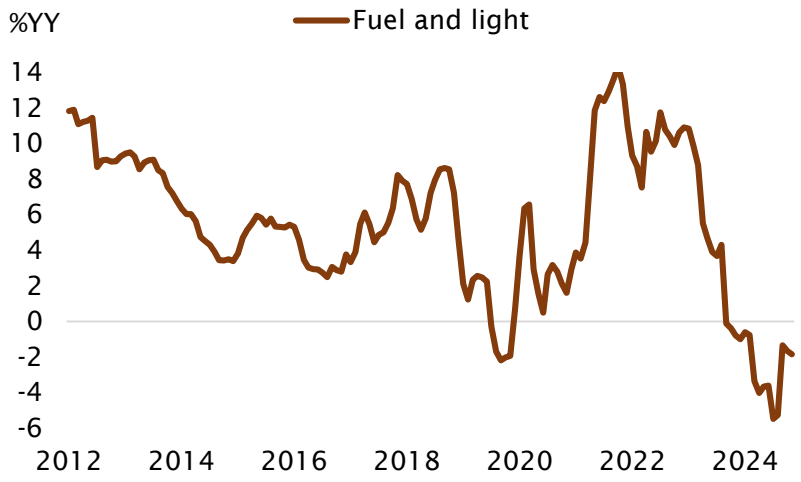


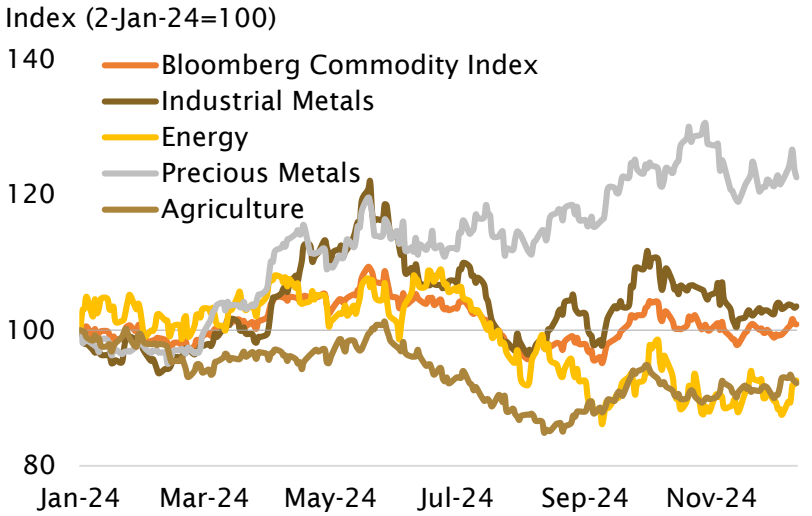
* Price stickiness in CPI and its sensitivity to demand shocks in India, RBI Occasional Papers, Vol. 42, No.2, 2021

Domestic fuel index stayed in deflation; global commodities mixed

- Domestic fuel index remained in deflation for the fifteenth consecutive month in November at 1.8%, though the extent of price decline has eased in the past couple of months. The index fell 0.1% month-on-month, compared to the historical median increase of 0.7% for the month of November amid mildly favorable base effect. Among sub-indices, deflation in kerosene and LPG sub-indices steepened, and inflation in electricity eased, thereby offsetting year-on-year gains in coke, and firewood and chips. Domestic household LPG price has been stable since October 2023, even as commercial LPG price has been gradually rising since July.
- Globally, the Bloomberg commodity index (as on Dec 13) remains at the same levels as at the beginning of 2024, amid disparate trends within sub-indices. Industrial metals remain vulnerable to demand outlook from key economies, while precious metals have been gaining on safe haven demand. Agriculture and energy prices are lower than at the beginning of the year but there are caveats to these.
- Global food inflation, as indicated by the UN FAO index, has been on the rise since September after remaining in deflation for 21 months. Gains have been particularly steep in edible oils sub-index that was up over 30%YY in November, and is also trickling down to domestic inflation. In case of crude oil, prices have been mostly range-bound between USD70-80/b since September, and futures prices indicate prices to remain sub-USD75/b till mid-2025. The OPEC+ was slated to unwind production cuts starting January, but amid supply glut and demand concerns, the group, at its meeting this month, decided to delay increasing output until April 2025.

