

Inflation Watch: Food prices, unfavorable base effects drove headline CPI to nine-month high in September

21 October, 2024

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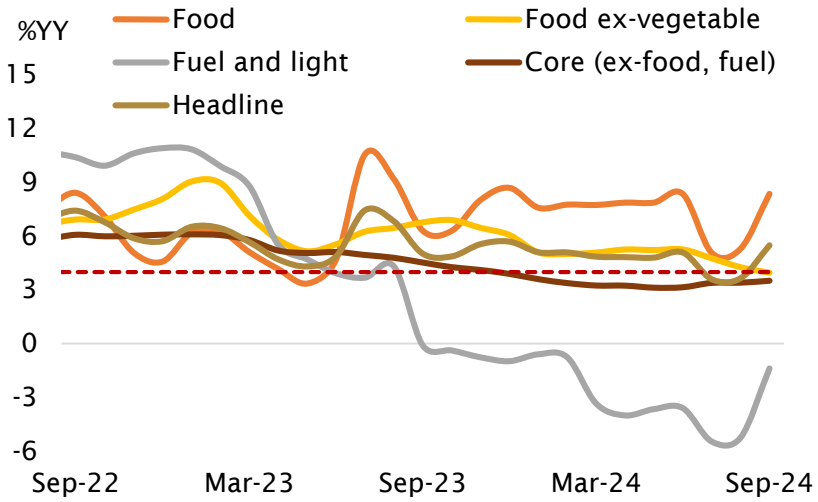
Key takeaways

- After remaining below RBI's 4% target for two straight months, headline CPI inflation surged to nine-month high in September at 5.49%, surpassing market expectations (Bloomberg survey: 5.10%) but remaining below the RBI's upper tolerance band of 6% for more than a year now. Both base effects and month-on-month change contributed to higher inflation in September. In term of sub-groups, food, particularly vegetables, added strongly to inflation. The fuel index remained in deflation but at a shallower rate. Core inflation was muted despite a slight uptick.

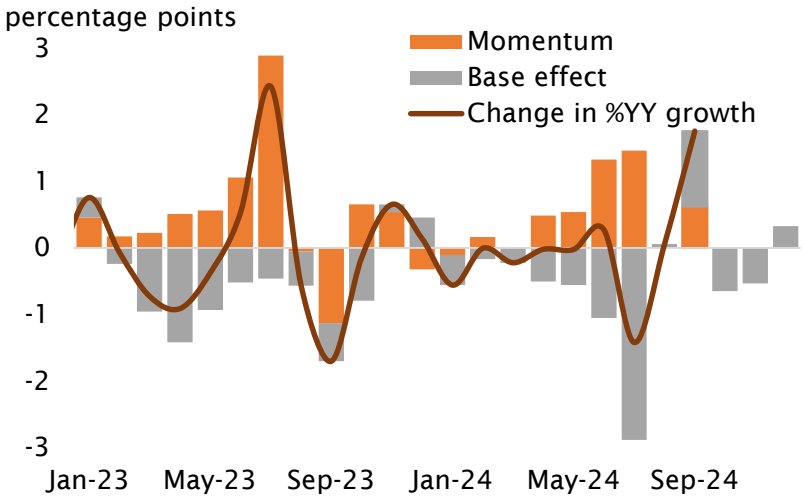
- Historical trends and price pressures in certain food items seen in recent high frequency data suggest headline inflation to rise further in October. There are some bright spots though, with inflation in certain sticky spots of the food basket easing in recent months, and households' inflation expectations moderating in the latest round of RBI's survey. Global prices remain a wild card, with volatile but range-bound movements in crude oil prices, the recent rise in food inflation, and the vulnerability of metal prices to global economic activity and outlook.

- In terms of policy implications, comments from some of the MPC members in the latest post-policy conference and recent views of the RBI Governor indicate that despite the change in policy stance to neutral, the RBI MPC is likely to wait and watch until 2025 before it starts to calibrate the policy rate.

Headline CPI swung to nine-month high in September..



