

Inflation Watch: Muted monthly momentum kept headline CPI inflation below 4% in August

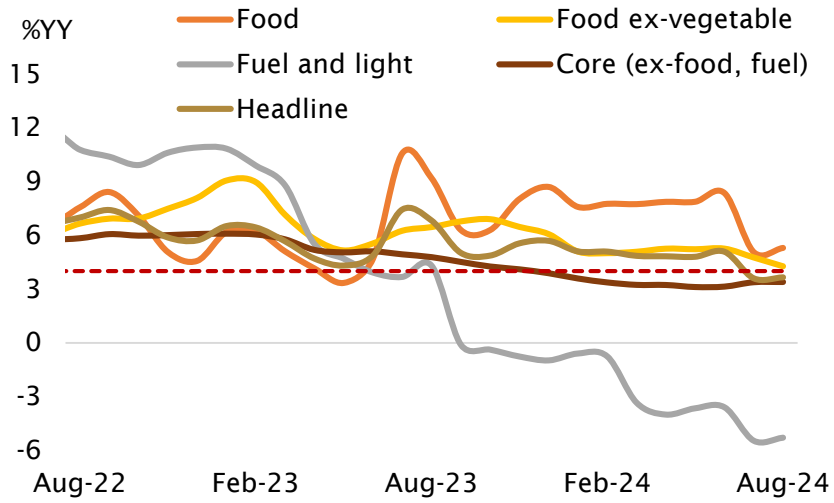
17 September, 2024

TRUST
In Partnership. With Trust.

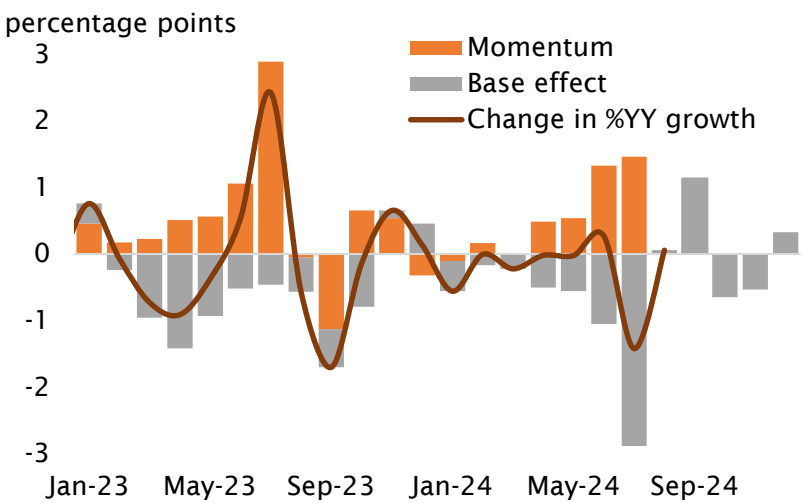
Key takeaways

- Headline CPI inflation remained below the RBI's 4% target for the second straight month in August at 3.65%, slightly above market forecasts (Bloomberg survey: 3.47%) and last month's print at 3.60%. Food inflation stayed above 5% due to unfavorable base effects amid a month-on-month fall in the index for the first time in seven months. Vegetable prices remained volatile, with food ex-vegetable inflation easing to 4.3% from 4.8% in July.
- Core inflation (ex-food and fuel) was largely steady at 3.40%, compared to 3.39% in July. Inflation was benign across most key categories despite an uptick in some groups. However, stable core inflation masked the slight upward pressure in core services inflation triggered by the hike in telecom tariffs last month. The fuel category remained in deflation for the twelfth straight month, though the extent eased slightly from an all-time low in July.
- Base effects are expected to be unfavorable for the month of September, but latest data indicates a high probability of headline inflation undershooting the RBI MPC's forecast of 4.4% average for Q2-FY25. Future path will largely depend on how food prices evolve, as core inflation is expected to remain benign. Even as monsoon and Kharif sowing are progressing well, the skewness in spatial distribution of rainfall and risks of excess rains in a year marked by La Nina, need to be watched out for. Government policy intervention will remain crucial to keep a lid on food price pressures. External factors in the form of global commodity prices and monetary policy easing by systemic central banks are also likely to weigh on central bank decision making when the MPC meets next in October with a new set of three external members.

