

Inflation Watch: May-2024: Food prices remained a sore point even as core inflation slipped to a fresh low

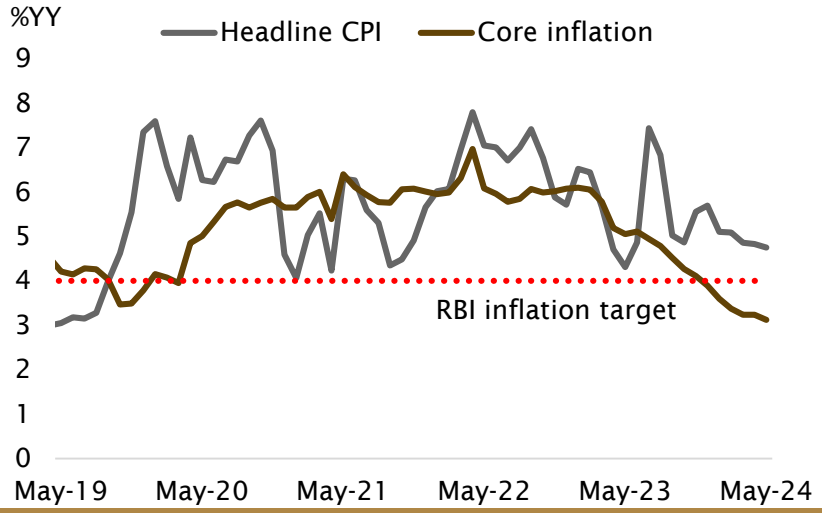
17 June, 2024

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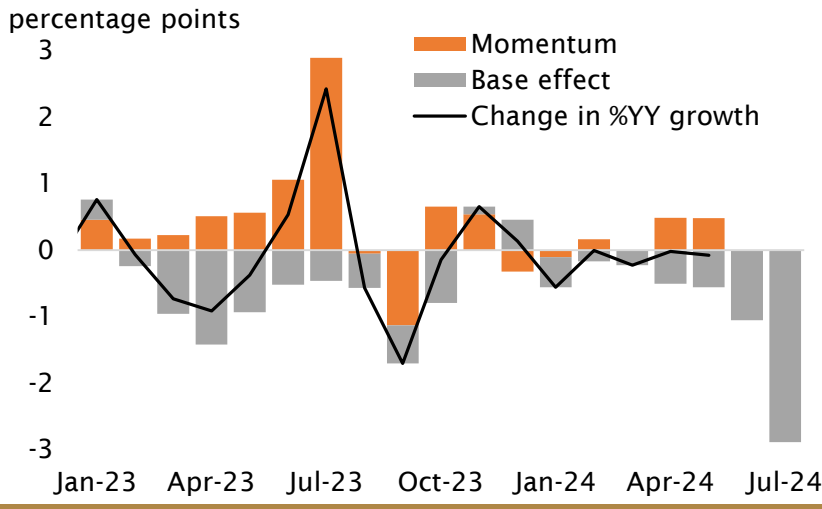
Key takeaways

- Headline CPI inflation was at 4.75%YY in May, lower than 4.83% in April and below market expectations (Bloomberg survey estimate: 4.85%). The moderation was supported by favorable base effect amid 0.48% month-on-month increase in the index on a non-seasonally adjusted basis. Food inflation stayed elevated at 7.9%, with vegetables remaining the largest contributor, and stickiness in pulses and cereals inflation. Fuel sub-index remained in deflation, though at a lower rate than the previous month, aided by government fuel price cuts. Core inflation surprised on the downside, reaching a fresh low of 3.1%. In terms of month-on-month change, prices of food and fuel rose amid moderation across other categories.
- The forecast of an above normal monsoon bodes well for inflation prospects. Domestic inflation also remains vulnerable to global commodity prices, the outlook for which remains clouded by ongoing geopolitical tensions, uncertainty over central bank policy pivots and their impact on economic activity.
- The CPI prints for both April and May indicate reasonable probability of headline inflation undershooting the central bank's estimate of 4.9% for Q1. With Q2 inflation expected to be sub-4% due to favorable base effects, RBI MPC could gain the required confidence to ease policy stance to 'neutral' from the current 'withdrawal of accommodation' at its August meeting. However, policy rate cuts could be a function of actual monsoon outturn, upcoming Union Budget, expected US Fed policy rate cut and RBI's update on estimate of neutral rate of interest for the economy – likely to be published in the central bank's monthly bulletin for June.

