

Lower CPI inflation in December keeps window open for policy rate cut in February but external risks weigh

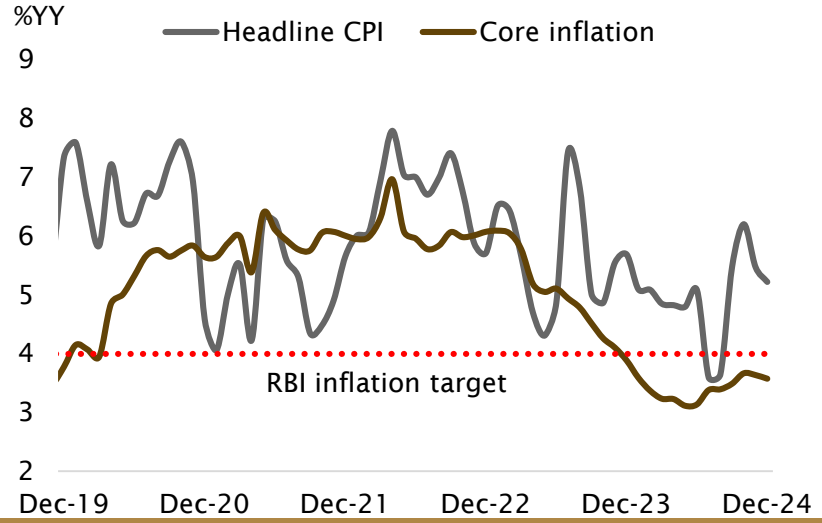
20 January, 2025

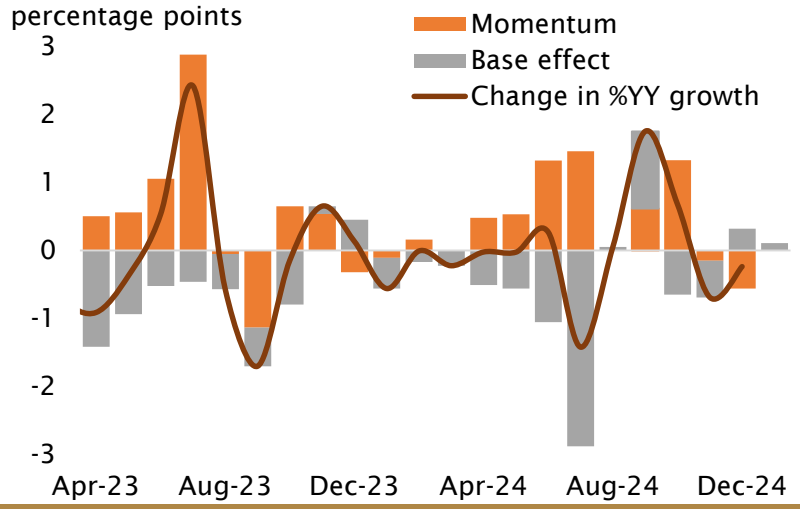
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Key takeaways

- Headline inflation eased to four-month low of 5.22% in December from 5.48% in November amid month-on-month decline in the index that offset unfavorable base effects. The print was marginally below market expectation of 5.3% (Bloomberg survey, Reuters poll) and marked further moderation from 14-month high of over 6% in October. On a fiscal year-to-date basis, inflation average stands at 4.9%YY, below 5.5% in April-December FY24.
- The easing in headline CPI was mainly driven by deceleration in food inflation due to seasonal correction in prices that tends to happen in winter months. Food inflation eased to 7.7% in December from 8.2% in November. However, there are increasing signs of second round effects of persistently high inflation in primary food articles that are trickling to other items and these trends need to be watched out for.
- The fuel index remained in deflation for the sixteenth successive month amid rising global energy prices.
- Core inflation (ex-food, fuel) was largely stable compared to the previous month at around 3.6%. In FYTD terms, core inflation average stands at 3.4%, lower than 4.7% in April-December FY24.
- Inflation averaged 5.6% for October-December quarter, mildly undershooting the latest RBI MPC forecast of 5.7%. While further moderation in food inflation and the ongoing sluggishness in economic activity can open the window for policy rate cut(s) as early as at the upcoming MPC meeting in February, the easing cycle is likely to be a shallow one of around 50bps in the backdrop of 1) recent INR depreciation, and 2) risks from ongoing volatility in global commodity prices due to policy uncertainties, particularly in the US.

