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Retail inflation inches up; RBI may continue 'accommodative' stance in FY22

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Upside risks on global oil, commodity prices, US Fed's tapering-rate hike fears loom.

Retail inflation inched up in October on the back of higher-than-expected food and fuel prices but remained within the central bank's comfort zone, official data showed. However, upside risks on account of global factors, including international commodity and fuel prices and the United States Federal Reserve's tapering persist.

The fuel tax cut by the government last week is expected to provide little comfort to the headline inflation number, according to economists, but may allow the monetary policy committee to continue with an accommodative monetary policy stance to support growth in the current fiscal, economists said.

The consumer price index (CPI)-based inflation rose marginally to 4.48 per cent in October from 4.35 per cent in October, data released by the National Statistical Commission showed on Friday. Food inflation increased marginally to 0.85 per cent in October 2021 from 0.68 per cent in September 2021 but contributed nearly half of the monthly increase in headline retail inflation.

"The uptick in CPI inflation in October relative to the previous month, while mild, was pretty broad-based, with the hardening in the inflation for clothing and footwear, and miscellaneous items suggesting that reviving demand is nudging producers in some sectors to pass through the input price pressures," said Aditi Nayar, Chief Economist, ICRA Ltd.

Fuel and light inflation jumped to its highest level in the new series in October 2021 at 14.3 per cent on the back of higher LPG and kerosene prices. The excise duty cut by the Centre on Diwali eve earlier this month is expected to have a limited impact on inflation going forward, feel economists.

Sunil Kumar Sinha, Principal Economist, India Ratings and Research said the impact of excise duty cut by the Union government and VAT reduction by more than 20 states on petrol and diesel in November 2021 will start reflecting from November 2021 in retail inflation. "While the first-round impact will lead to around 15bp reduction in retail inflation, the second-round impact through the reduction in freight cost will be felt in coming months," said Sinha.

Centre cut excise duty on petrol and diesel by Rs 5 and Rs 10, respectively, to lessen the burden of rising international crude oil prices on consumers and aid economic demand. It was followed by a reduction in value-added tax on petrol and diesel by over 20 BJP ruled states including Karnataka, Gujarat, Uttar Pradesh, Himachal Pradesh, Goa, Assam, etc. However, the weight of diesel in the CPI basket is just 0.15 per cent whereas the weight of petrol in the CPI basket is 2.2 per cent.

Petrol inflation rose to 27.19 per cent in October from 22.17 per cent in September. Diesel inflation shot up to 31.76 per cent in September from 22.38 per cent in the previous month.

Food and beverage inflation rose to 1.8 per cent in October from 1.6 per cent in September on a year-on-year basis. Vegetable prices contracted by 19.4 per cent in October versus 22.5 per cent in September. Cereals prices rose after a gap of 8 months. Cereal prices rose by 0.4 per cent in October. Inflation in Oils and Fats prices continued to remain elevated, at 33.5 per cent in October.

HDFC Bank in its note said that it expects inflation to rise above 5 per cent yet again from December, led by higher input/commodity prices and as favourable base effect wanes.

Nish Bhatt, Founder & CEO, Millwood Kane International said that the rise in food and vegetable prices is primarily responsible for the rise in inflation. Core inflation above 6 per cent is a cause of concern as we head for the next RBI policy in December, said Bhatt.

Economists expect the RBI to maintain an accommodative stance going forward but may take note of the impact of global factors. The US inflation surged to the highest rate in over 30 years, fuelling speculation that the Fed Reserve may raise interest rates sooner than expected. This may lead to capital outflows from India and put pressure on the rupee, making imports expensive, fuelling inflation. However, the impact is expected to be limited, feel economists. The US Fed decided to taper its ongoing quantitative easing programme worth USD 120 billion per month by a magnitude of USD 15 bn per month starting November.

Rumki Majumdar, Economist, Deloitte India said the monetary policy committee will like to see the impact of the US Fed's tapering (that starts late November) on India's capital flows and currency before acting.

"We expect that the RBI is not likely to change its policy stance and hold the rates at current levels in this fiscal but will closely monitor the liquidity in the system. The RBI will also have to take note of the impact of tapering in the Fed and the European Central Bank," said M Govinda Rao, Chief Economic Adviser at Brickwork Ratings.

Nayar of ICRA Ltd pointed out the opportune timing of the tax cuts on fuels, which should help to soften the November 2021 CPI inflation print, will help in preventing premature tightening in the December 2021 MPC review. "This will allow the committee to remain growth-supportive until the demand revival becomes more fully entrenched, said Nayar. She expects the MPC is likely to change the monetary policy stance to neutral only after there is additional evidence that the domestic demand revival has become durable, which is likely in the Feb 2022 review. "We expect this to be accompanied by a 15 bps hike in the reverse repo rate by the RBI," added Nayar.

Core inflation in October 2021 again breached the 6 per cent mark after a gap of three months. "A part of the jump in core inflation can be attributed to festive season demand, however, with health inflation turning structural, retail inflation is likely to remain around the 5 per cent mark in the third quarter of FY22. We expect retail inflation in FY22 to be in the 5-5.2 per cent range and expect RBI to continue with its accommodative monetary policy stance at least for the rest of FY22," said Sinha of India Ratings.