Core inflation slipped to a fresh low of 3.1% in May



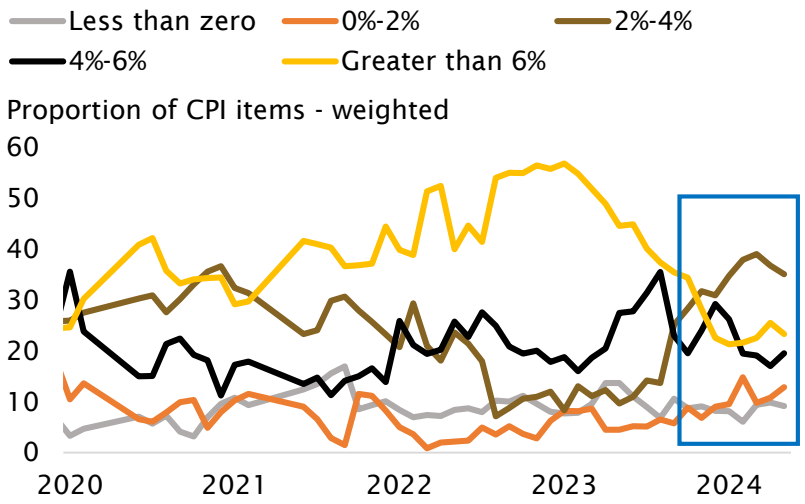
Base effects to remain favorable till July



CPI inflation moderated in May, even as food inflation stayed elevated

- Headline CPI inflation eased to 4.75%YY in May from 4.83% in April, and was lower than Bloomberg estimate of 4.85%. Amid favorable base effects similar to April, momentum was stable at 0.48% month-on-month in non-seasonally adjusted terms, lower than the historical (FY12-24) average change of 0.68% for the month.
- Among major components, food inflation stayed elevated, and at the same rate as previous month at 7.9%. There was also an increase in inflation in pan, tobacco, intoxicants, etc. category, while deflation in the fuel and light group moderated. Inflation eased in clothing, housing and miscellaneous items. In terms of month-on-month change in non-seasonally adjusted terms, unlike previous month, when there was broad-based uptick in prices across groups in May, prices were up in case of food and fuel but eased in other groups.
- Core inflation (ex-food, fuel) eased to a fresh low of 3.1% from around 3.2% in the previous two months. Both core goods and services inflation continued to ease, including services ex-housing.
- There was a slight rise in the proportion of items with inflation above the RBI's upper tolerance of 6%, though on a weighted basis, there was a moderation.

Weighted proportion of items with inflation over 6% fell



CPI inflation lower than expected in May

%YY	Weight	Mar-24	Apr-24	May-24
Headline CPI	100.0	4.85	4.83	4.75
Food	45.9	7.74	7.87	7.87
Intoxicants, etc.	2.4	3.11	2.99	3.03
Clothing	6.5	2.97	2.85	2.74
Housing	10.1	2.71	2.68	2.56
Fuel and light	6.8	-3.35	-4.02	-3.83
Miscellaneous	28.3	3.50	3.54	3.41