Headline inflation remained below 4% in August…



… amid muted momentum, mildly negative base effect



Muted monthly momentum kept headline CPI below RBI's 4% target

- In August, headline CPI inflation remained below the RBI's 4% target for the second straight month at 3.65% but was slightly above market expectations. (Bloomberg survey: 3.47%) and marginally higher than July's print at 3.60% (revised up from the initial estimate of 3.54%). The month-on-month momentum was flat in August, so that the fractional increase compared to July was due to mildly unfavorable base effects.
- Food inflation rose to 5.3% from 5.1% in July due to unfavorable base effects amid a month-on-month decline in the index for the first time in seven months. This was in contrast to an average increase (FY12-24) of 0.8% for the month of August. Vegetable prices echoed a similar trend, declining month-on-month, even as the year-on-year gains reverted to double-digits after receding to a nine-month low in July. Food ex-vegetable continued to inch closer to RBI's inflation target of 4% (4.3% in August versus 4.8% in July).
- Core inflation (ex-food and fuel) was largely steady at 3.40%, compared to 3.39% in July. Inflation was benign across most key categories despite an uptick in some groups such as pan, tobacco, and intoxicants; clothing and miscellaneous items. Stable core inflation was supported by softness in core goods amid a slight increase in core services inflation. A few trends stood out within the miscellaneous group, which largely comprises of services: 1) there was a broad-based rise in inflation across sub-indices, except for personal care and effects 2) the impact of telecom tariff hikes in the communication sub-group largely subsided after showing a spike in July 2) personal care and effects group continued to contribute the most to inflation in this category but inflation eased, partly reflecting the impact of custom duty cuts on precious metals such as gold and silver.
- The fuel category remained in deflation for the twelfth straight month, though the extent eased slightly from an all-time low in July (-5.5% to -5.3% in August) amid increases in sub-indices of electricity and firewood.

Inflation rose in Aug except housing, intoxicants, etc.

%YY	Weight	Jun-24	Jul-24	Aug-24
Headline CPI	100.0	5.08	3.60	3.65
Food	45.9	8.36	5.06	5.30
Intoxicants, etc.	2.4	3.08	3.02	2.71
Clothing	6.5	2.73	2.67	2.72
Housing	10.1	2.69	2.68	2.66
Fuel and light	6.8	-3.61	-5.48	-5.31
Miscellaneous	28.3	3.41	3.84	3.89

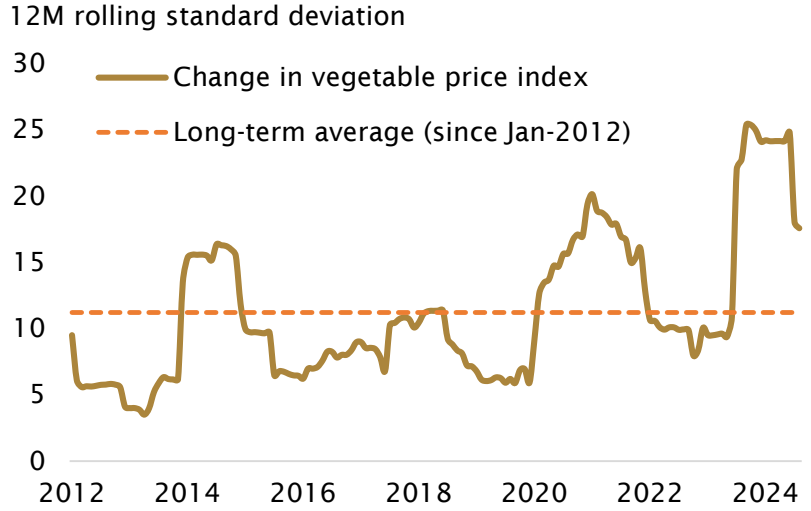
Monthly momentum flat in overall CPI; negative in food

%MM, NSA	Weight	Jun-24	Jul-24	Aug-24
Headline CPI	100.0	1.33	1.47	0.00
Food	45.9	2.69	2.47	-0.30
Intoxicants, etc.	2.4	0.29	0.24	0.14
Clothing	6.5	0.31	0.21	0.26
Housing	10.1	-0.56	0.50	0.61
Fuel and light	6.8	0.11	-0.17	0.34
Miscellaneous	28.3	0.28	0.82	0.33

