Research

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CPI creeps higher

CRISIL First Cut | November 2017

CPI ticks up 30 bps to 3.6% on costlier food, lower overall fuel inflation caps upside

Consumer price index (CPI)-based inflation jumped to a seven-month high of 3.6% in October, compared with 3.3% in September. The pick-up was driven by food inflation, which rose over 60 basis points (bps) on-month to 1.9%, while fuel inflation fell 30 bps to 6.1%, and core inflation edged up 10 bps to 4.5%.

Food inflation crept higher as vegetable prices surged because of unseasonal rains. Retail prices of onion and tomatoes – which have large weights in the food index – nearly doubled since September with consumers paying nearly Rs 40 per kg for each even in November.

Inflation in cereals and pulses continued to ease backed by near-normal southwest monsoon and bumper crop from last year. Healthy agriculture production will ensure that food inflation stays in check this fiscal, too. Also, global food inflation is forecast to stay benign, which will cap upside to domestic food inflation.

Meanwhile, core inflation edged up 10 basis points this month to 4.5%, led by higher inflation in housing, personal care and effects and clothing and footwear. The nature of these items – most of the pick-up is in services-related items -- suggests that part of the higher inflation could have been due to the implementation of Goods and Services Tax (GST). GST rates for most services are higher than the erstwhile service tax rate.

Overall fuel inflation *(fuel and light and petrol and diesel)* eased 30 bps to 6.1% on-month, led by lower inflation in petrol and diesel, which had seen a sharp increase in the preceding months. Inflation in liquefied petroleum gas (LPG), kerosene and other imported fuels continued to rise. With crude oil prices shooting up by ~14% on-year and rupee weakening, India's import bill can have a bearing on inflation.

In the months ahead, inflation could see an upside from further rise in oil prices and higher household spending led by (i) implementation of farm loan waiver and (ii) an expected upward revision in salary and allowances of state government employees. The Reserve Bank of India (RBI) expects CPI inflation to average 4.2-4.6% in the second half, up from 2.6% in the first half of fiscal 2017. Yet, domestic food inflation, which is largely expected to stay low, will play a key role in keeping overall inflation in fiscal 2018 low.

Our base case is CPI averaging 4% this fiscal (4.5% in fiscal 2017) with the RBI holding rates. If the downside risks to growth rise, and inflation materially undershoots the Monetary Policy Committee's forecast, only then there is a possibility of a rate cut. Second-quarter GDP data (to be released on November 30) will also influence the RBI's decision. If growth declines further, it can potentially bring down core inflation, too. A dip in core can provide a faster downside to overall inflation.

Data snapshot

- Food inflation crept higher to 1.9% in October from 1.3% in September. The pick-up was mainly led by a sharp jump in inflation in vegetables, milk and eggs. Vegetables' inflation rose to a 15-month high of 7.5%, up from 3.9% in September driven by higher prices of onion and tomatoes. Inflation in eggs also climbed up to 0.7% from -0.2%, while that in milk rose to 4.3% from 3.9%. Meanwhile, pulses capped the upside to the food index with inflation in this commodity slipping to -23.1% from -22.5%. Inflation also softened in cereals, meat and fish, oils and fats, and fruits.
- Fuel inflation, calculated by adding petrol, diesel, fuel and light components, eased to 6.1% from 6.4% in September. Within this category, while inflation in petrol and diesel dipped to 5.1% from 9.7%, that in fuel and light jumped to 6.4% from 5.6% driven by higher inflation in LPG and kerosene. During October, prices for the Indian crude oil basket surged 2.8% on month and 13.8% on-year, while rupee also weakened 1% on-month, pushing up the import bill.
- Core inflation (CPI excluding food, fuel and light, petrol and diesel) edged up 10 basis points this month as well, to settle at 4.5%. This was primarily led by higher inflation in housing (up to 6.7% from 6.1%), personal care and effects (up to 3.4% from 2.9%) and clothing and footwear (4.8% from 4.6%).

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