Headline CPI eased in in December due to month-on-month fall in prices that offset slightly unfavorable base effects





Monthly decline in prices drove softness in CPI inflation in December

- Headline CPI inflation eased for the second consecutive month to 5.22% in December from 5.48% in November. The moderation was slightly sharper than market expectation of around 5.3% (Bloomberg survey, Reuters poll) after reaching 14-month high of over 6% in October, and was driven by month-on-month decline in prices that offset unfavorable base effects. The headline index fell 0.56% from the previous month, steeper than the historical (FY12-FY24) median drop of 0.45% in December, and average decrease of 0.39%.
- On a fiscal year-to-date basis (FYTD), CPI inflation has averaged 4.9% versus 5.5% in April-December FY24. In October-December, average inflation of 5.6% implied a fractional undershoot to RBI MPC's projection of 5.7%.
  - The moderation in headline CPI was mainly driven by deceleration in food inflation, though it remained above 6% for the fourth successive month and contributed 68% to the headline print. Despite lower headline print FYTD, food inflation average increased to 7.6% versus 6.8% in April-December FY24.
  - Inflation was lower compared to November across most major groups, except pan, tobacco, and intoxicants, where inflation rose mildly but remained sub-4%, and fuel and light category that remained in deflation for the sixteenth straight month but at a slightly shallower pace compared to November. These two were also the categories where prices rose month-on-month.
  - In addition to the intoxicants group, inflation remained below 4% in clothing and housing segments. Though inflation in miscellaneous group eased, it remained above 4%, mainly because of personal care and effects sub-group, where inflation has been above 6% for almost a year now. Nonetheless, inflation in this sub-group eased in December, tracing the trend in global prices of precious metals such as gold.
  - Core inflation (ex-food, fuel) was largely stable compared to the previous month at around 3.6%. In FYTD terms, core inflation average stands at 3.4%, lower than 4.7% in April-December FY24.

Headline CPI inflation remained below 6% in December

%YY	Weight	Oct-24	Nov-24	Dec-24
Headline CPI	100.0	6.21	5.48	5.22
Food	45.9	9.69	8.20	7.69
Intoxicants, etc.	2.4	2.50	2.35	2.49
Clothing	6.5	2.70	2.75	2.74
Housing	10.1	2.81	2.87	2.71
Fuel and light	6.8	-1.67	-1.83	-1.39
Miscellaneous	28.3	4.32	4.26	4.19

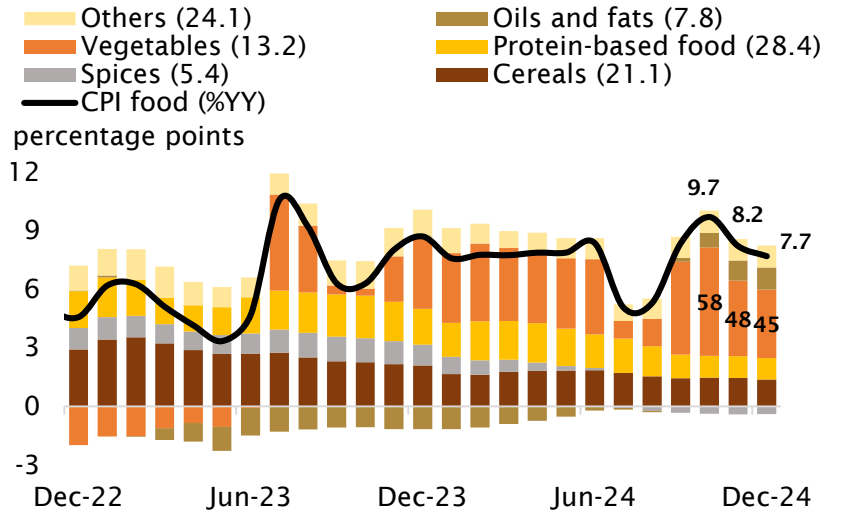
Monthly momentum eased across most major groups

%MM, NSA	Weight	Oct-24	Nov-24	Dec-24
Headline CPI	100.0	1.34	-0.15	-0.56
Food	45.9	2.25	-0.48	-1.20
Intoxicants, etc.	2.4	0.19	0.10	0.19
Clothing	6.5	0.36	0.26	0.21
Housing	10.1	0.94	0.16	-0.71
Fuel and light	6.8	-0.06	-0.11	0.62
Miscellaneous	28.3	0.43	0.22	0.16

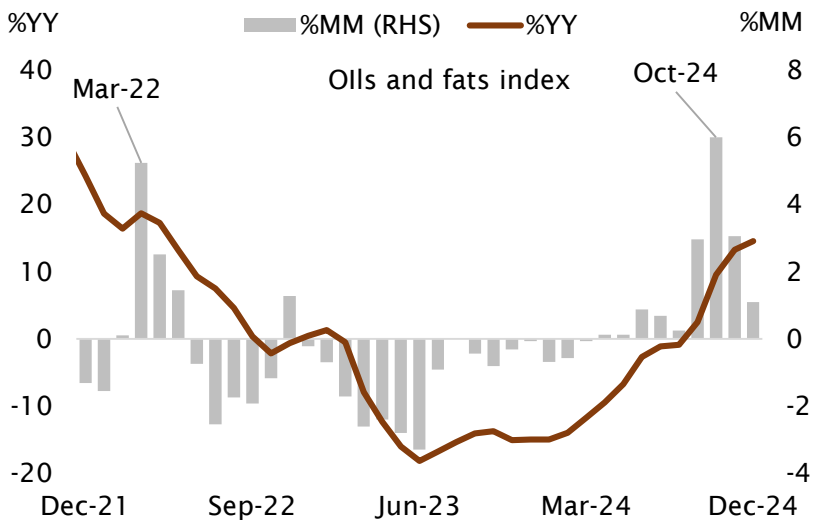
Despite correction in vegetable prices, food inflation remained high