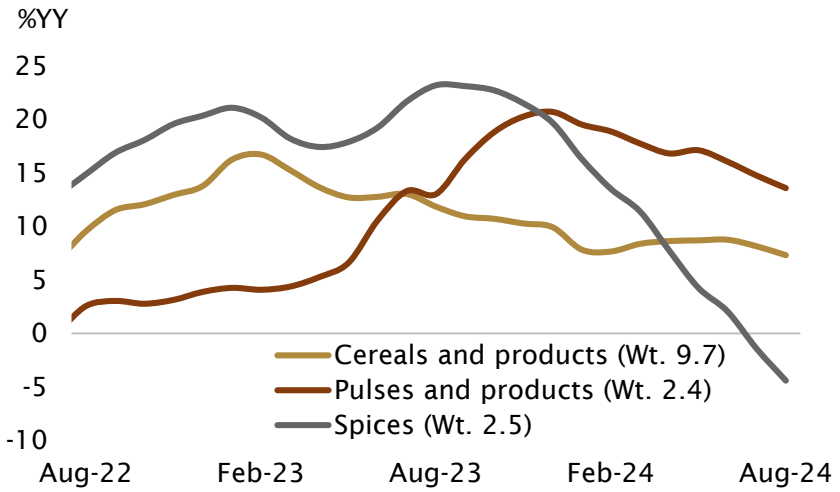
Vegetable prices remain volatile; slower disinflation in cereals, pulses

- Inflation in the food and beverages category increased to 5.3% in August, after easing to 13-month low of 5.1% in July. The uptick was despite month-on-month decline in the index and was contributed by higher inflation in non-alcoholic beverages, eggs, fruits and vegetables. Food inflation contributed 66% to the headline CPI, fractionally higher than 65% in July but below the average of 72% between January-June.
- The month-on-month seasonal softening in vegetable prices at (-)2.5% was better than historical average for the month of August (increase of (+)2.7% for FY12-24), so that higher year-on-year price gain compared to July was due to unfavorable base effects. Volatility in vegetable prices tends to be higher than the headline CPI (long term average of 11.2SD versus 1.7SD for headline CPI) and despite recent easing, continues to hover above the historical trend.
- In addition to the swings in vegetable prices, stickiness in three sub-groups – spices, cereals, pulses – added to food price pressures in FY24. Inflation in spices has abated, with the sub-index remaining in deflation for the second straight month in August. The disinflation process in cereals and pulses is progressing but has been rather tardy. Inflation in pulses has remained in double-digits since June 2023, even as it eased to a two-year low in case of cereals in August.
- In all months of FY24, the oils and fats sub-index remained in double-digit deflation. However, the pace of deflation has been dwindling in recent months and was sub-1% in August.

Volatility in vegetable prices higher than historical trend



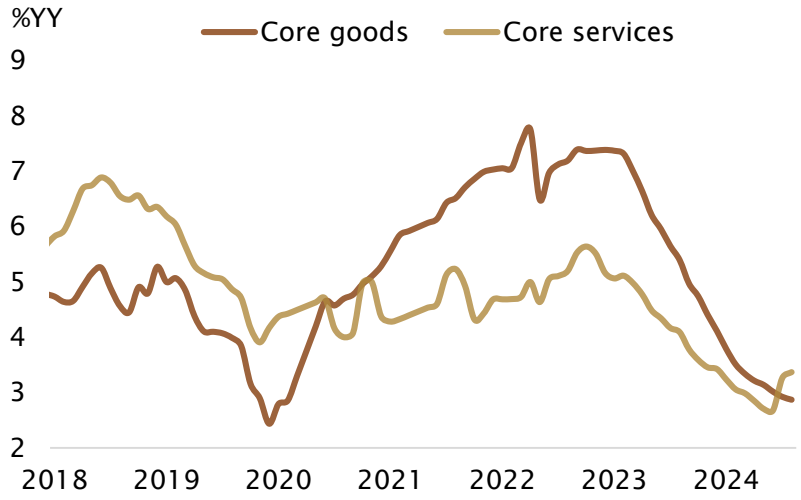
Deflation in spices; slower disinflation in pulses, cereals



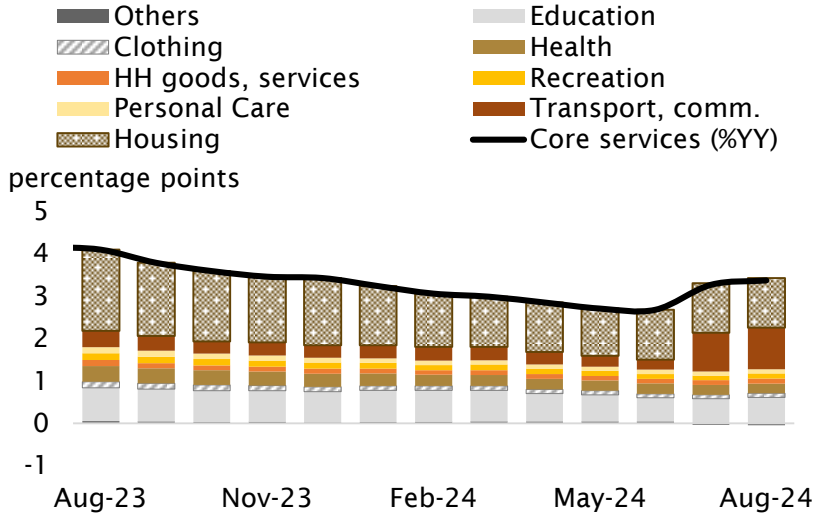
Core inflation steady; soft goods inflation offset mild rise in services