…amid unfavorable base effects and momentum



Food prices, base effects drove headline CPI to nine-month high in Sep

- Headline CPI inflation printed at nine-month high of 5.49% in September after remaining below the RBI's 4% target for two successive months. Higher inflation was on expected lines due to unfavorable base effects, but the extent of increase was above street estimates (Bloomberg survey: 5.10%). In Q2-FY25, inflation averaged 4.2%, missing the RBI MPC's latest projection of 4.1% by a fraction. However, the disinflationary process seems to be on track with inflation averaging 4.6% in H1-FY25, lower than 5.5% in H1-FY24 and 5.2% in H2-FY24. The month-on-month change in headline number at 0.62% was higher than the historical median increase of 0.48% (FY12-24) for September, though the impact of unfavorable base outweighed the monthly momentum.

- The trend in headline CPI traced the surge in food inflation to nine-month high of 8.36%. Base effects were unfavorable, and the month-on-month change of 1.04% was higher than historical median for September at 0.48%. Inflation in vegetables soared to 14-month high at 36%YY from an average of 8.8% in the previous two months. Food ex-vegetables inflation slipped below 4% for the first time in the post-pandemic period.

- Core inflation (ex-food and fuel) rose slightly to 3.5% from 3.4% in August. Monthly momentum was muted relative to historical trend. Various measures of core inflation inched up during the month but remained benign. Core services inflation increased marginally and remained above core goods inflation that was steady.

- Though fuel prices have been in deflation for more than a year, the pace of decline narrowed in September to (-)1.39% from (-)5.25% in August. Despite softer month-on-month momentum compared to historical trend, base effects were unfavorable, as September 2023 marked the first month of deflation in recent data.

Headline CPI inflation breached 4% in September

%YY	Weight	Jul-24	Aug-24	Sep-24
Headline CPI	100.0	3.60	3.65	5.49
Food	45.9	5.06	5.30	8.36
Intoxicants, etc.	2.4	3.02	2.71	2.51
Clothing	6.5	2.67	2.72	2.71
Housing	10.1	2.68	2.66	2.78
Fuel and light	6.8	-5.48	-5.25	-1.39
Miscellaneous	28.3	3.84	3.89	4.05

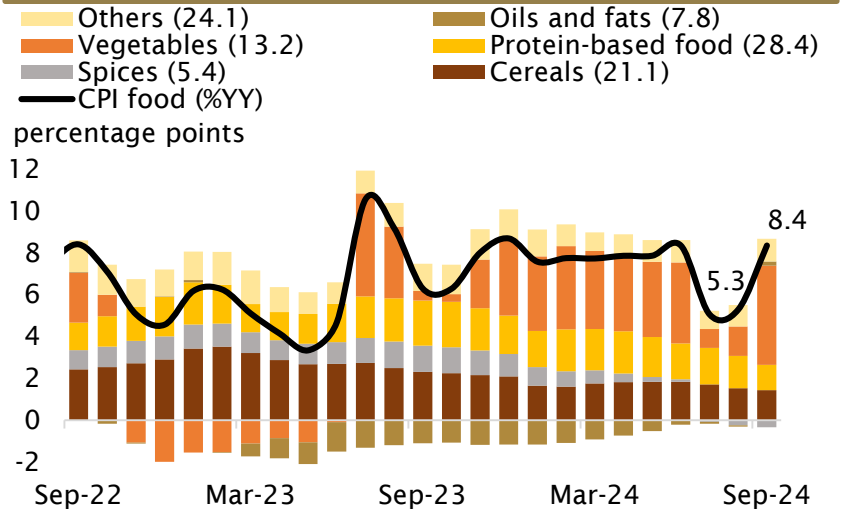
Strong monthly momentum in food, misc. groups

