



**ECONOMIC  
RESEARCH**



**INFLATION REVIEW**



# Uptick in Inflationary expectations warrants cautious approach by MPC

Economy Report

## CPI Inflation crosses MPC mid-point target of 4% in October 2019

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### Contacts

#### Dr M Govinda Rao

Chief Economic Advisor

+9180 40409940

[govindrao.m@brickworkratings.com](mailto:govindrao.m@brickworkratings.com)

#### Anita Shetty

Research Editor

+91 22 28311426

[anitashetty@brickworkratings.com](mailto:anitashetty@brickworkratings.com)

- The Consumer Prices Index (CPI) increased by 4.62% year-on-year for October 2019, largely due to continued rise in vegetable prices.
- Core inflation actually slipped to 3.5%, its lowest level in the current series.

As per the provisional estimates on CPI inflation released by MOSPI on 13 November 2019, the Consumer Prices Index (CPI) increased by 4.62% for October 2019, on account of sharp uptick in food price inflation which crossed 39-months high. The CPI inflation also touched a 16-month high in October 2019.

Easing Core Inflation (excluding food and fuel) to 3.5%, lowest in the current series, provides some respite. The current level of increase in CPI inflation is elevated by spike food inflation, particularly from vegetables and fruits (increasing onion prices is a main contributor) perhaps caused by unseasonal rains.

Table 1: Inflation rate in CPI and its Major Components

Groups	Weights (%)	Rate (Y-o-Y in %)		
		Oct-18	Sep-19	Oct-19
<b>CPI Combined (1+2+3+4+5+6)</b>	<b>100.0</b>	<b>3.38</b>	<b>3.99</b>	<b>4.62</b>
<b>1. Food and beverages</b>	<b>45.9</b>	<b>-0.14</b>	<b>4.70</b>	<b>6.93</b>
<b>2. Pan, tobacco and intoxicants</b>	<b>2.38</b>	<b>6.07</b>	<b>4.59</b>	<b>3.92</b>
<b>3. Clothing and footwear</b>	<b>6.53</b>	<b>3.55</b>	<b>0.96</b>	<b>1.65</b>
<b>4. Housing</b>	<b>10.07</b>	<b>6.55</b>	<b>4.75</b>	<b>4.58</b>
<b>5. Fuel and light</b>	<b>6.84</b>	<b>8.55</b>	<b>-2.18</b>	<b>-2.02</b>
<b>6. Miscellaneous</b>	<b>28.32</b>	<b>6.73</b>	<b>4.45</b>	<b>3.45</b>
<i>Consumer Food</i>	<i>39.06</i>	<i>-0.86</i>	<i>5.11</i>	<i>7.89</i>
<i>Core *</i>	<i>44.91</i>	<i>6.19</i>	<i>4.00</i>	<i>3.45</i>
<b>Note: The weights are indicative to show relative importance of groups</b>				
<i>*calculated (excluding 'Food &amp; Beverages', 'Pan, Tobacco &amp; Intoxicants' and 'Fuel &amp; Light')</i>				
<b>Source: Mospi, BWR Research</b>				

## Government's initiatives to arrest Food price inflation

### Government's efforts to arrest sharp spike in Food prices

Tomato producing States were requested to facilitate augmenting the supply from their respective States to regions which are in short supply to improve availability.

Major Tomato producing States were advised to interact with APMCs, Traders and Transporters to ensure regular supply. In the meantime, Andhra Pradesh Horticulture Commissioner been asked to dispatch the fresh Tomatoes immediately for augmenting supplies in major demand

To augment availability of Pulses across the nation, agencies like Kendriya Bhandar and Safal were advised to utilise the pulses available in the Central buffer to lower their retail prices.

NAFED was directed to release Pulses as sufficient stock of Pulses are available with the Government. It was directed to undertake disposal of Pulses from the central buffer through States Governments and open market auctions.