- Food inflation eased to 7.7% in December from 8.2% in November due to month-on-month fall in prices that offset unfavorable base effects. The food index fell 1.20% month-on-month, steeper than the historical decline (FY12-24) for the month at 1.12% (average) – 1.13% (median). Among 12 major sub-groups, prices fell in six categories – meat and fish, fruits, vegetables, pulses, sugar and confectionary, and spices. But the decline in case of fruits and vegetables was slightly below historical trends, in terms of both average and median.
  - Vegetables, with a weight of 13% in the food index, continued to add the most to food inflation, though 45% contribution marked a moderation from the recent peak of 58% in October. However, contribution of major vegetables to food inflation – tomato, onion, potato – rose to 47% from 39% in November. Inflation in potatoes remained elevated at more than 60%, swung to double digits in case of onions after reaching 17-month low in November, even as it continued to moderate in case of tomatoes from the recent peak of over 160% in October. Fiscal year-to-date inflation in vegetables has more than doubled to 26.3% from 11.1% in April-December FY24.
- In addition to fruits and vegetables, the sub-groups that continued to add the most to food inflation in November were cereals, edible oils, and prepared meals. Edible oils posted double-digit inflation for the second straight month, reflecting the impact of import duty hike effective mid-September and rising global prices. Inflation in prepared meals rose for the fourth consecutive month but remained benign at 4%.

Food inflation eased but stayed above 6% in December



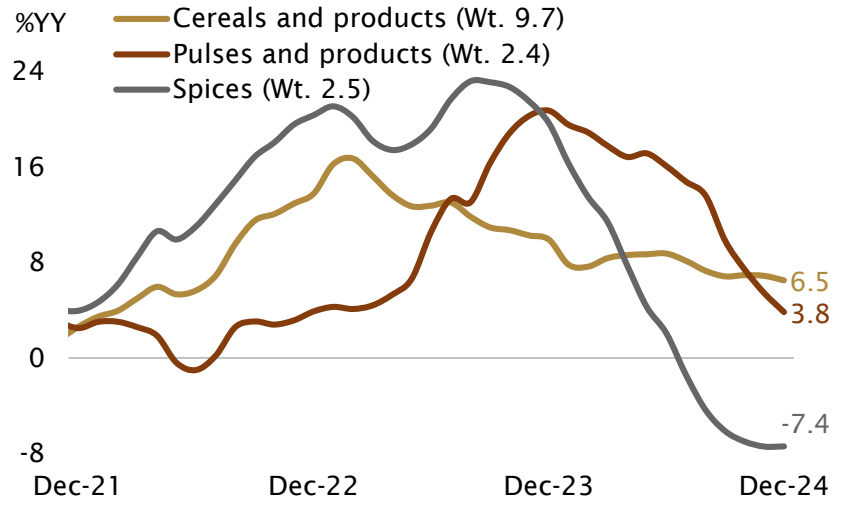
Rapid rise in edible oils inflation



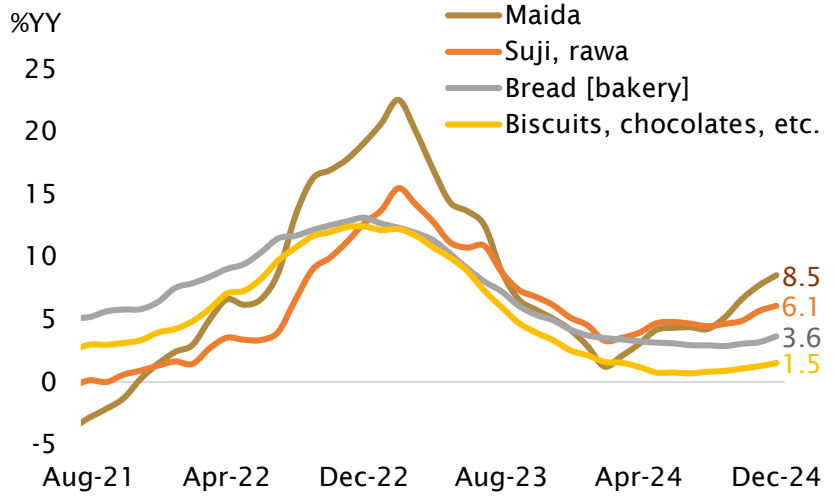
Second order effects of high food inflation starting to reflect in data