%MM, NSA	Weight	Jul-24	Aug-24	Sep-24
Headline CPI	100.0	1.47	0.00	0.62
Food	45.9	2.47	-0.30	1.04
Intoxicants, etc.	2.4	0.24	0.14	0.05
Clothing	6.5	0.21	0.26	0.21
Housing	10.1	0.50	0.61	0.00
Fuel and light	6.8	-0.17	0.40	0.06
Miscellaneous	28.3	0.82	0.33	0.38

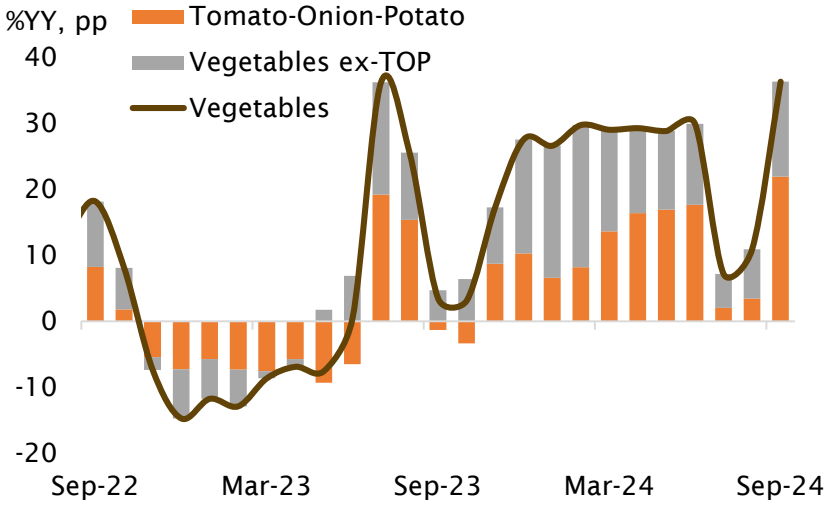
Vegetables roiled food inflation; firm momentum in cereals, edible oil

- It is not surprising that the RBI MPC remains wary of food inflation. In July 2023, when vegetable prices had flared up, food inflation had averaged 6.4% in H1-FY24, which increased to 7.7% in H2. Despite softening in H1-FY25, food inflation remained elevated at 7.1%, contributing over 70% to headline CPI.
- In September, vegetables contributed 57% to food inflation, up from 27% in August. Within vegetables, 60% of price surge was due to key vegetables – tomato, onion and potato. High frequency data for October indicates persistence of these price pressures. In addition to vegetables, the monthly change in prices in September was higher than the historical trend in case of fruits, cereals, eggs, edible oils, and meat. However, the year-on-year change in prices was benign in case of edible oils and meat, but above 6% in case fruits, cereals and eggs.
- For most of FY24, the sticky inflation in spices, cereals, pulses was a cause of concern. In recent months, there has been gradual disinflation in these categories. Spices have been in deflation for three straight months, with high momentum in FY24 turning into favorable base effects. Inflation in pulses dwindled to single digits after 15 months amid favorable base effects and lower monthly momentum relative to historical trend. Inflation in cereals was the softest in over two years, aided by favorable base effects, even as the monthly momentum reached an eight-month high to due increase in prices of small millets and PDS prices of rice and wheat.
- The oils and fats sub-index moved out of deflation after 19 months, with prices up 2.5%YY. This could be attributable to higher global prices and the recent hike in import duty of edible oils.

Food inflation surged in Sep due to vegetable prices



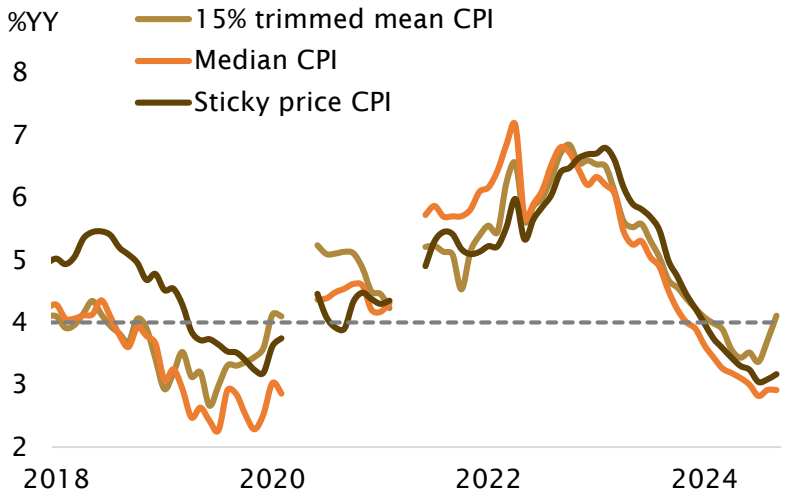
Tomato-onion-potato added 60% to vegetable inflation