- Core inflation (ex food and fuel) was steady in August at 3.40%, similar to the print of 3.39% in July. The softness in core goods inflation at sub-3% was offset by a mild uptick in the core services component, though the increase was lower than in July.
- In July, tariff hikes of up to 25% by telecom firms became effective that lifted core inflation and paused an easing trend of more than a year. The impact of tariff hike on mobile phone charges has faded from monthly data after a spike in July but continued to translate into higher year-on-year inflation. Mobile phone charges account for 21% of the transport and communication sub-index that has a weight of 8.6% in the CPI index.
- In addition to transport and communication within the miscellaneous group (that mostly includes services), education, and household goods and services also added more core inflation compared to July. Within education, tuition and other fees have been rising since June, while among household goods and services, domestic help has been adding more to inflation.
- Personal care and effects has been contributing the most to core inflation within the miscellaneous group for five months in a row now, though inflation in this sub-group eased for the first time since March 2024. Inflation in personal care tends to reflect trends in global gold prices, and despite higher prices during the month compared to July, moderation in this sub-index probably reflected the cut in customs duty on precious metals announced in the Union Budget for FY25.

Core inflation steady amid uptick in services segment…



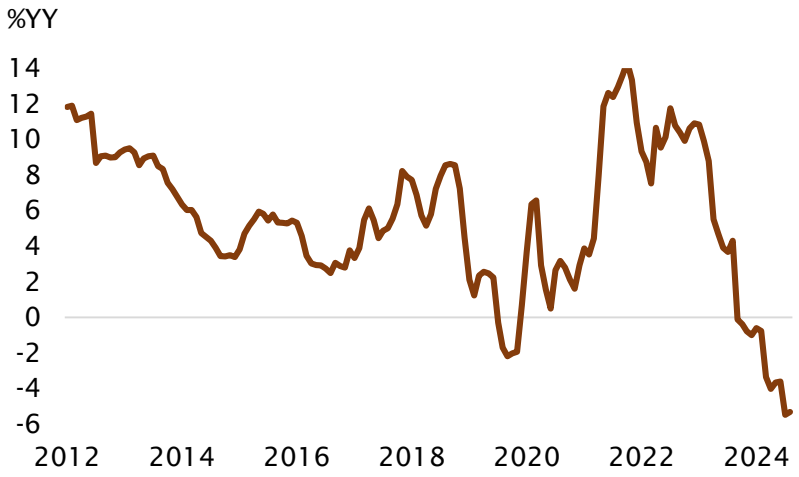
… largely reflecting the impact of telecom tariff hike



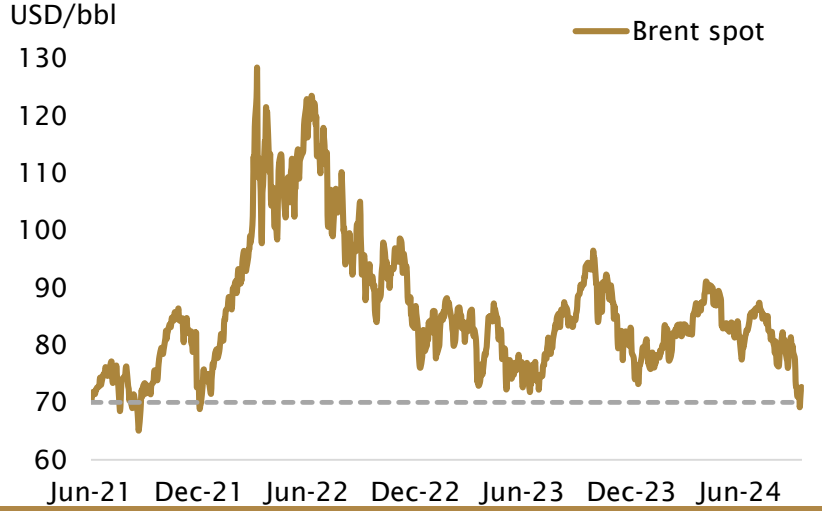
Fuel index in deflation for a year now; crude slips below USD70/bbl