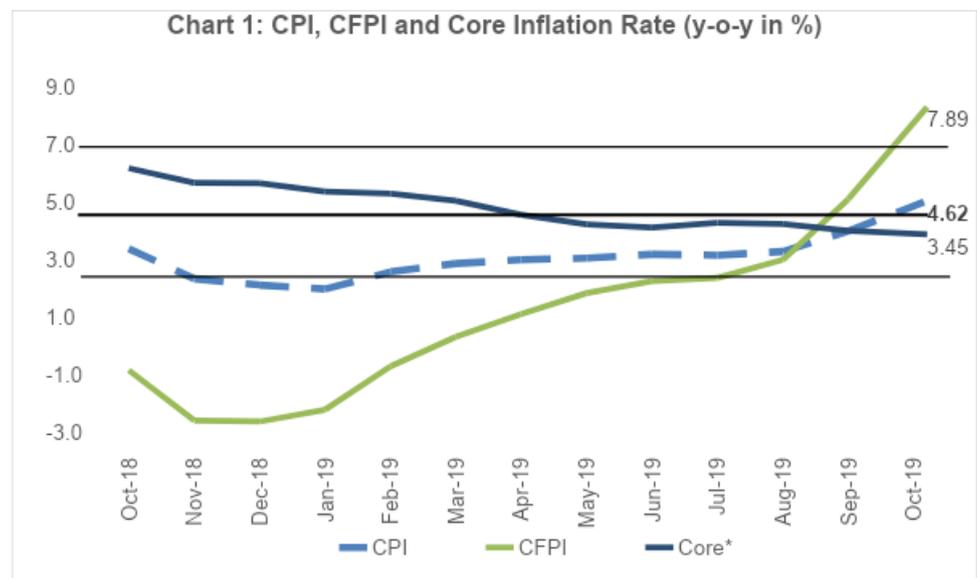
Source: PIB Releases, compiled by BWR Research

Vegetable prices increased sharply in September and continued to rise in October 2019, (inflation in Onion stood at 98%), largely due to disrupted production and supply conditions after the flood-like situation witnessed in the country across regions. The Ministry of Consumer Affairs took several key decisions to limit sudden rise in prices particularly of Onions in September. Further during October, the government reviewed the price and availability situation of Onions, Tomatoes, Pulses, Oil seeds and took several decisions to augment their supplies. Though the unseasonal rains and floods disrupted production and supply conditions, the pick-up in arrival of kharif vegetables expected to soften the vegetable prices from November onwards. Pick up in kharif Onions and Tomatoes may also help to moderate prices in the coming days.

### Deflation in fuel prices and easing core inflation offsets sharp rise in food inflation

Food Price Inflation rose to 7.89% in October 2019 as the prices of vegetables, pulses and meat and fish accelerated significantly. On the other hand, 'Fuel and light group' continued with deflationary trend for the fourth straight month, offsetting the rise in food inflation (Chart 1 and Table 1).

Sustained fall in crude oil prices helped easing domestic fuel prices, resulting in deflation in fuel items. If the trend continues, maintaining inflation at RBI MPC's mid-point target of 4% level becomes easier. However, the U-turn in inflation trajectory that had begun from February 2019 seems to have sustained till October (except a marginal fall in July). On facts, the MPC of the RBI is caught between the 'rock and the hard place' in deciding the policy rate as the GDP growth in the second quarter is expected to be below 4.5% and the inflation rate at 4.62% has crossed the mid-point in the range. The pressures are emanating from the food group, it would not be easy for the RBI to ignore these pressures as the monetary easing cycle has also started from February 2019.



\*calculated (excluding 'Food & Beverages', 'Pan, Tobacco & Intoxicants' and 'Fuel & Light'), Data is provisional.

Source: www.mospi.gov.in, BWR Research

## Industry Perspective

“My projection is the closest to the actual headline CPI, which has come in at 4.62%. This was expected given the spikes in vegetables, meat & fish and egg prices due to disruption in transportation caused by excessive and unpredictable rains. Inflation in pulses too is on the higher side due to demand-supply mismatch. However, core inflation has collapsed to 3.44% in October versus 4.01% in September due to broad based weakness in demand. While the RBI will continue to provide comfort on the liquidity front, it makes sense to take a pause in the rate cutting cycle. The need of the hour is to boost investment confidence at the individual sector level through corrective measures and a fiscal boost.”