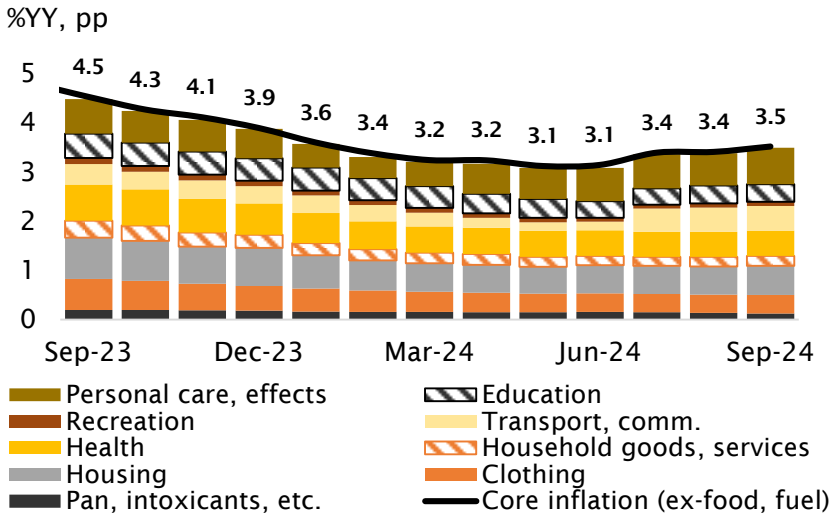


Core inflation remained muted despite mild uptick

- The marginal rise in core inflation (ex-food and fuel) to 3.5% in September from 3.4% in August was due to higher contribution from personal care and effects, housing, and transport and communication. There was also mild increase in inflation in the households goods and services group, though contribution remained unchanged from the previous month.
- Inflation remained soft across most core categories, below or around 4%, except for personal care and effects that recorded 9% inflation, up from 8% in August. The largest contribution to personal care (over 70%) remained from gold, reflecting the impact of ongoing rally in global prices of precious metals on safe haven demand and the surge in domestic demand due to cut in customs duty announced in the latest Union Budget.
- Housing inflation remained soft at 2.8% in September. The slight uptick from 2.7% in August was due to unfavorable base effects, as the month-on-month momentum was flat. The impact of one-off spike in the transport and communication index due to the telecom tariff hike in July continues to reflect in year-on-year price changes, though inflation remains muted at an average of 2.7% in Q2-FY25 versus 1% in Q1.
- In the aftermath of the telecom tariff hikes effective July, various measures of core inflation have been rising slightly, though the extent of increase suggests no cause of concern. Results from the RBI's latest survey of professional forecasters suggest that in the upcoming quarters, even as headline inflation is expected to ease as food price pressures wane, core inflation is likely to increase and rise above the headline print by Q2-FY26.