- There is increasing evidence that persistently high inflation in primary food items is starting to trickle down to certain groups within the CPI basket, as part of second order effects. For instance, increase in inflation in domestic servant/cook category within household goods and services could be attributable to high food inflation, while gains in prices of prepared meals partly reflect the impact of rise in edible oil prices.
  - For most of FY24, in addition to vegetables, inflation in cereals, pulses and spices were sources of concern for overall food inflation. However, these trends have changed in FY25. Inflation in pulses slipped below 4% in December, and spices have been in deflation for six months now. Recent prints show that while cereals continue to remain plagued by month-on-month momentum, this increase is notable in certain items that are derivatives of primary items such as rice and wheat. As a result, inflation in cereals remains sticky and the pace of disinflation could continue to remain tardy if these second order effects continue to exacerbate.

Inflation in cereals inflation remains sticky…



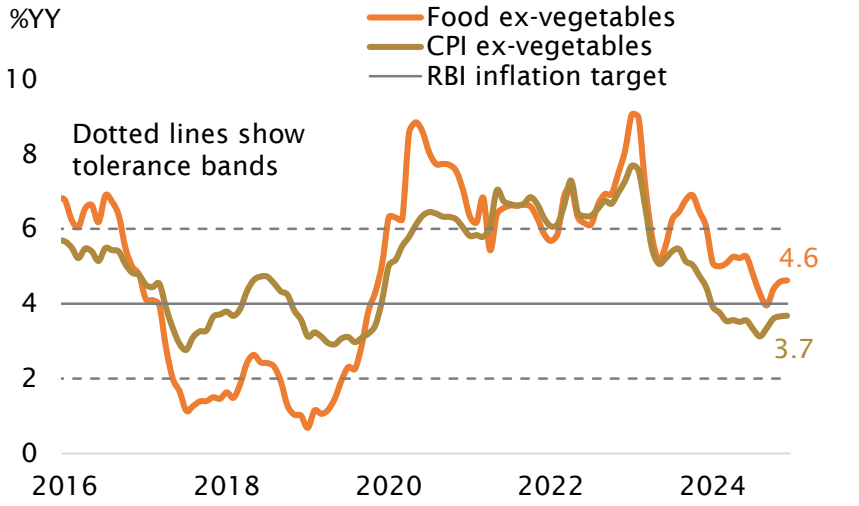
…and starting to trickle down as second order effects



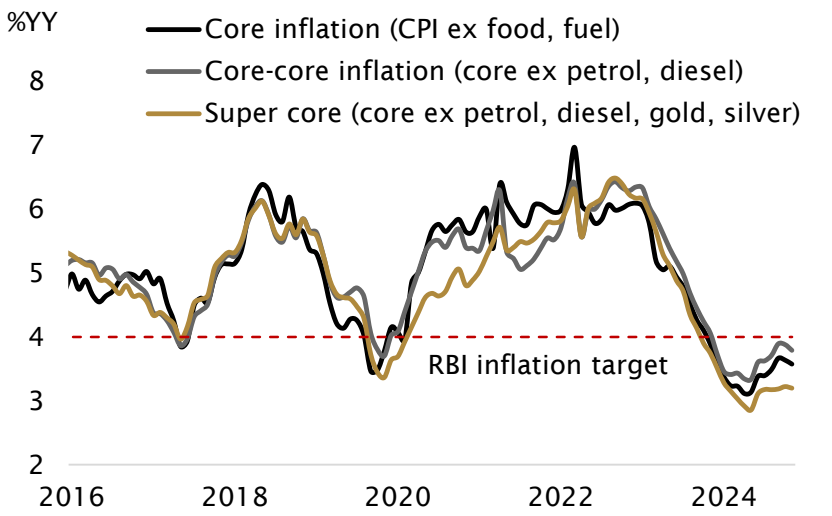
Various measures of core inflation remain benign

- Core inflation (ex-food, fuel) remained largely stable in December, and in fact, eased fractionally to 3.58% from 3.64% in November. Compared to the previous month, inflation eased across most major categories except for pan, tobacco, intoxicants; health; and recreation.
  - In terms of goods versus services classification, the fractional uptick in core goods inflation was more than offset by a mild moderation in core services inflation. The modest rise in core services inflation post the telecom tariff hike effective July 2024 has stabilized. However, as a result of the tariff hike, transport and communication category has become the second largest contributor to core services inflation after housing, displacing the education sub-group. The marginal rise within core goods was the result of higher inflation in the intoxicants group, household goods and services, health, personal care.
  - In December, various measures of core inflation remained benign and below 4%. In fact, excluding the volatile vegetables component, CPI inflation has been below 4% since January 2024. Food ex-vegetables inflation also slowed to 4% in September 2024 but further moderation was arrested by the surge in edible oil prices due to the import duty hike.