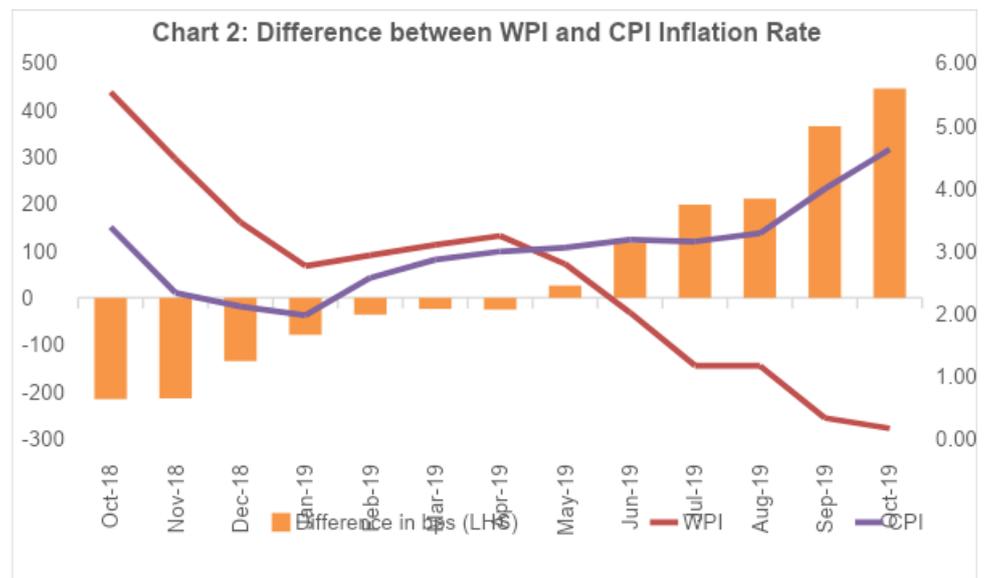
**Adds Rupa Rege Nitsure, chief Economist, L&T Finance Holdings Ltd.**

Disclaimer: Views expressed by the third-party industry commentators and experts is personal and not the view of Brickwork Ratings.

## Diverging Trends between WPI and CPI

Based on the latest available data on WPI and CPI inflation, the difference between these two inflation indicators widened sharply as CPI Inflation accelerated to 4.62% in October 2019, but WPI inflation plunged to 0.16%. In the last five months, inflation in WPI has consistently moved downwards, CPI inflation moved in the opposite direction (Chart 2).

The gap between CPI and WPI widened to 450 basis points (, the level observed in August 2016). The diverging Inflation in CPI and WPI is not new, but sudden fall in WPI and rising trend in CPI is a renewed concern. The widening gap between these two inflation indicators are largely due to the changes in the price levels of the selective items included in these two inflation baskets which differ from each other. For instance, in CPI, food items constitute a major chunk of ~39%, whereas in WPI they constitute only 24%. Though MPC doesn't take into consideration WPI inflation while deciding the monetary policy actions, low level of WPI indicates sagging manufacturing sector, as it comprises 64% of the WPI basket.



Source: [www.mospi.gov.in](http://www.mospi.gov.in), [eaindustry.nic.in](http://eaindustry.nic.in), BWR Research

## Rising CPI inflation warrants cautious approach by MPC

First time in 15-months, the CPI inflation crossed mid-point target of MPC, hence the scope of continued monetary easing cycle may be restrained. Yet, given the underlying economic concerns and expected further slowdown in GDP during the second quarter, the MPC may decide to maintain its accommodative monetary policy stance.

Although the flexible inflation targeting framework has some more scope for rate cuts, the MPC may take a cautious stance in deciding the quantum of rate cuts, if the trend of increasing retail inflation continues. The October inflation has already exceeded the MPC's projections of 3.5-3.7% for H2:2019-20, and the month-on-month or sequential rise in inflation rate is much quicker than before. Despite 10% higher rainfall than the Long Period Average (LPA), unseasonal rains and delayed withdrawal of monsoon damaged most of crops output. BWR feels CPI inflation to continue to remain within the RBI's target, but may inch up further in November.

Despite some positives such as a drop in the core inflation, the unfavourable dynamics of inflation comes through the food segments of vegetables and fruits. Though it is a supply-side issue, BWR feels that the RBI will maintain caution on monetary policy, but very likely to go with one more slice of rate cut. The core inflation is still lower at 3.5%, hence considering the low GDP growth which is expected to slow-down even more during the second quarter, the MPC may decide to cut the repo rate by ~25 basis points in the upcoming monetary policy.

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