Various measures of core inflation trending up but remain benign; largest contribution from personal care due to gold prices

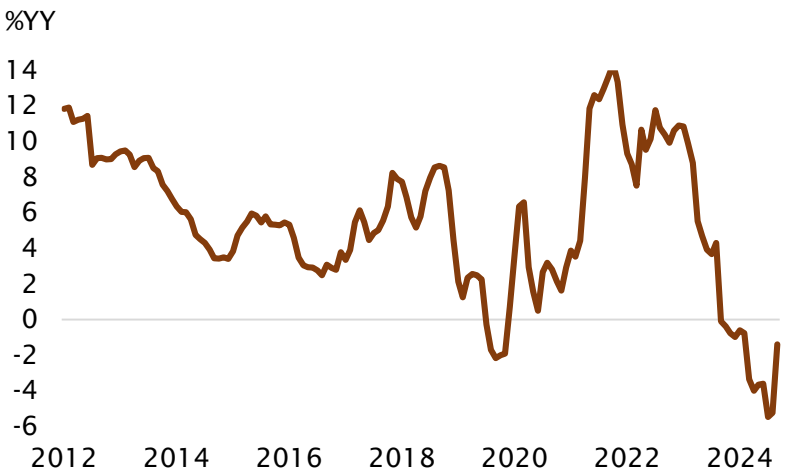




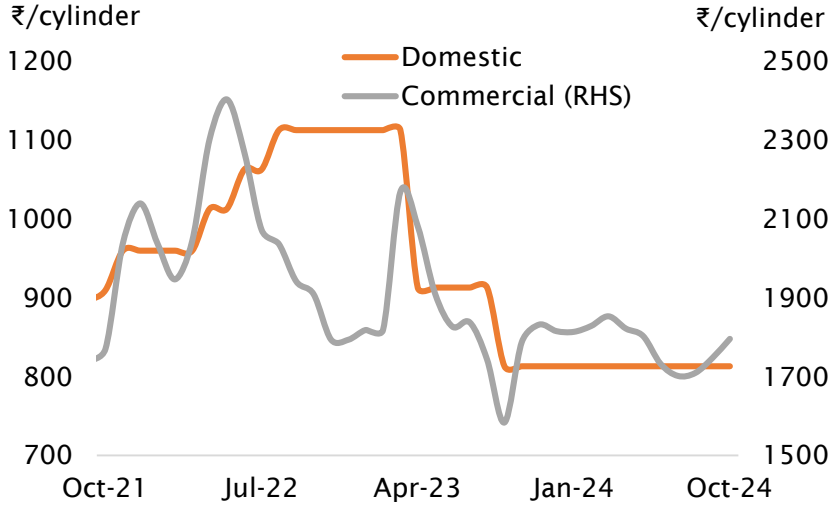
Deflation in fuel index narrowed due to unfavorable base effects

- The fuel and light index remained in deflation for the thirteenth straight month in September, but the extent of price decline was shallow at (-)1.4%YY versus (-)5.3% in August, as base effects turned unfavorable due to the LPG price cuts effective September 2023. The monthly momentum was muted relative to historical trends.
- There was an increase in inflation in the electricity sub-index, though the quarterly average remained low at 5.1% in Q2-FY25 compared to 10.2% in Q1, as temperatures cooled post the heatwave conditions in summer. In terms of contribution, electricity continued to add the most, followed by firewood and chips.
- Even as domestic LPG prices remain stable, oil marketing companies have been hiking commercial LPG prices ahead of the festive season, offsetting some of the deflationary impulses in the LPG sub-index.
- For its baseline projections of macroeconomic forecasts, the RBI, in its latest bi-annual monetary policy report, lowered the price assumption of Indian basket of crude oil price to USD80/b for H2-FY25 from USDUSD85/b for FY25 in the previous update to capture the easing in crude oil prices. In H1-FY25, crude oil (Indian basket) price had averaged 82/b, and despite recent volatility due to geopolitical risks and changing narratives around global demand, latest futures data indicate prices to remain sub-USD75/b in the next couple of months.
- In its latest monthly energy outlook note published in October, the US EIA lowered its forecast for Brent crude oil spot price for 2024 by USD2/b to USD81/b and for 2025 by around USD7/b to USD78/b. Also, in its latest outlook update, OPEC cut global oil demand forecast for both 2024 and 2025 for the third straight month.