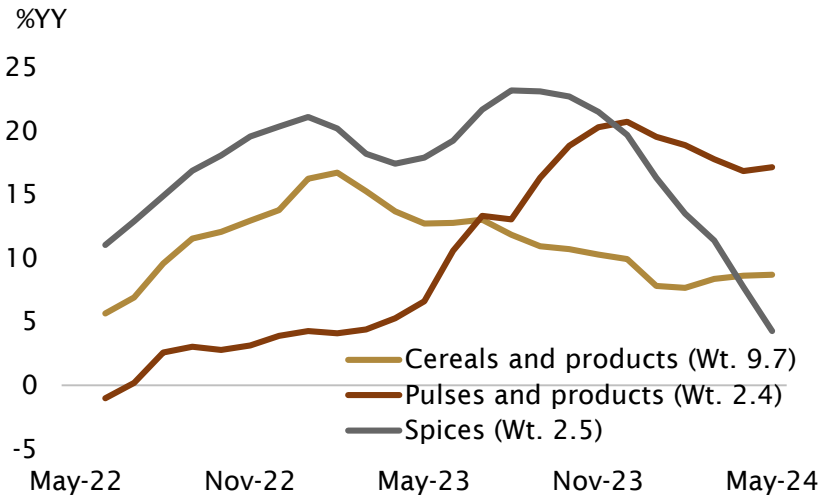
Food and fuel prices rose month-on-month in May

%MM, NSA	Weight	Mar-24	Apr-24	May-24
Headline CPI	100.0	0.00	0.48	0.48
Food	45.9	0.21	0.63	0.68
Intoxicants, etc.	2.4	0.24	0.44	0.24
Clothing	6.5	0.16	0.21	0.16
Housing	10.1	-0.17	0.95	0.11
Fuel and light	6.8	-2.71	-0.80	0.80
Miscellaneous	28.3	0.22	0.55	0.28

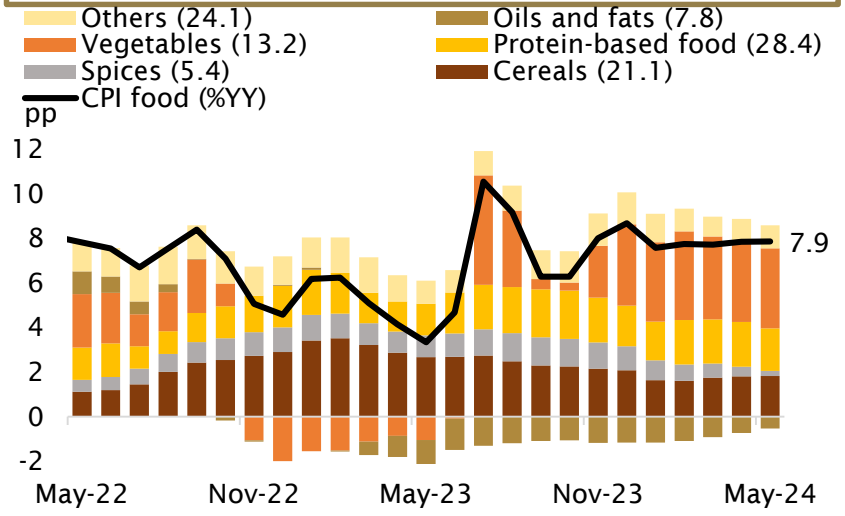
Inflation in vegetables, cereals, and pulses remained worrisome

- Inflation in the food and beverages category remained high in May at 7.9%YY, unchanged from the previous month. The latest print marked the 11th consecutive month of above 6% inflation for the sub-index.
- Vegetables remained the largest contributor to food inflation followed by protein-based food and cereals. Within protein-based items, meat prices have seen an uptick, even as inflation in pulses remains sticky. Inflation in spices has been easing, but has been rising in case of fruits. Sugar prices continued to ease for the second straight month after gaining for almost a year.
- In May, the number of food items with higher-than-average monthly price increases stayed low. The month-on-month increase in food prices at 0.7% was lower than the historical average of 0.9% for the month (FY12-24) and was driven by vegetables, egg, meat and pulses.

