CPI Inflation - A Pressing Concern, Food Inflation - Too Costly A Component, Reveals Data for July 2023*

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The all India y-o-y CPI inflation scaled to 7.44% in July 2023, reaching a 15 months high and is much higher than the market expectation of 6.5%. The inflation rate was 4.8% in June. The sharp increase in the July inflation caused the Monetary Policy Committee (MPC) to revise the projection for the second quarter from 5.2% to 6.2% and for FY 2024 the projection has been revised from 5.1% to 5.4%. Even this may be revised upwards if the food inflation rate does not come down within the next few days. It is not surprising that the MPC did not change the repo and reverse repo rates and mandated an additional cash reserve ratio of 10% on the incremental net demand and time liabilities recorded between May 19, 2023 to July 28, 2023.

Food inflation has spiked extremely high at 11.4% on the back of very high vegetable prices inflation (37.34%). This has severe implications for the lower income groups whose major part of income is spent on food expenses. They may be compelled to forego some very basic food items including vegetables and pulses (inflation 13.27%). However, an aspect of respite in the food prices is that inflation in oils and fats has dropped down to -16.80% y-o-y in July 2023.

Another aspect of the inflation trajectory that deserves consideration is that though the headline wholesale inflation stood in the deflationary zone (1.4%) for the fourth consequent month in July 2023, its food inflation component stood elevated at 14.3% from 1.3% in June 2023, the highest in nearly 10 years. This also highlights the pressure on food inflation and may contribute to sustaining inflationary concerns in the medium term.

The inflation trajectory highlights downside risks to growth as inflation for Q2 FY2023-24 is likely to be much higher than expected. Downward risks persist though we expect the core inflation to stay below 4.9%. Further, though the core inflation still stands below the upper tolerance limit of the inflation target of 6%, the MPC will have to remain vigilant to ensure it stays so. Considering the overall objective of brining the inflation rate down to 4%, there is no possibility of the MPC reducing the interest rates in the near term. In fact, the MPC may be forced to raise the policy rate if the core inflation rate crosses the upper tolerance limit until the next MPC meeting in early October. This may adversely impact growth. It may be noted that the MPC has already increased the policy rate by 250 basis points since May 2022.

*** Views are personal.**

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