Deflation in fuel index narrowed in September



OMCs have been hiking commercial LPG prices



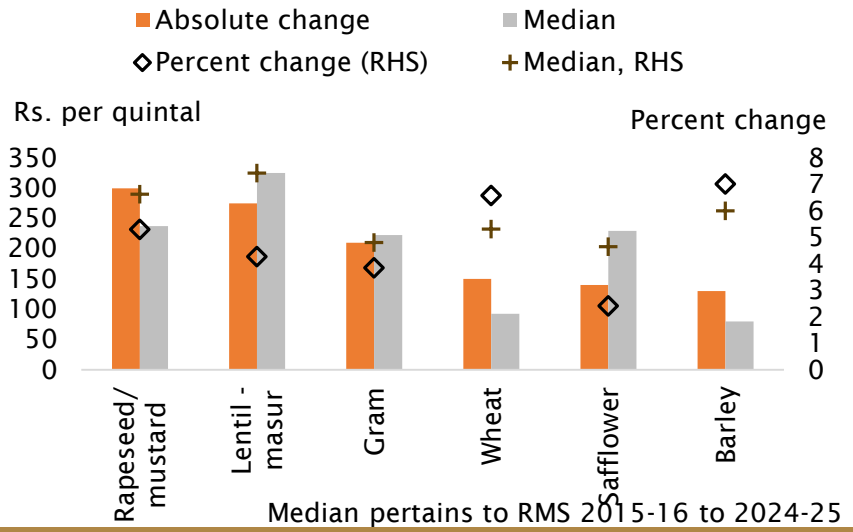
Outlook

- **The historical lens:** For October, base effects are slated to be favorable, shaving off around 0.6 percentage point from headline CPI and 0.3pp from core inflation. However, monthly momentum in both headline and core prices tends to be stronger in October compared to September, which could lift these inflation numbers above the latest prints of 5.5% and 3.5%, respectively. Historical trends (FY12-24) based on average and median month-on-month change indicate headline inflation in October at around 5.5-5.6% and core inflation around 3.6-3.7%. However, recent high frequency data on certain food items indicate upward risks to the headline estimate.
- **High frequency data:** Daily data from the Department of Consumer Affairs (as on October 10) on key vegetables indicates elevated inflation, particularly in case of tomatoes. Edible oils moved out of deflation in September, and price pressures are continuing to build. However, data on cereals, pulses and sugar indicate softer inflation vis-à-vis September, so it needs to be seen how these trends aggregate over the entire month.
- **Monsoon and reservoir levels:** The southwest monsoon has retreated and the northeast season has commenced. In the 2024 southwest monsoon season, rainfall in the country as a whole was 8% above long-period average (LPA). The spatial distribution was slightly skewed, with the southern (+14%), central (+19%), and northwest (+7%) regions receiving excess rains. The east and north-east regions (-14%) recorded deficient rains. A similar pattern reflects in reservoir levels (as of October 17), with most regions recording above normal storage, except for the northern part. However, the impact on crops from extreme climate related events, including extended rains in a year marked by La Nina, remains a relevant risk to watch out for.
- **Sowing:** As of September 27, Kharif sowing surpassed last year's levels across major food grains, but remained lower in case of cotton and jute. In case of pulses, sowing was higher than last year's levels but was less than normal area in the corresponding week between FY19-23. Among horticulture crops, as of October 4, Kharif onion sowing exceeded last year's levels, was at par in case of potato but deficient in case of tomato.
- **Global commodity prices:** In the RBI's latest Monetary Policy Report, published bi-annually, authors noted that the contribution of imported components to domestic CPI inflation had turned positive since April 2024 and increased to 0.5pp by August due to higher gold and silver prices. Global prices of precious metals have been rising due to safe haven demand amid geopolitical risks, and monetary and trade policy uncertainties across economies. Other commodity prices such as industrial metals remain volatile and vulnerable to risks of slowdown in major economies such as the US, Eurozone and China. Global food prices are also on the rise, with the UN FAO index moving out of deflation in September and posting year-on-year increase for the first time in 21 months. In that context, the RBI MPC, in its latest policy meeting, noted the recent uptick in global food and metal prices as one of the external uncertainties to account for in policy making.