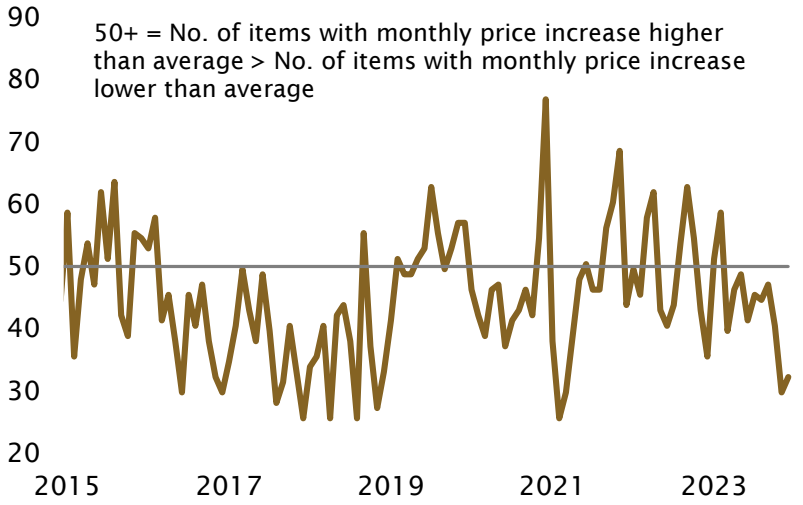
Inflation in cereals and pulses remained sticky



Contribution to food inflation - select items



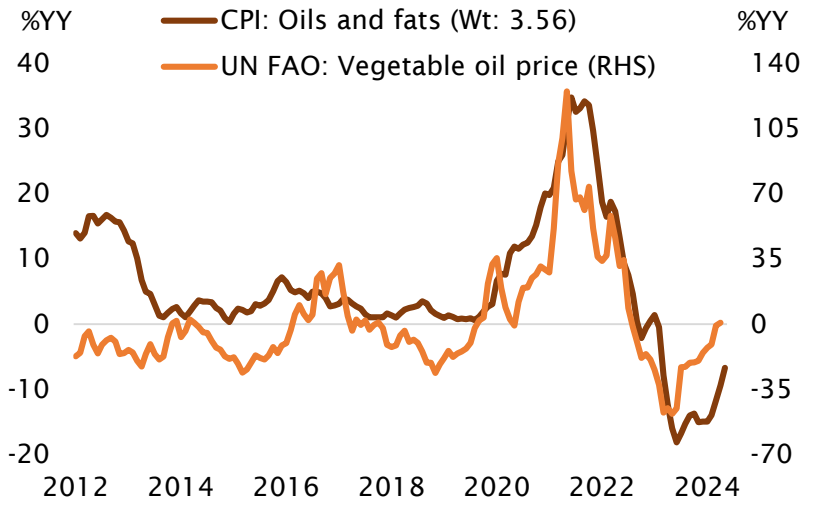
Food diffusion index remained benign in May



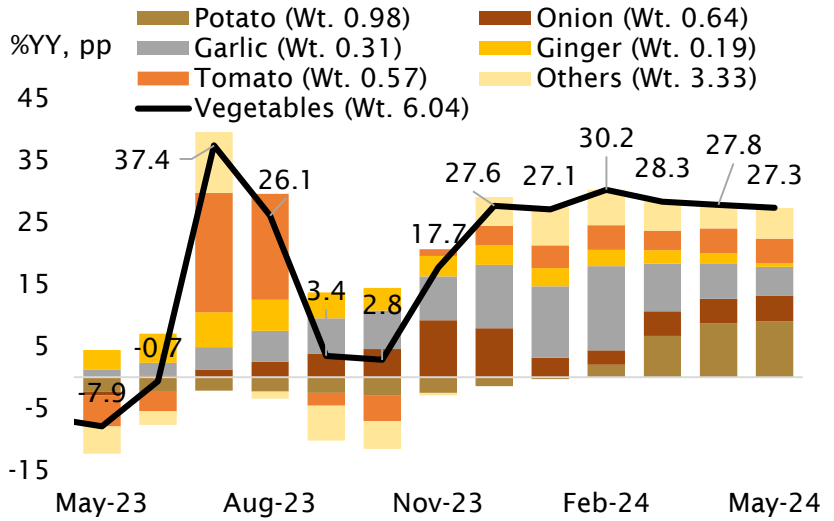
High frequency data indicate continued food price pressures in June