- The fuel and light index, with a weight of 6.8% in the CPI basket, has remained in deflation since September 2023. The initial slip was triggered by LPG subsidies, followed by price cuts in diesel and petrol ahead of the general elections. With the onset of monsoon and cooling temperatures, inflation in electricity has dwindled to sub-5% in the past two months after remaining in double digits for almost a year. However, the sub-indices of coal, coke, and, firewood and chips posted higher inflation in August compared to the previous month.
- Global commodity prices remain volatile, marked by divergent trends, and vulnerability to incoming economic data and monetary policy expectations from systemic central banks. There has been a softening bias since July amid concerns of weakening demand from China and a slowdown in the US. The Bloomberg commodity index remains below the levels at the beginning of 2024, even as industrial metal prices have started to rebound and precious metals continue to surge on safe haven demand amid a volatile global macroeconomic backdrop.
- A recent highlight was crude oil slipping USD70/bbl for the first time since end-2021, as OPEC slightly lowered demand outlook for 2024 and 2025 in its latest monthly note. However, the extension of voluntary production cuts by OPEC+ countries till December could cap the downside, as could a possible lift to the US economy when the Fed starts to ease. Amidst these various push and pull factors, crude has averaged USD83/bbl FYTD so far, lower than the USD85/bbl penciled in by the RBI's bi-annual monetary policy report published in April, indicating a potential tailwind to domestic inflation.

Fuel and light index in deflation for a year now



Crude below USD70/bbl for the first time since end-21



Outlook

- **The historical lens:** In its latest policy meeting held in August, the RBI MPC raised CPI inflation forecast for Q2-FY25 by 60bps to 4.4% amid concerns over persistent food inflation and potential spillovers to other components. However, latest data suggests that inflation will need to hit 6% in September to meet the MPC forecast and this looks unlikely based on historical trends. Though base effect will add more than a percentage point to the headline print vis-à-vis August, both median and average monthly momentum for September (FY12-24) indicate inflation to be in the range of 5.0-5.2% for the month, implying an undershoot of 20-30 basis points for the quarter. Similarly, historical trends suggest core inflation is likely to be at 3.6% in September, implying an undershoot at 3.5% average for the quarter vis-à-vis median forecast of 3.8% based on results from the RBI's latest survey of professional forecasters.
- **Monsoon:** As of September 11, rainfall in the country as a whole was 7% above long-period average (LPA). The spatial distribution has improved since the beginning of the season but remains skewed, with the southern (+25%), central (+19%), and northwest (+4%) regions receiving excess rains. The east and north-east regions (-16%) continue to record deficient rains.
- **Reservoir levels:** A similar pattern reflects in reservoir levels (as of September 12), with most regions recording above normal storage, except for the northern part. The forecast of La Nina bodes well for farm output prospects, including Rabi crop. However, the skewness in rainfall and reservoir levels, and the risk of excess rains and floods in a year marked by La Nina need to be watched out for.
- **Sowing:** As of September 6, area sown under Kharif crops exceeded last year's levels across major food grains, but remained lower in case of cotton and jute. Also, in 2023, sowing progress was slow due to the impact of El Nino. In that context, comparison with earlier years suggests that there is still room for catch up in case of pulses sowing. Among key horticulture crops, as of August 29, Kharif onion sowing exceeded previous year's levels but was lower in case of potato and tomato.
- **Government intervention:** To keep a lid on food prices, the government continues to actively intervene via policies on stock limits for food grains and distribution of essential horticulture items at lower prices. Recent measures include retail sale of onions at subsidized rates and lowering stock holding limit of wheat for traders. However, some other policy steps, while aimed at supporting the farm sector, need to be assessed in terms of their near-term impact on prices. Examples include recent hike in import duty on edible oils, lowering minimum export price (MEP) on onions and removing MEP on basmati rice. With food inflation continuing to impart volatility to the headline CPI and climate-related uncertainties that have increased in recent times, continuous monitoring of price trends and timely policy intervention is likely to remain instrumental in keeping food inflation in check.