Policy implication

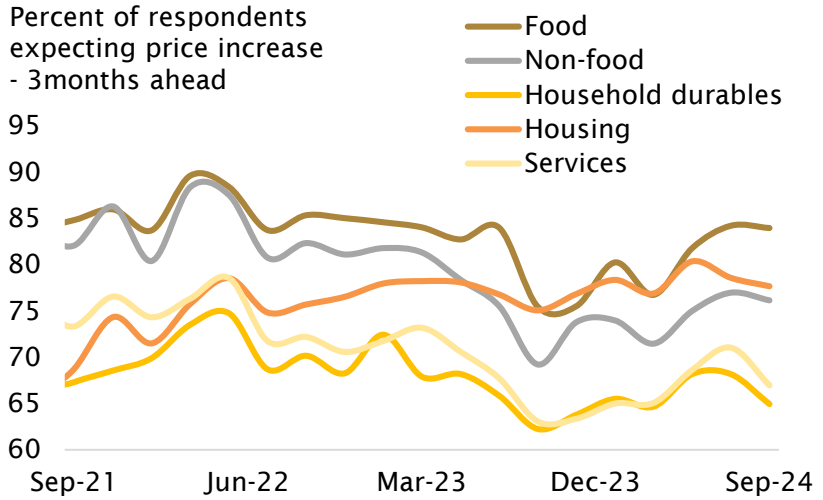
- **MSP:** The government recently approved minimum support price for Rabi crops for marketing season 2025-26. The absolute year-on-year increase was the largest in case of mustard and masur, while in terms of percent change, it was the highest for barley and wheat. However, the increase is unlikely to add to price pressures, considering that the current market price is already above the MSP for most crops.
- **Government intervention:** The government continues to actively intervene on the supply side to ensure timely availability of food grains and horticulture items at reasonable prices. Some of the recent steps include imports of pulses, transport of onions by rail rake, distribution of onions and tomatoes at subsidized prices. Amid the uncertainties related to climate related events and global prices, government intervention measures will remain instrumental in keeping a check on food inflation.
- **Latest views from the RBI:** In the post-policy conference of the latest RBI MPC meeting, one of the members noted that the committee would prefer to see off the expected rise in inflation in Q3-FY25 before considering the next policy move. Also, in one of his recent speeches, RBI Governor noted that it would be pre-mature and risky to ease rates at a point when growth is still holding up. This indicates that despite the change in stance to 'neutral' at the latest meet, the RBI MPC might prefer to wait until 2025 before it starts calibrating the policy rate. In an encouraging sign though, the RBI's latest survey on households' inflation view suggests easing, which is crucial from the point of view of anchoring of expectations.

MSP for Rabi Marketing Season 2025-26



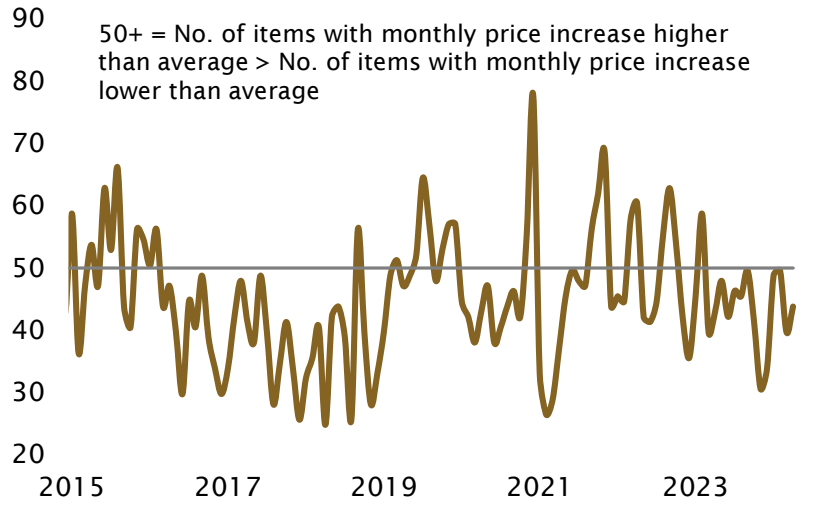
Median pertains to RMS 2015-16 to 2024-25