- The oils and fats sub-index had been in double-digit deflation for a year, aided by lower global prices and policy measures to ease imports. Though edible oil prices remained in contraction in April and May, deflation slipped to single-digits amid firming up of global prices.
- Inflation in vegetables stayed elevated at 27.3%YY in May, with potato, onion and tomatoes contributing 17pp; ginger and garlic adding 5.4pp. High frequency data till June 13 shows easing of inflation in potato and tomato compared to May, but an increase in case of onion. Data also indicates that high inflation is likely to prevail in June in case of cereals, particularly rice, and pulses. As on June 1, stocks of both rice and wheat were in line with the stocking norms. Procurement of wheat in Rabi Marketing Season FY25 as on June 14 was higher year-on-year, though paddy procurement in Kharif Marketing Season FY24 was lower year-on-year.

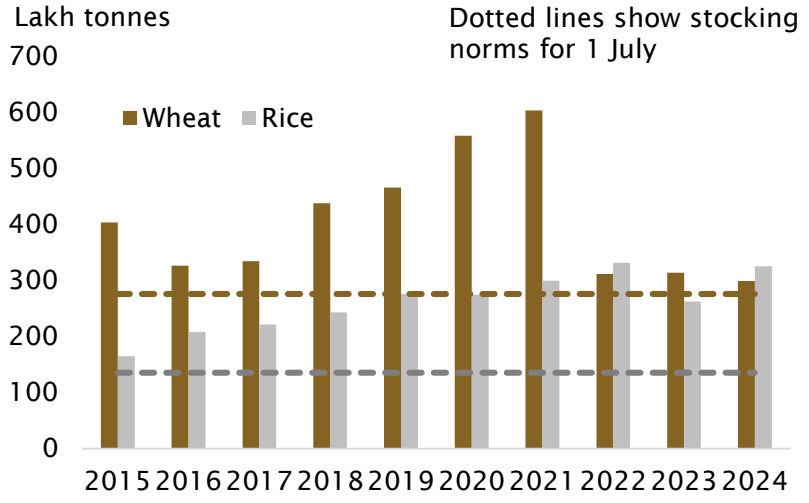
Global edible oil prices are firming up



Contribution to vegetables inflation - select items



Stock levels of main cereals above norms (as on June 1)