Since Jan-24, CPI ex-veg sub-4% and food ex-veg below 6%



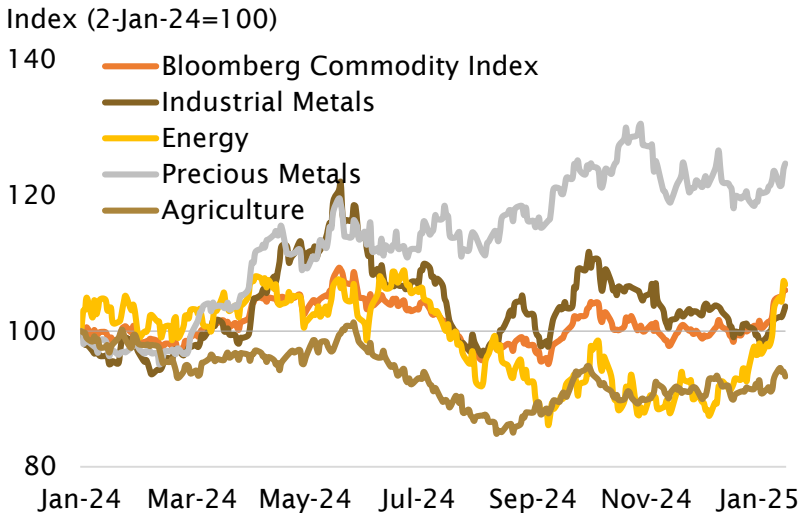
Different measures of core inflation remain below 4%



Domestic fuel index stayed in deflation amid rising global energy prices

- The domestic fuel and light index has been in deflation since September 2023, though at a shallower pace of (-)1.4%YY in December, compared to (-)1.8% in November. There was a mild uptick in inflation in electricity and coal sub-indices, even as kerosene, LPG, and diesel sub-groups remained in deflation.
- Global commodity prices have been gyrating to multiple triggers over the past few weeks.
  - Brent spot breached USD80/b in mid-January for the first time in three months following tighter US sanctions against Russian oil, higher demand from Europe and the US due to weather conditions, and expectations of stronger economic stimulus by China. In addition to hopes around stimulus, China GDP data for the entire year came in line with the government's target, which also triggered a relief rally in industrial metals such as copper. Even as uncertainty over monetary, fiscal, and trade policies in the US sustained demand for safe haven assets such as precious metals, price gains were capped by the US-brokered ceasefire between Israel and Hamas that tentatively reduced geopolitical tensions.
- The Bloomberg spot index rose over 5%YY in December, similar to the increase in May 2024, when a spike in industrial metal prices had lifted the overall index, in addition to the ongoing rally in precious metals due to demand for safe haven assets. While the latest gains were again supported by precious metals, they were also driven by energy, livestock, and industrial metals. Inflation in livestock is also reflected in higher prices of meat and diary products in the UN FAO index, which has been rising year-on-year since September after remaining in deflation for 21 months. Within the FAO index, inflation in edible oils has increased the most, which is trickling to domestic CPI, particularly post the import tariff hike.
- In its latest note, the OPEC kept global oil demand forecast for 2025 unchanged at 1.4mb/d, and expects it to remain strong at around the same level in 2026. At its meeting in Dec-2024, the OPEC+ postponed unwinding of production cuts to April from January, which according to the US EIA is expected to keep upward pressure on oil prices in early 2025, post which prices are expected to decline from mid-2025 through end-2026, as growth in global oil output outpaces growth in demand. The EIA has forecast Brent price to average $74/b in 2025 and $66/b in 2026, below the average of $81/b in 2024.

Global energy prices on the rise; Brent crossed $80/b



Outlook

- **Assessing historical trends:** The headline CPI 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. In January, base effects are slated to be mildly negative for headline inflation, adding around 0.11pp but favorable for core inflation, shaving off around 0.25pp. Historical trends (FY12-24) based on average and median month-on-month change indicate headline inflation in January at about 5.1-5.2% and core inflation around 3.7%. Also, high frequency data on certain food items in January so far indicates a downward bias to headline CPI, raising probability of the print slipping below 5%.

- **High frequency data:** Daily data from the Department of Consumer Affairs (as on January 17) shows easing in prices of major vegetables (tomato-onion-potato), cereals, and pulses vis-à-vis December. In fact, data indicates deflation in certain items such as tomato, 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 January.