Domestic fuel index in deflation since September 2023; global commodity index around same level as start of 2024





Outlook

- **Assessing historical trends:** In December, base effects are slated to be negative for headline CPI but mildly favorable for core inflation, adding around 0.30 percentage points to CPI, and shaving off around 0.05pp from core CPI. The headline index typically tends record either weak month-on-month impulses or fall in winter, as climatic conditions support produce of certain horticulture crops, and Kharif output hits the market. Historical trends (FY12-24) based on average and median month-on-month change indicate headline inflation in December to be at around 5.2-5.3% and core inflation around 3.8%. This estimate of headline CPI would imply average inflation of 5.6% for the quarter and a mild undershoot to the RBI MPC forecast of 5.7% for Q3-FY25. Also, high frequency data on certain food items in December so far indicates a downward bias to headline CPI.

- **High frequency data:** Daily data from the Department of Consumer Affairs (as on December 16) shows further easing in prices of major vegetables (tomato-onion-potato), cereals, pulses and sugar vis-à-vis November. In fact, data indicates deflation in certain items such as onions, rice, moong and masur dal. However, inflation is continuing to rise in case of edible oils post the import duty hike that was effective mid-September. It needs to be seen how all these trends aggregate over the entire month but continued softening in prices of major vegetables and deflation in some of the items is likely to further lower food inflation in December.

- **Post-monsoon rain:** Data on post-monsoon season rainfall from Oct 1 – Dec 11 shows that the country as a whole received cumulative rainfall that was 10% below the long period average (LPA) but remained within the normal range. The spatial distribution was skewed, with the south (+6% departure from long period average), and east and northeast regions (0%) receiving rainfall that was within the normal range. The central and northwest regions recorded less rains that were in the deficient (-22%) and large deficient (-79%) ranges. The Southern Oscillation Index (SOI) continues to indicate La Nina conditions that augurs well for Rabi crop.

- **Reservoir levels:** Data till December 5 suggests that reservoir levels in the country as a whole were above normal and last year's levels, except for the northern region that continued to record deficiency. Reservoir storage in the eastern region stayed above last year's levels but slipped a tad below normal.

- **Procurement and stock:** In Kharif Marketing Season (KMS) 2024-25, 189.14 LMT of paddy had been procured (as of Nov 30) versus 201.51 LMT in the same period last year. The procurement of wheat in Rabi Marketing Season (RMS) 2024-25 was 266.05 LMT, up from 261.97 LMT in RMS 2023-24. As of December 1, wheat and rice stocks in the central pool totaled 488.50 LMT, higher than 377.36 LMT in the same period of 2023.