Policy implication

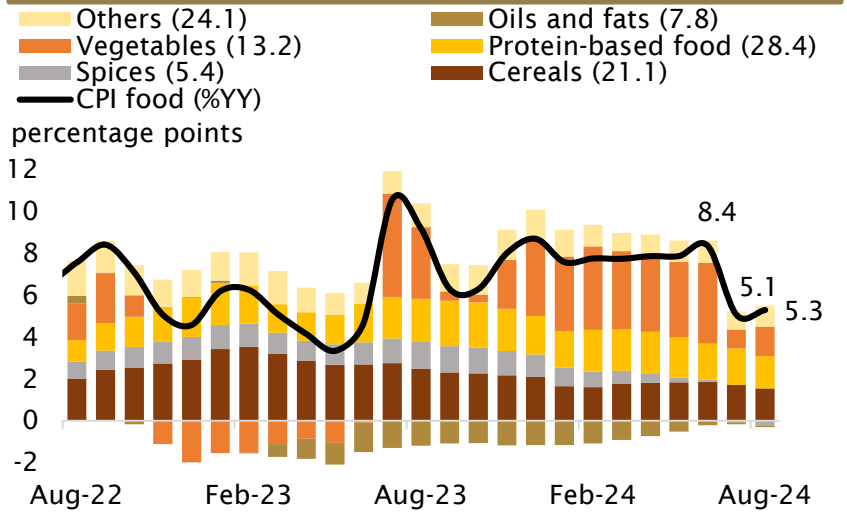
- Based on latest data, there is a high probability of headline inflation undershooting the RBI MPC's forecast of 4.4% average for the quarter. The RBI MPC is likely to look through the statistically-induced softening in the headline print, and remain focused on the progress in monsoon and sowing to assess the outlook for food inflation, which has been hindering the disinflation process and preventing the alignment of headline CPI with its 4% target on a durable basis. However, it could take respite from the fact that food prices fell month-on-month for the first time in seven months, defying the historical trend for the month of August.

- There are other uncertainties at play, both domestic and external. Three new external members will join the MPC and be part of decision making at the upcoming policy meeting in October, with the four-year term ending for earlier external members. Easier global monetary conditions could also pave the way for easing by central banks in emerging markets, including India. For the second time this year, the ECB delivered a rate cut at its policy meeting this month. The Fed FOMC is expected to start easing at its meeting this week, though the extent and pace remain uncertain. The CME FedWatch tool is currently pricing a 69% probability of a 50bp cut at the September meeting.

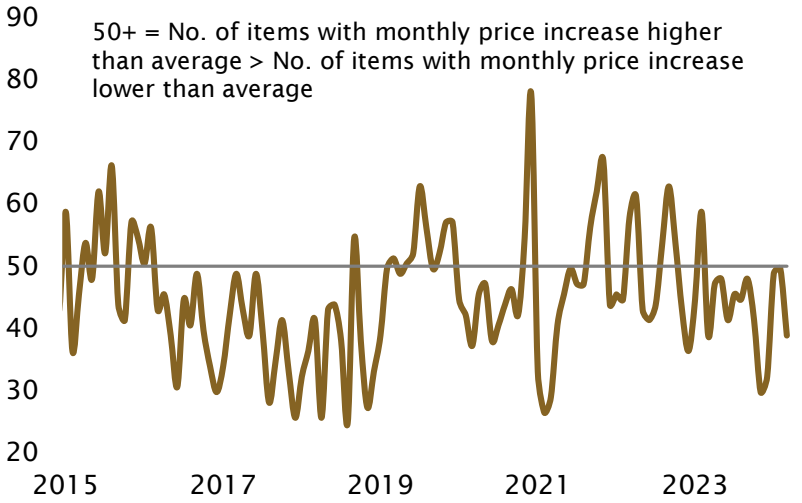
- In a recent interview, RBI Governor Das noted that the future trajectory of growth and inflation would have a bearing on policy making. In that context, the MPC's inflation forecast for Q3 stands at 4.7%, higher than 4.4% projected for Q2, before easing to 4.3% in Q4. It is possible that the central bank might still prefer to wait and watch in order to understand how the monsoon and food inflation dynamics play out, and a clearer picture is likely to emerge by its December meeting. However, at its October meeting, the MPC could ease the hawkish tone in the backdrop of monetary policy easing by systemic central banks, with the RBI Governor already acknowledging in a recent speech that the growth-inflation balance is now well-poised within the domestic economy. The MPC might prefer to set the stage before actual tweaks to policy stance or rates to avoid any knee-jerk reaction in the markets and also to keep inflation expectations anchored.