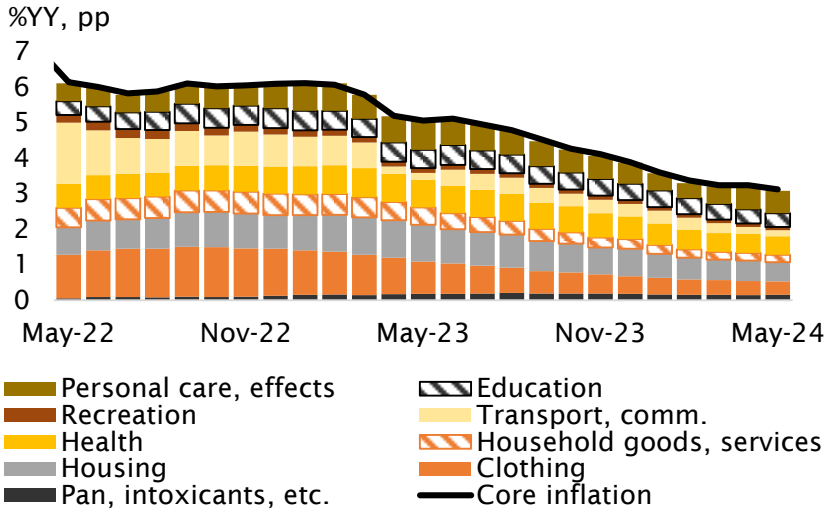


Core inflation remained below 4% for the sixth straight month in May

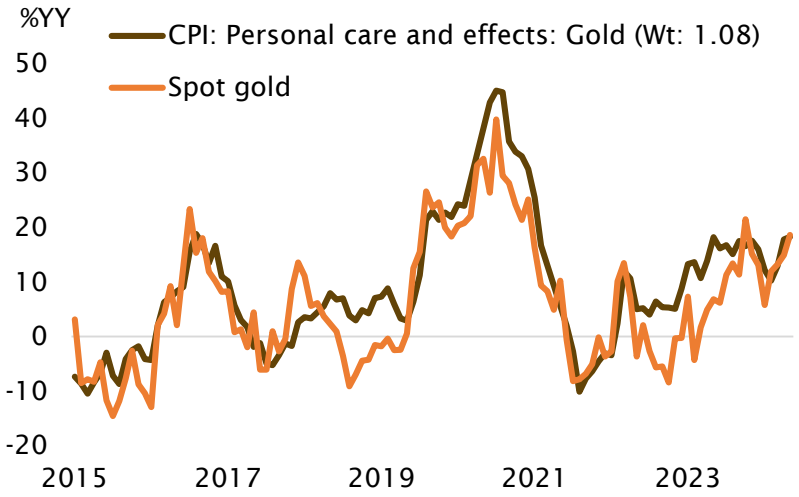
- Core inflation (ex-food, fuel) slipped to a fresh low of 3.1% in May, compared to 3.2% in April. Variants of core inflation remain muted amid signals of bottoming out at current rates. Inflation either moderated or remained stable across core categories, except for personal care and effects group that tends to track global price of gold. RBI's latest round of Survey of Professional Forecasters suggests median forecast of core inflation at 3.3% for Q1-FY24, lower than the previous survey print at 3.4%.

- Headline CPI print averaged 4.8% for the months of April and May. With RBI MPC's estimate at 4.9% for Q1 and favorable base effect lined up for June, there is a probability that the headline CPI undershoots the central bank's expectation in the current quarter.

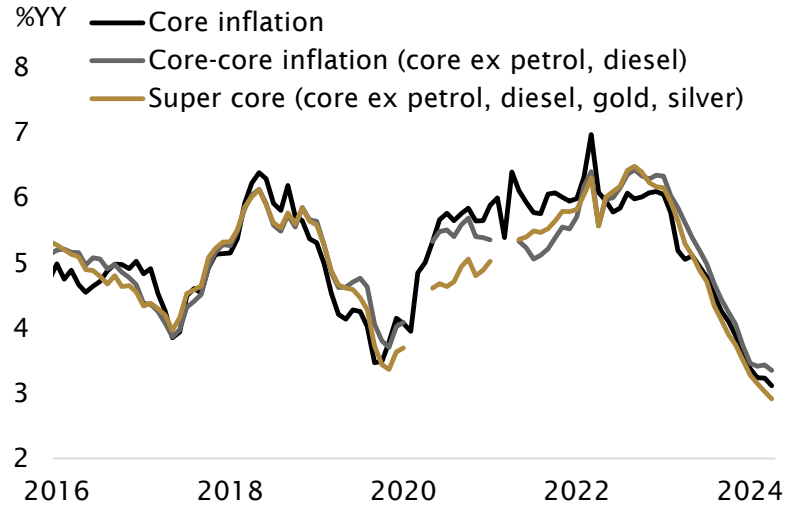
Core inflation stayed below 4% for sixth straight month