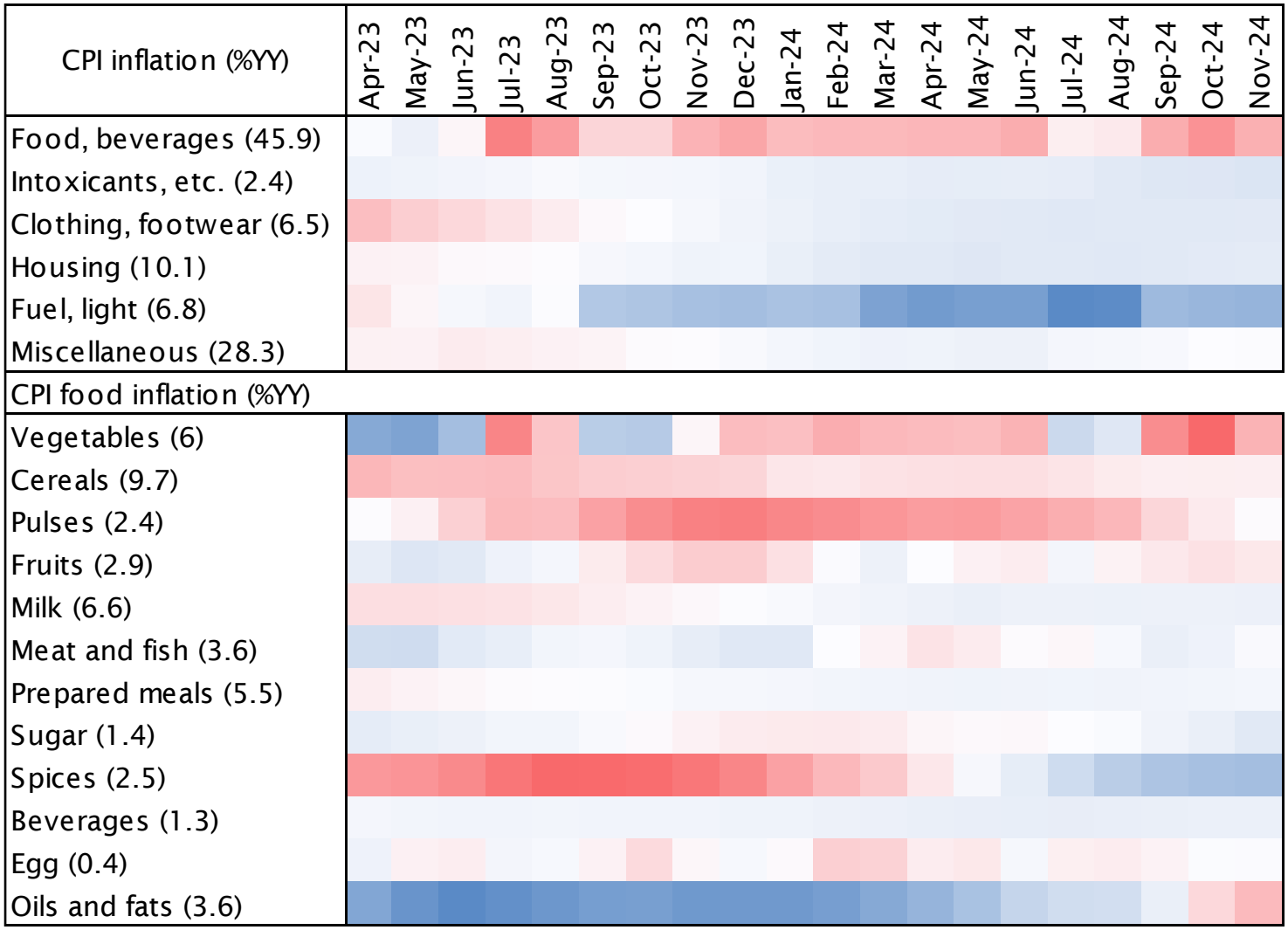
Policy implication

- **Government intervention:** The government continues to actively intervene on the supply side via different measures to ensure availability of food grains and horticulture items at reasonable prices. Over the past few weeks, the government has brought more food items, particularly pulses, under the 'Bharat' brand of food items for sale at subsidized rates. To ease inflation in wheat, the government resorted to open market sale scheme and cut stock limits for traders, retailers and processors. Also, the first advance estimates of Kharif crop indicate record output for the year. However, availability need not imply lower food inflation, as was duly noted in a government press release in October, when decline in wholesale mandi prices of certain pulses were not reflected in retail prices, indicating excessive retail margins. In such instances, continuous government monitoring and intervention will remain crucial to pass on price easing to end consumers and keep retail prices in check.

- **Policy implication:** The policy statement of the latest RBI MPC meet held earlier in the month acknowledged that the near-term growth and inflation outcomes had turned adverse recently, with growth surprising on the downside and inflation on the upside. Even as the policy repo rate was kept unchanged, CRR was cut by 50bps to ease potential tightening of liquidity conditions that is expected to unfold in coming months. The MPC lowered growth forecast for FY25 by 60bps to 6.6%, and raised inflation estimate by 30bps to 4.8%. The committee chose to avoid a knee-jerk reaction to weak Q2 GDP print but acknowledged that persistent slowdown could necessitate policy support. Amid this evolving growth path, food inflation is expected to ease in coming months due to seasonal softening in prices of horticulture items and record Kharif harvest of food grains. However, core inflation is gradually increasing and despite being benign for now, it is slated to rise above headline CPI by Q2-FY26. Recent and subsequent gains in some of the alternate underlying or 'sticky' measures of inflation, partly attributable to second order effects or spill overs from high food inflation, could impinge on the headline trajectory, further complicating the MPC's task in the next fiscal year. Thus, even as recent CRR cut paves the way for start of policy repo rate easing at the upcoming meeting in February, the evolving inflation dynamics could keep the easing cycle a shallow one.

Appendix: Shifting penny-pinching pockets within the food basket

Inflation in vegetables stays elevated, and has increased recently in edible oils. Spices have moved into deflation. Inflation in pulses has eased, and remains sticky in case of cereals.



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