RBI survey on households' inflation expectations



Appendix I

Food diffusion index remained benign in September

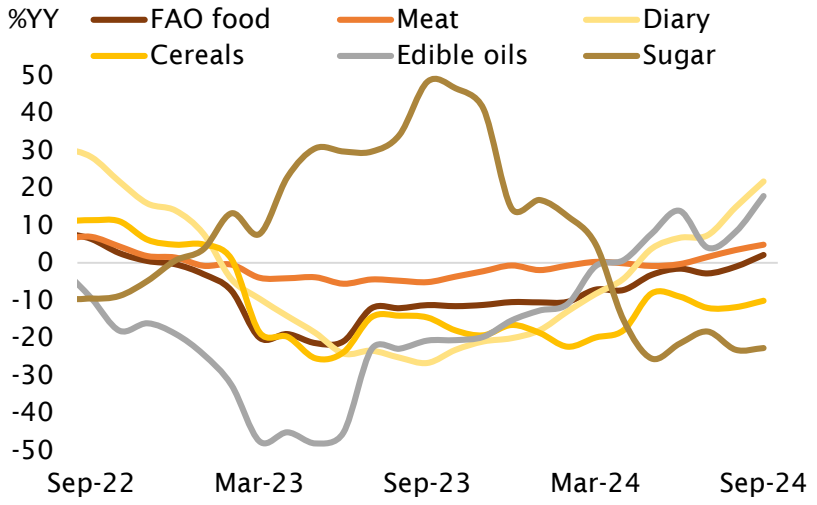


Price pressures persist in major vegetables

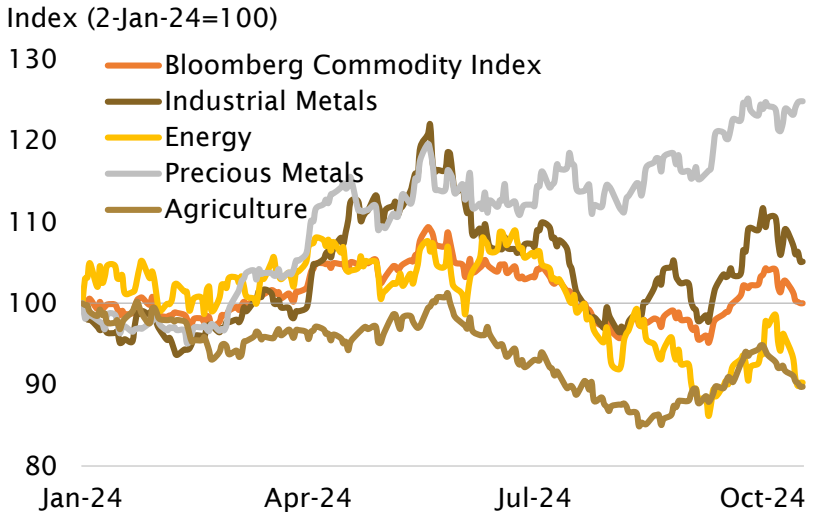
%YY	Tomato	Onion	Potato	Vegetables
Wt. in CPI	0.57	0.64	0.98	6.0
Jul-24	-43.0	60.6	65.8	6.8
Aug-24	-47.9	54.1	64.1	10.7
Sep-24	42.2	66.1	65.0	36.0
Oct-24*	132.4	55.8	51.9	
%MM				
Jul-24	41.7	20.5	16.7	14.1
Aug-24	-28.8	7.9	1.3	-2.5
Sep-24	-4.1	18.5	-1.4	3.5
Oct-24*	49.9	6.7	4.8	

Note: *All India retail price till Oct 17.
Source: Department of Consumer Affairs

Global food prices – UN FAO index



Global commodity prices – Bloomberg



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