Appendix I

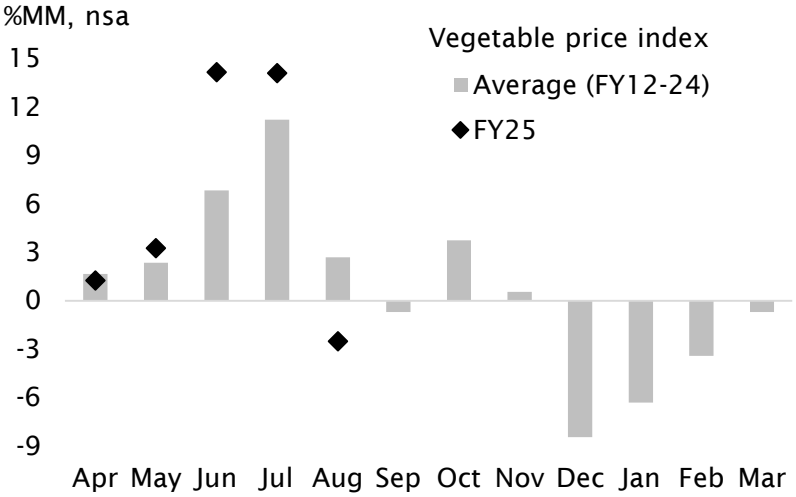
Contribution to food inflation - select items



Food diffusion index eased in August



Despite steep month-on-month easing in prices in Aug…



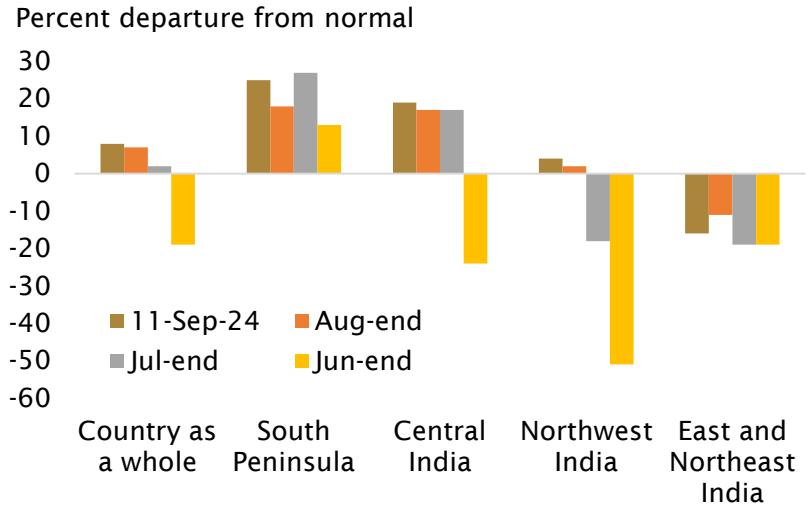
…inflation remains elevated in major vegetables

%YY	Wt. in CPI	Jul-24	Aug-24	Sep-24*
Tomato	0.57	-43.0	-47.9	6.6
Onion	1.57	60.6	54.1	49.8
Potato	2.57	65.8	64.0	47.9
Vegetables	3.57	6.8	10.7	
%MM				
Tomato	0.57	41.7	-28.8	-15.1
Onion	0.64	20.5	7.8	15.3
Potato	0.98	16.7	1.2	-2.0
Vegetables	6.04	14.1	-2.5	

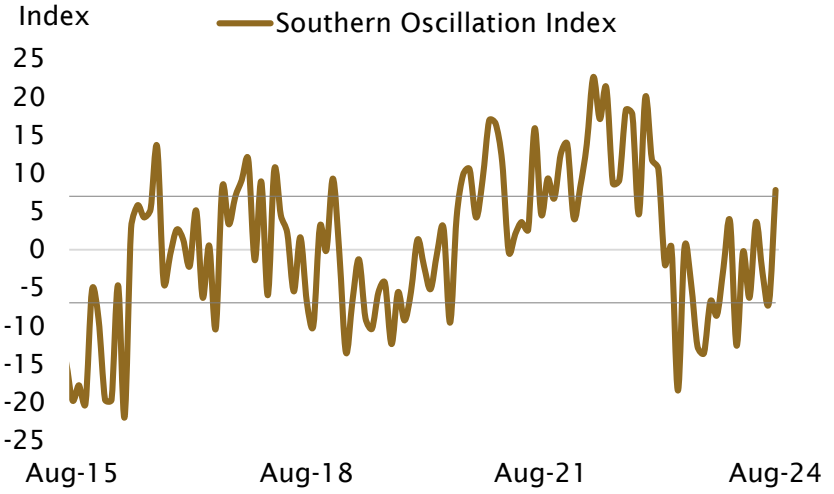
Note: *All India retail price till Sep 12.
Source: Department of Consumer Affairs