- **Rabi sowing:** As on January 10, rabi sowing was above last year's levels across major crops, except oil seeds. However, sowing of pulses was mildly below normal area sown during the season (FY17-21 average), and more so in case of rice (normal area considered as FY23 and FY24 average). As on January 2, Rabi sowing of key vegetables (tomato, onion, potato) was above last year's levels but below normal area (FY20-24 average).

- **Rainfall and reservoir conditions:** In the post-monsoon season (October-December), cumulative rainfall was 97% of its long-period average (LPA). Data for the initial two weeks of January shows that total winter rainfall was 63% below LPA but expected to improve in the remainder of the month. La Nina conditions, though weak, are prevailing over the Pacific Ocean and are expected to persist through January-March, which bodes well for Rabi crop prospects. Data till January 16 shows that reservoir levels across regions and in the country as a whole were above normal and last year's levels, except for the north that continued to record deficiency.

- **Procurement and stock:** In Kharif Marketing Season (KMS) 2024-25, 313.13 LMT of paddy had been procured (up to Dec 31) versus 300.15 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 on December 31, wheat and rice stocks in the central pool totaled 475.03 LMT, higher than 345.29 LMT in the same period of 2023.

Policy implication

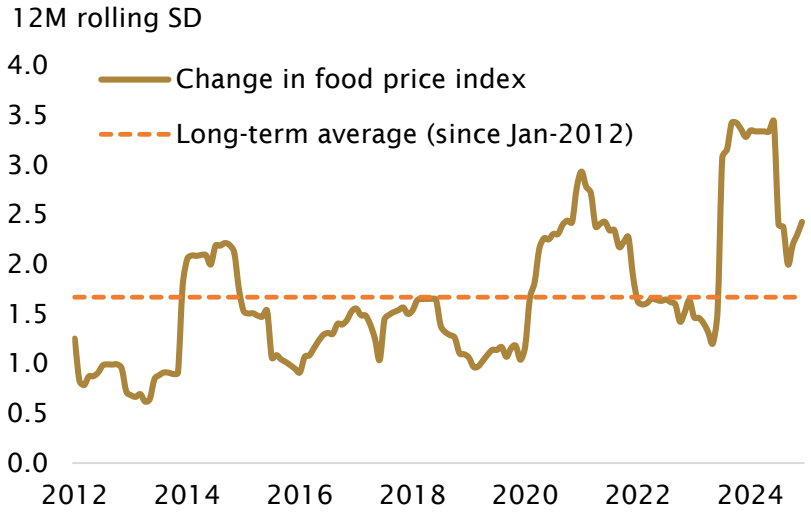
- **Government intervention:** The progress in aligning inflation to the central bank's target hinges on curbing volatility in food inflation, which necessitates supply side measures by the government such as selling major food grains and horticulture items at subsidized rates. While the government has been actively monitoring and intervening in the market, it has also been adopting policies to ensure support to farmers and thereby, boost farm sector prospects. Some of these are noted below. In this regard, the upcoming Union Budget for FY26 would hold important cues for the sector outlook that could further support the disinflation process.
  - In mid-January, the Union Cabinet approved continuation of Pradhan Mantri Fasal Bima Yojana and Restructured Weather Based Crop Insurance Scheme till FY26, which includes allocation for setting up of Fund for Innovation and Technology for technology improvements in insurance schemes.
  - In December 2024, the government launched a Credit Guarantee Scheme for e-NWR Based Pledge Financing (CGS-NPF) to support post-harvest financing for farmers. Under this scheme, farmers can access credit by pledging their produce stored in Warehousing Development and Regulatory Authority (WDRA) accredited warehouses, backed by electronic negotiable warehouse receipts (e-NWRs).

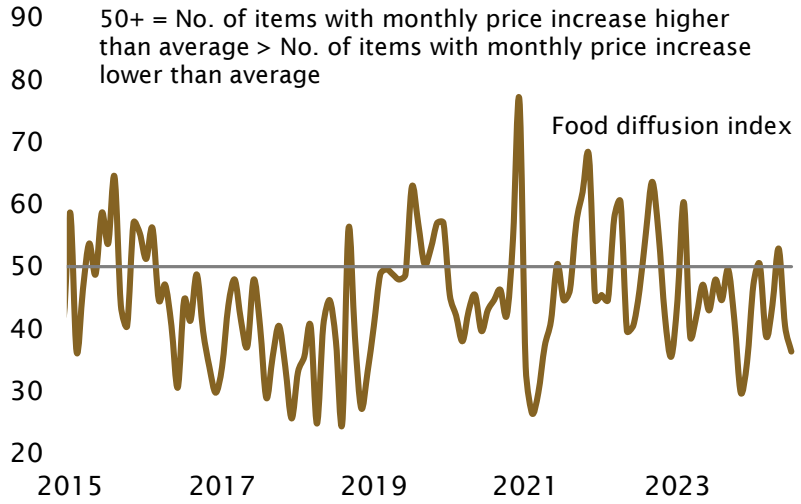
  However, uncertainties related to weather and pass-through from global prices continue to pose risks to inflation and need to be watched out for.