Inflation in personal effects tends to track gold price



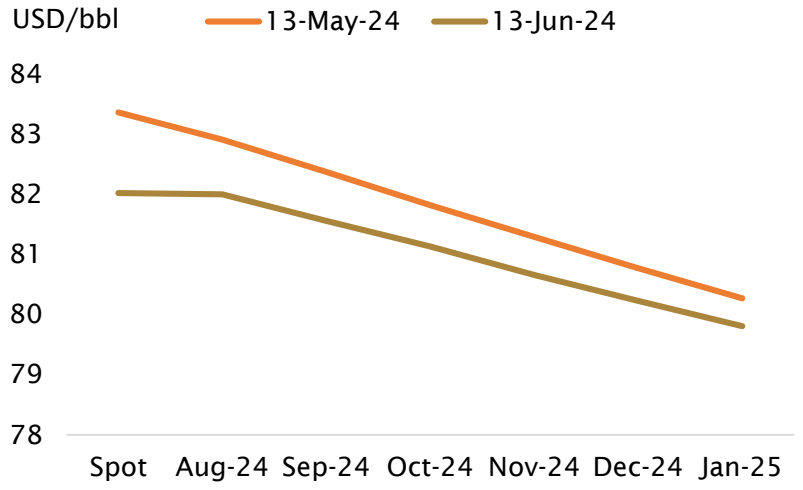
Variants of core inflation remain muted



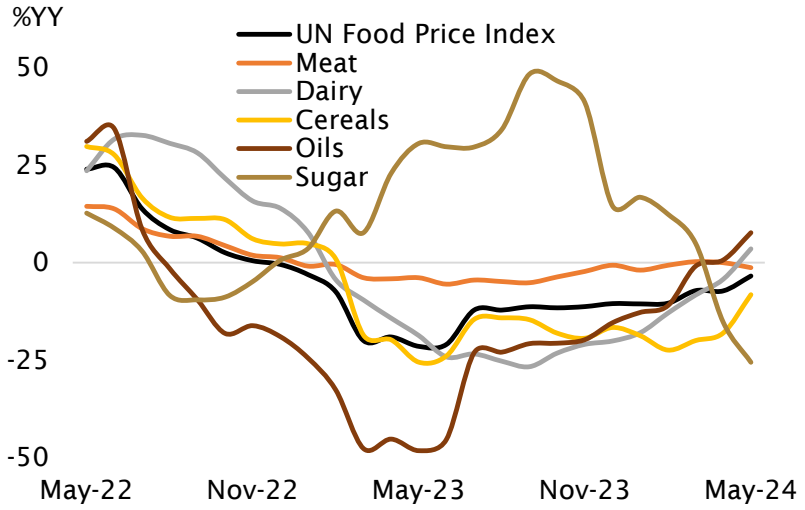
Mixed trend in global prices; oil and metals ease, food on the rise

- The fuel sub-index stayed in deflation for ninth straight month in May, supported by cuts in prices of LPG, petrol and diesel, though decline in inflation eased to -3.8% from -4.0% in April amid gains in kerosene prices.
- The outlook for global commodity prices remains clouded by ongoing geopolitical tensions, uncertainty over central bank policy pivots and their impact on growth outlook. Since mid-April, crude oil prices have been on a largely easing trend, while gold prices have been range-bound amid volatility after posting strong gains between February and April on safe haven demand.
- Industrial metal prices that had gained over 20% in mid-May since the beginning of the year shed some gains recently but remain around 9% higher.

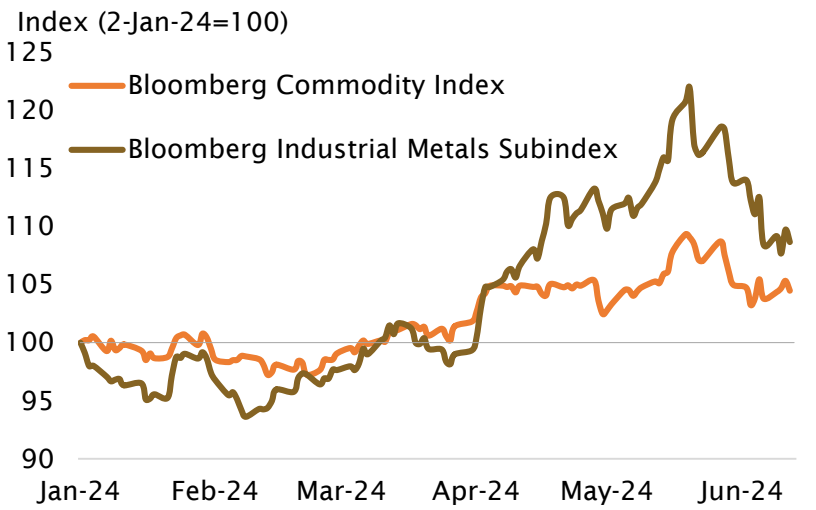
Brent crude oil prices – spot and futures