Appendix II

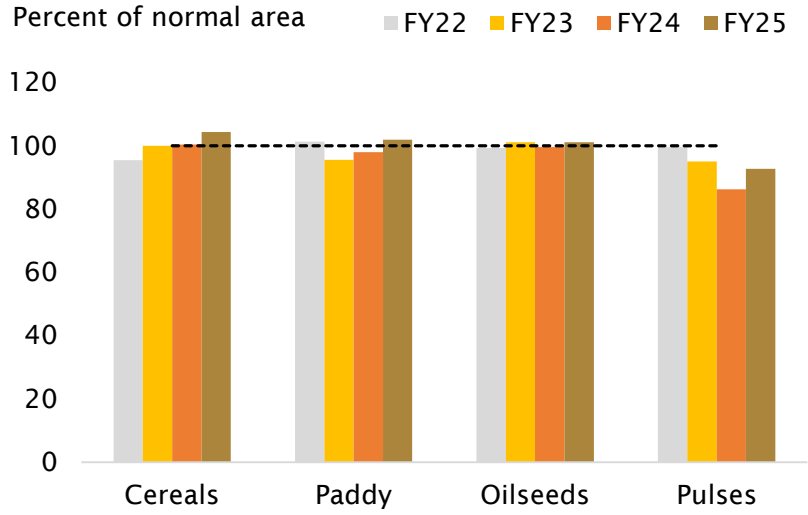
Progress in rainfall distribution; deficient in east/NE



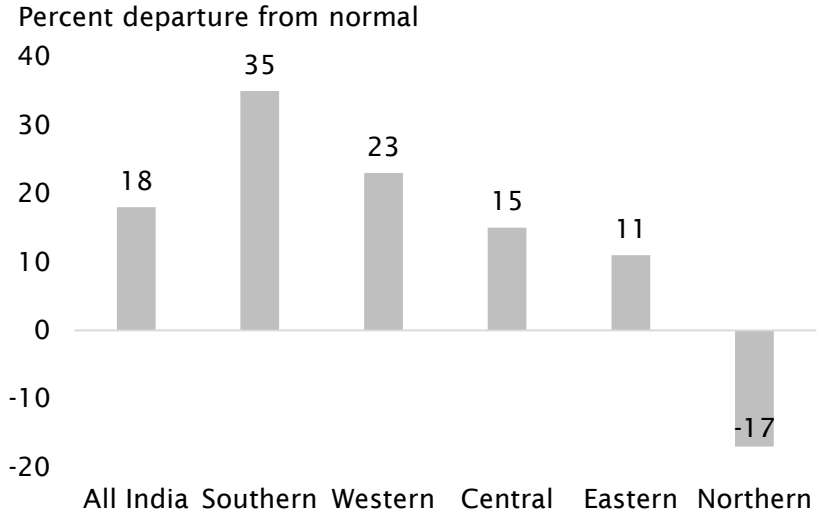
SOI above 7 indicates La Nina conditions



Kharif sowing (as on September 6)



Reservoir level (as on September 12)



DISCLAIMER:

We are committed to providing completely independent views to help our clients reach a better decision. This document is provided for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. Nothing in this document should be construed as investment or financial advice, and nothing in this document should be construed as an advice to buy or sell or solicitation to buy or sell the securities of companies referred to in this document. The intent of this document is not in recommendary nature. The recipient of this document should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved), and should consult its own advisors to determine the merits and risks of such an investment. The investment discussed or views expressed may not be suitable for all investors. Trust Group has not independently verified all the information given in this document. Accordingly, no representation or warranty, express or implied, is made as to the accuracy, completeness or fairness of the information and opinions contained in this document. The Company reserves the right to make modifications and alternations to this statement as may be required from time to time without any prior approval. Trust Group, its affiliates, their directors and the employees may from time to time, effect or have effected an own account transaction in, or deal as principal or agent in or for the securities mentioned in this document. They may perform or seek to perform investment banking or other services for, or solicit investment banking or other business from, any company referred to in this report. Each of these entities functions as a separate, distinct and independent of each other. The recipient should take this into account before interpreting the document. This report has been prepared on the basis of information, which is already available in publicly accessible media or developed through analysis of Trust Group. The views expressed are those of analyst and the Company may or may not subscribe to all the views expressed therein. Neither the Firm, not its directors, employees, agents or representatives shall be liable for any damages whether direct or indirect, incidental, special or consequential including lost revenue or lost profits that may arise from or in connection with the use of the information. This document is being supplied to you solely for your information and may not be reproduced, redistributed or passed on, directly or indirectly, to any other person or published, copied, in whole or in part, for any purpose.

Copyright in this document vests exclusively with Trust Group.

Trust Group

1101, Naman Centre, Bandra Kurla Complex, Bandra (E), Mumbai -400 051, Maharashtra.

Ph: +91 22 4084 5000 • Fax: +91 22 4084 5052 • www.trustgroup.co.in