- **Rupee depreciation and policy implication:** In addition to food price shocks that continue to roil headline CPI, recent weakening of USDINR has triggered the risk of increase in imported inflation that could derail the disinflation trajectory.
  - As per the latest bi-annual Monetary Policy Report (MPR) of the RBI, published in October 2024, baseline inflation projections for the last quarter of FY25 and FY26 are pegged at 4.2% and 4.1%, respectively under the assumption of USDINR at 83.5/USD in H2-FY25. However, the INR has depreciated a lot more in recent months, slipping to 86.6/USD on January 16 from 84.0/USD three months back. Compared to the baseline assumption, depreciation has been to the tune of 3.7%, which is close to the 3.8%YY decline in year-to-date terms against the USD. The MPR notes that if INR depreciates by 5% over the baseline, it could lift inflation higher by 35 bps, and vice versa. The impact on growth would be lower at 25bps and in the reverse direction due to short-term boost to exports in the event of depreciation.
  - The recovery in high frequency indicators of economic activity continues to be underwhelming, which calls for some fine-tuning of the policy rate, particularly post the CRR cut at the December MPC meeting. However, the increasing evidence of second order effects of persistently high inflation in primary food articles, and the recent INR depreciation are likely to keep the policy easing cycle a shallow one.

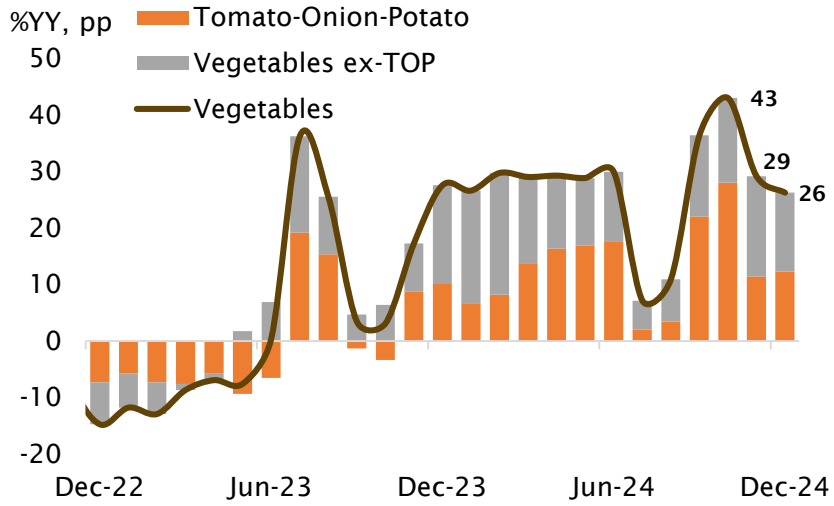
Appendix I

Food price volatility remains as concern; less items posted above average month-on-month price gains in December





Key vegetables added slightly more to inflation in Dec



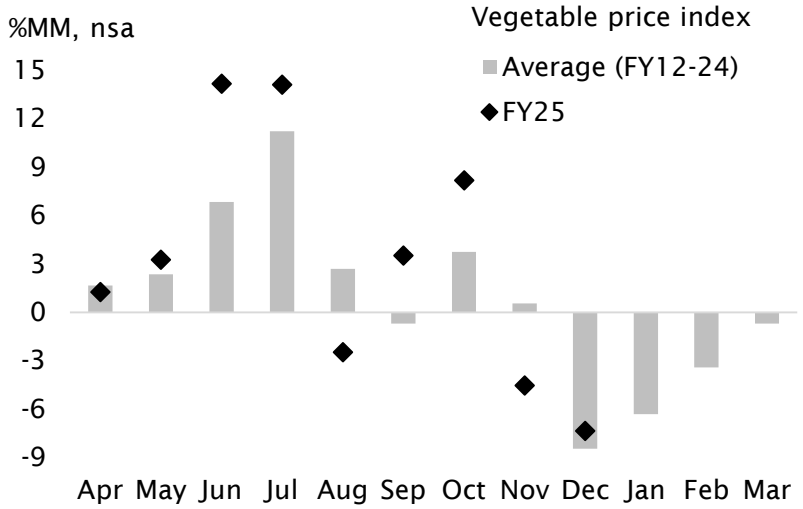
Daily data shows easing in key vegetable prices in Jan