Global food prices remain in deflation but trending up



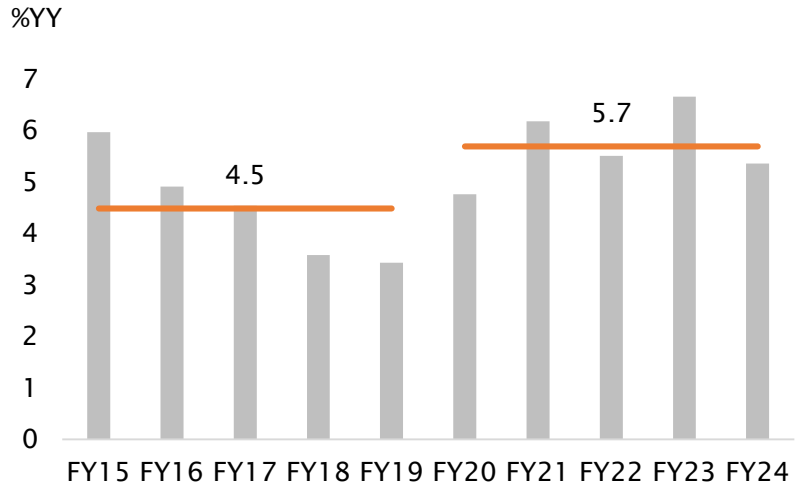
Global industrial metal prices off peak but remain high



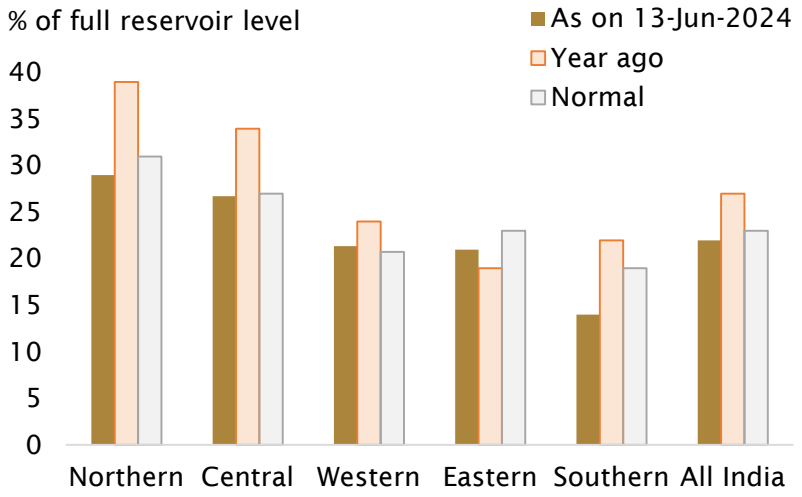
Outlook and policy implication

- Headline CPI inflation prints for the months of April and May averaged 4.8%. Base effect is set to be favorable for the months of June and July. Core inflation continues to surprise on the downside, reaching fresh lows and shrugging of concerns of bottoming out at current rates. Fuel sub-index remains in deflation, supported by government price cuts. Despite elevated food inflation, these trends suggest that it is likely that the headline inflation undershoots RBI MPC's estimate of 4.9% for Q1. With Q2 inflation expected to be sub-4% due to favorable base effects, this could give the RBI MPC the required confidence to ease stance to 'neutral' from the current 'withdrawal of accommodation' at its August meeting.
- Policy easing in terms of rate cuts is likely to be a function policy pivot by global systemic central banks and RBI's estimate of neutral rate of interest, expected to be published in its monthly bulletin for June. In recent months, more central banks in advanced economies have cut rates, though the extent and pace remains uncertain amid the complexities of muted growth and sticky inflation. The RBI's latest estimate of the natural rate of interest for the economy is in the range of 0.8%-1.0% for Q3-FY22. Based on the current policy repo rate of 6.5% and the RBI's FY25 CPI inflation projection of 4.5%, the current real rate of interest stands at 2%, which could be construed as restrictive.
- Despite vulnerability of domestic inflation to global commodity prices, including input price pressures, forecast of an above normal monsoon bodes well for inflation outlook, and could support agriculture output by raising reservoir levels, among other factors.

Average inflation higher than pre-pandemic trend



Storage in reservoirs below last year's and normal levels



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