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PRICE PRESSURE SEEN RISING FURTHER IN MARCH

Inflation hits 8-month high

Analysts say RBI falling behind the curve

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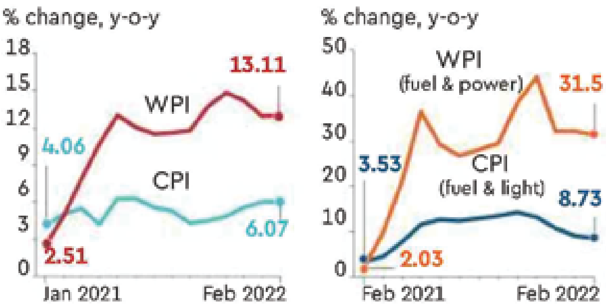
RETAIL INFLATION SCALED an eight-month peak of 6.07% in February, having hit the upper band of the Reserve Bank of India's (RBI's) medium-term target of 2-6% for a second straight month, as food inflation rose to its highest since November 2020 and price pressure in the fuel segment continued to remain sticky.

As oil marketing companies are set to soon pass on the spike in global crude oil prices to consumers after a tactical pause in the build-up to crucial assembly polls, inflationary pressure is only going to exacerbate in March, analysts caution. The latest inflation print and the rising threat of 'imported inflation' might make the RBI's accommodative policy stance look a bit untenable. A growing number of analysts now feel that the RBI has been wrong on inflation assumptions, and that it continued to tolerate higher inflation.

Headline retail inflation will overshoot the central bank's 5.7% target for the March quarter (of course, its forecast was made before the flare-up of the Russia-Ukraine conflict), although a favourable base effect in fuel inflation will somewhat help from April-May.



Sources: MoSPI; Industry ministry

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Retail food inflation – driven partly by elevated prices of edible oils that are mostly imported and inconducive base effect – remained high at 5.85% in February, compared with 5.43% in the previous month. Core inflation, too, remained sticky at 5.86%, having exceeded the 5%-mark for 21 months now.

Fuel and light inflation, according to the consumer price index (CPI), continued to remain elevated (it was as high as 8.73%). It, however, is less vulnerable to global oil price shocks than the wholesale price index (WPI) for fuel and power that surged to 31.50% in February.

Headline WPI inflation, too, inched up to 13.11% in February from 12.96% in the previous month, having eased from November's 30-year high of 14.87%.

Elevated price pressure, on top of fragile industrial recovery, will compound the worries of policy-makers as they seek to soften the blow of the global oil price rise to the Indian economy as well as consumers. Any faster tightening of interest rates by the US Federal Reserve (although some analysts now believe the US central bank will be forced to delay the hawkish action given the Ukraine crisis) will only add to the woes of the government as well as the RBI. Last week, RBI deputy governor Michael Patra hinted at an upward revision of its FY23 retail inflation forecast of 4.5% and review of its economic growth projection of 7.8% for the next fiscal in April, as he cited the ongoing geopolitical tension. Many analysts have warned the RBI's inflation forecast for FY23 might be overshot by a significant margin; Nomura, for instance, put the figure at 5.8%.

However, given the risks to growth, the monetary policy committee (MPC) will likely continue with its accommodative stance in the April meeting and refrain from snuffing out economic recovery, although the tone may turn less dovish. But some analysts have pencilled in a 25 basis point hike in the benchmark lending rate in June if the Russia-Ukraine conflict lingers on for a while and prices of a broad range of commodities — from oil to fertiliser – continue to rise.

A 10% rise in crude oil prices, according to Nomura, typically leads to a 0.3-0.4 percentage point (pp) rise in headline inflation and shaves off about 0.20 pp from GDP growth.

India Ratings chief economist DK Pant said the persistently high CPI core inflation is driven by "structural turn" taken by certain segments, such as clothing & footwear, health, transport & communications and household goods & services.

Clothing and footwear inflation, Pant said, stood at a 99-month high in February on the back of elevated cotton prices. Household goods and services inflation hit 7.22%, a 96-month high. "Firms across sectors are increasingly passing on the high input costs into their output prices to safeguard their margins despite tepid demand," he said, expecting this trend to continue in the near term.

M Govinda Rao, chief economic adviser at Brickwork Ratings, said: "The price levels are likely to remain sticky in the next few months, despite the fading base effect, due to continued supply disruptions caused by the ongoing geopolitical developments and continued increase in prices of crude oil, edible oil and metals."

Aditi Nayar, chief economist at ICRA, said the transmission of elevated commodity prices to the WPI inflation will be relatively rapid. "However, in an uncertain demand scenario, output prices that reflect in the CPI basket may adjust relatively slowly," she said. Moreover, an eventual cut in the excise duty of fuel could absorb a portion of the impact of higher crude on the retail selling prices of petrol and diesel and, therefore, on the CPI inflation. Still, higher edible oil prices will exert pressure on the food inflation in March 2022, she added.