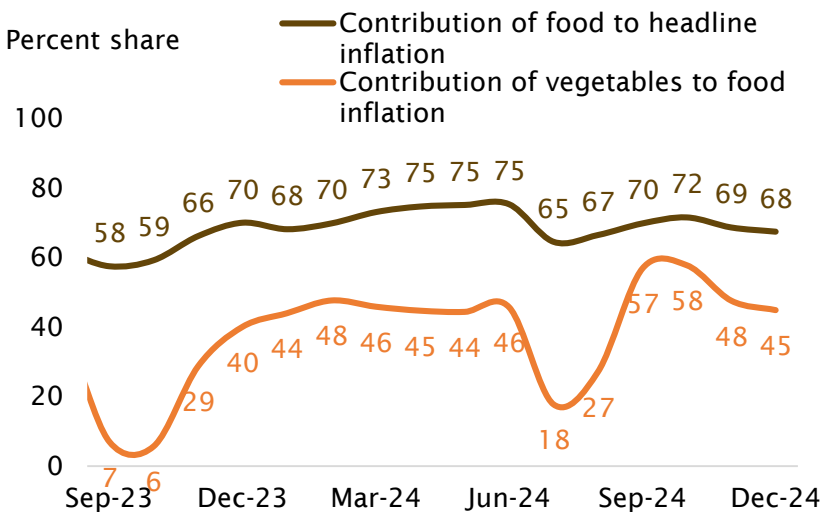
%YY	Tomato	Onion	Potato	Vegetables
Wt. in CPI	0.57	0.64	0.98	6.0
Oct-24	161.0	51.9	64.9	42.2
Nov-24	41.8	5.5	66.5	29.4
Dec-24	31.3	11.0	68.2	26.6
Jan-25*	-1.5	2.2	37.4	
%MM				
Oct-24	48.7	5.8	0.2	8.2
Nov-24	-23.4	2.6	-0.1	-4.5
Dec-24	-16.1	-11.8	-4.9	-7.4
Jan-25*	-28.4	-21.4	-14.6	

Note: *All India retail price till Jan 15.

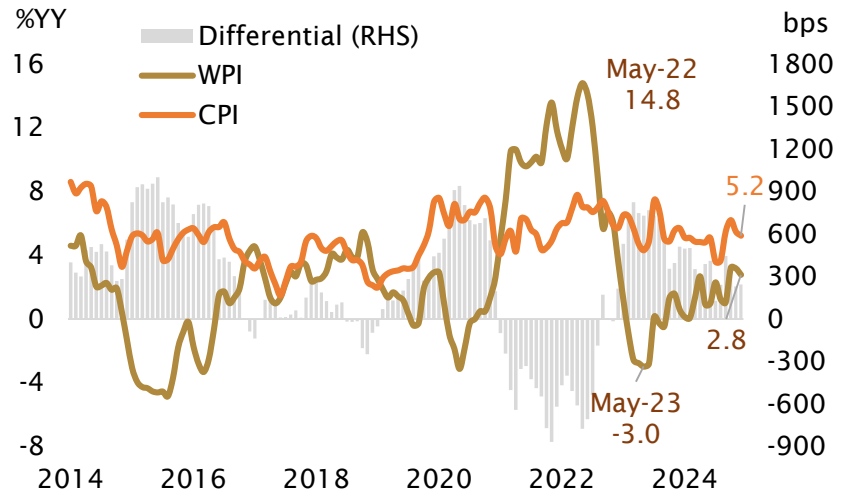
Appendix II

Though seasonal fall in vegetable prices was below average in December, their contribution to food inflation eased

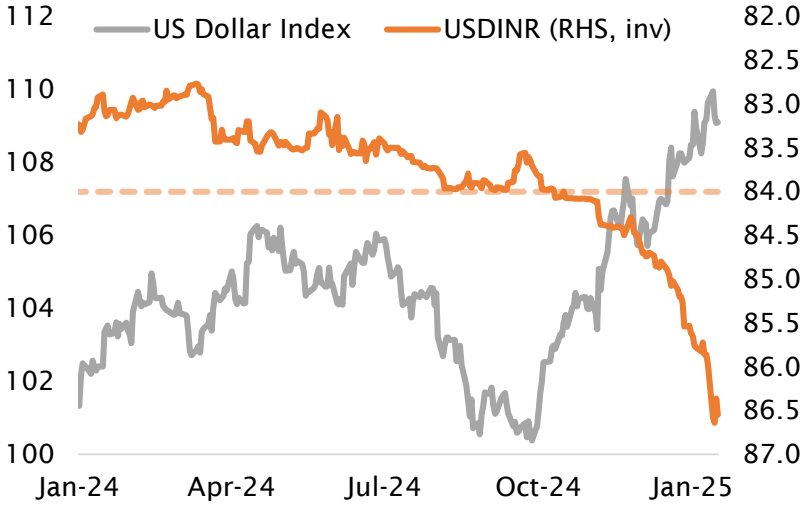




CPI-WPI differential is narrowing



Imported inflation a risk amid weakening USDINR



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