THE WEEK

CPI inflation breaching upper target in consecutive months a matter of concern: Experts

Further price hikes likely as domestic demand is expected to improve gradually

By Abhinav Singh | July 13, 2021 14:47 IST

The CPI (Consumer Price Index)-based inflation remaining at 6.26 per cent in June is a matter of concern even as the economy has slowly started recovering from the second wave of the pandemic. Though there has been an easing of sequential momentum in both headline and core inflation, within food, perishables showed mixed trends while non-perishables were mostly lower month-on-month.

However, the most glaring aspect has been that fuel inflation shot up to 12.68 per cent, following rising crude oil prices on account of increasing international price of crude oil, with constraints on production in the wake of rising demand conditions.

Besides this, the IIP (Index of Industrial Production) surged 29.3 per cent in May amid a distorted base. Sequentially, industrial activity softened across sectors and the current levels are still below May 2019 levels.

"The first quarter has already breached the RBI's inflation outlook by 40 basis points to 5.6 per cent. With this, the inflation outlook of 5.1 per cent for the full fiscal by the RBI looks challenging. Going forward, with the lifting of the lockdown in phases, domestic demand conditions are expected to improve gradually, and this may lead to a further increase in prices. We expect the MPC (Monetary Policy Committee) to revise its inflation outlook upwards both for the second quarter as well as for the full fiscal in its upcoming policy meeting. With commodity prices rising, and the uncertainty surrounding the inflation outlook, it remains to be seen for how long the MPC will continue with the accommodative monetary policy stance. Considering the emphasis given by the RBI Governor in the recent interview, they may continue with the accommodative policy in the near term. However, if the situation persists, balancing growth and inflation would become a real challenge and would call for close monitoring," remarked M. Govinda Rao, Chief Economic Adviser, Brickwork Ratings.

He feels that as far as fuel inflation is concerned the outlook in the near term will depend on the agreement of the oil producers, Organization of Petroleum Exporting Countries, and its allies (OPEC+) to increase production. He further feels that the OPEC+ deal is going to play a major role in defining oil prices outlook.

"The consequences of higher transportation costs on other goods and services are already evident with food inflation rising to 5.15 per cent, despite easing supply bottlenecks. At the same time, the increase in the price of edible oil is another major concern. The inflation in the oils and fats group rose to 34.78 per cent in June (vs 30.8 per cent in May) driving food inflation higher. While the recent announcement by the government to cut import duty on crude palm oil by 5 per cent effective from June 30 may help in arresting the prices in the domestic market to some extent, this is only limited till September 30," added Rao.

Market experts feel that it has been some time since persistent inflationary trend on account of elevated global commodity prices and increasing oil prices are reflecting on domestic items, too. In particular, high petroleum product prices are exerting upward pressure on transport, food, and other items in the domestic consumption basket that have seen a sharp price rise in recent periods.

"This is the second consecutive month when the consumer inflation level at 6.3 per cent YoY in June is above RBI's comfort zone of up to 6 per cent YoY, and hence a cause for attention. In case of IIP, the base effect of the stringent national lockdown last year continues to reflect on the 29.3 per cent YoY growth seen in May. Recently announced fiscal stimulus measures for the supply side will support industry to come out of the second wave impact. However, only sustainable revival in consumption demand can ensure improved production capacity utilisation to reflect upon IIP trends. Albeit with the disturbance of base effect, there are some early signs of improvement, but impending third wave is keeping market participants on tenterhook," explained Vivek Rathi, Director - Research, Knight Frank India.

May saw substantial increases in some of the services categories like health, recreation, and personal care, and effects which did not really fit the slower demand narrative for the period. For June, the food component saw sequential increase led by vegetables, eggs and edible oils.

"Overall the June print is a positive surprise and should augur well for the inflation estimates ahead, and could also push the inflation average for the year near RBI's average if the momentum remains tamed. We remain watchful of pass-through of impending cost push pressures in core goods inflation, while re-opening-led ensuing demand revival in select contact-sensitive household services could pressure core services inflation ahead. However, MPC may still choose to look through the spike in inflation in the near term, with the monetary reaction function currently hinging more on growth revival becoming sustainable," observed Madhavi Arora, Lead Economist, Emkay Global Financial Services.