Perspective on the CPI data By Dr. M Govinda Rao, Brickwork Ratings

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Below is perspective on the CPI data By Dr. M Govinda Rao, Chief Economic Adviser at Brickwork Ratings

Although there is a marginal increase in the inflation rate in the last two months, it is below the market expectation of 5%. The food and fuel inflation are expected to be volatile due to exogenous factors like weather and global commodity prices. However, elevated level of core inflation at over 6 per cent in the last two months is a matter for concern. The fuel inflation eased to 13.35% from 14.35% following the softening international crude oil prices. The cut in excise duties has helped to ease the price a little. In addition to supply bottlenecks and adverse weather conditions, the consequences of higher transportation costs on other basket of goods is already evident with food inflation rising to 1.87% from 0.85% in the previous month.

With the prices of food items showing a steep rise due to unseasonal rains, and higher transportation cost and a shortage of chips affecting the manufacturing sector, the price situation requires close monitoring. The softening crude oil prices from the elevated levels may bring some respite to fuel inflation, while the hike in telephone tariffs may add to the problem. In addition, December month will not have a favourable base effect. We expect the December inflation to cross 5.5% and the third quarter inflation to remain below the RBI's inflation outlook of 5.1%.

Going forward, with the waning base effect, and improving domestic demand conditions, the inflation outlook for the remaining months also does not look bright. The Monetary Policy Committee of RBI has maintained the estimate of CPI inflation at 5.3% for FY22 in its December meeting but has increased the estimate for Q3 from 4.5% to 5.1% and reduced the Q4 inflation from 5.8% to 5.7%. Although the MPC did not highlight any serious concerns on inflation for the moment, it has continued the process of draining liquidity through variable reverse repo auctions at a faster rate. With the uncertainty surrounding the fuel and food inflation and core inflation steady at about 6% levels, RBI may continue to drain liquidity through variable reverse repo auctions, and the possibility of hiking the policy rates in the next MPC is minimal. We expect the RBI to continue with the accommodative monetary policy stance otherwise it poses risks to the recovery process.