

Sharp pick-up in inflation: a cautionary call

CPI print surprised way above expectation at 7.44%, and was the highest since Apr-22. Since the formation of MPC in 2016, it has been only on 10 occasions that headline CPI breached the 7% mark. The sequential momentum in retail food prices have been fairly strong, led by vegetables. Not only seasonality, there have been fair degree of supply side disruptions that have resulted in an upsurge in prices of major food categories. Notably, even on a seasonally adjusted MoM basis, vegetable inflation firmed up by 30.5%. In Aug'23 as well (till 11 Aug), tomato, onion, edible oils, and pulses are inching up. Our BoB ECI, is tracking at 7.5% till 11 Aug, on YoY basis. We do not see any respite on food inflation in Q2 and some spillover may be felt in Q3 as well in terms of rising household expectations.

WPI inflation contracted at much slower pace to stand at (-) 1.4% from (-) 4.1% in Jun'23. Food inflation accelerated on the back of spike in vegetable prices. Fuel and Power inflation contracted further to (-) 12.8% in Jul'23. On the other hand, manufactured inflation declined at a slower pace of (-) 2.5% in Jul'23

CPI inflation inched up

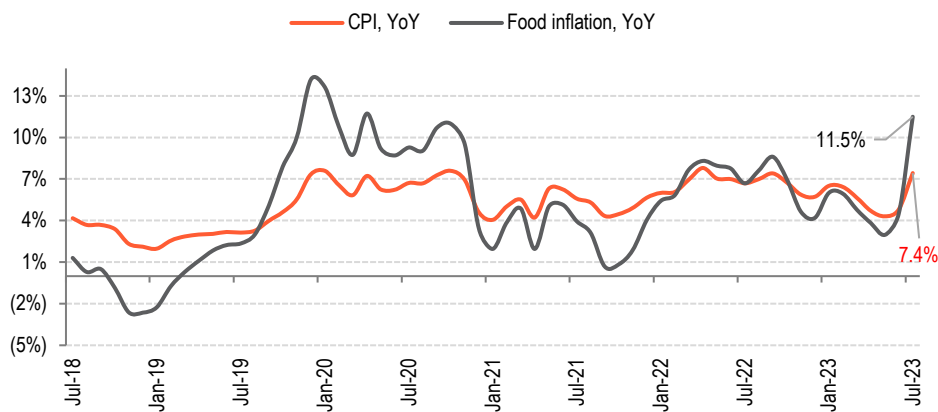
Food gave a shock to headline CPI: CPI inflation rose way more than our expectation of 5.8% to 7.44% in Jul'23 from 4.8% in May'23, on YoY basis. The upside surprise was on account of 702bps jump in food inflation, led by 37.3% jump in vegetable inflation from 0.9% decline in Jun'23, on YoY basis. Barring eggs and meat, all components of food noted sharp pickup. Double digit inflation is seen for cereals (13% in Jul'23 from 12.7% in Jun'23), pulses (13.3% from 10.5%) and spices (21.6% from 19.2%). For milk, inflation is still above the 6% mark, albeit some moderation.

On sequential basis, 7 out of 12 broad items of CPI food have registered pickup in inflation. The most considerable increase was seen in case of vegetables (38.5% increase against 12.2% in Jun'23). Even fruits (4.5% against -0.1% in Jun'23) and oils and fats (-1% from -3.2%) pose considerable risks.

Going forward, especially in Q2, considerable risks emanate from food inflation. *Notably, even on a seasonally adjusted MoM basis, vegetable inflation firmed up by 30.5%. In Aug'23 as well (till 11 Aug), tomato, onion, edible oils, and pulses are inching up. Monsoon (cumulative till 14 Aug) is also 4% below LPA. With most part of sowing of pulses being over and sowing being comparatively lower, a near term spiraling of pulses cannot be ruled out. We do not see any respite for food for the remaining part of CY23, as cycles of vegetables are generally for 6-7months and the fresh harvest also might be impacted due to weather vagaries and logistic issues.*

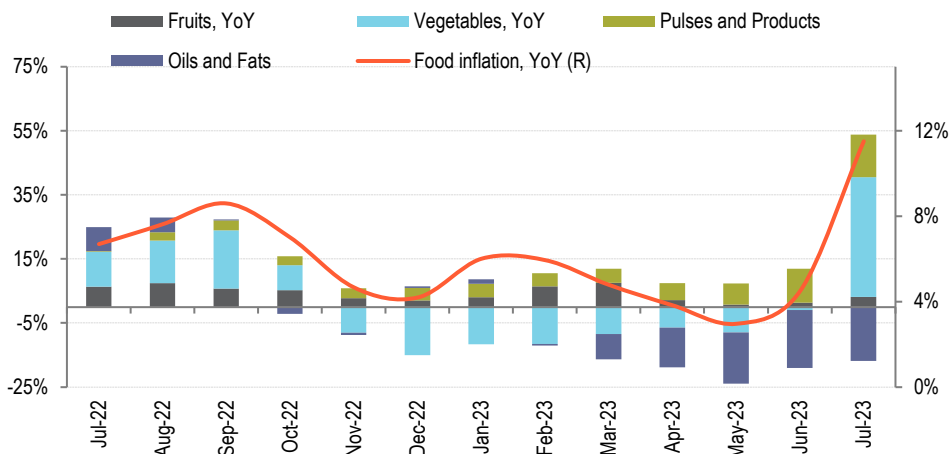
Food inflation excl. vegetables was also higher at 6.3% compared to 5.5% in Jun'23, thus indicating that price pressures are broad based in nature.

Figure 1: CPI inched up; led by food



Source: CEIC, Bank of Baroda Research

Figure 2: Vegetables drove food inflation higher



Source: CEIC, Bank of Baroda Research

Core CPI (excl. food and fuel) has moderated to 5%. Considerable drop was visible for clothing and footwear (5.6% in Jul'23 from 6.2% in Jun'23, on YoY basis). Other than that, housing (9bps drop), household goods and services (33bps drop) and education (37bps drop) showed moderation in its pace. It seems that pent up demand phenomenon has faded and actual transmission of rates into real economy has started shaping up.

On sequential basis, only housing and personal care and effect (due to rise in gold prices in Jul'23, on MoM basis) showed some momentum. Other components of core only rose marginally in the range of 0.1-0.2% in Jul'23.

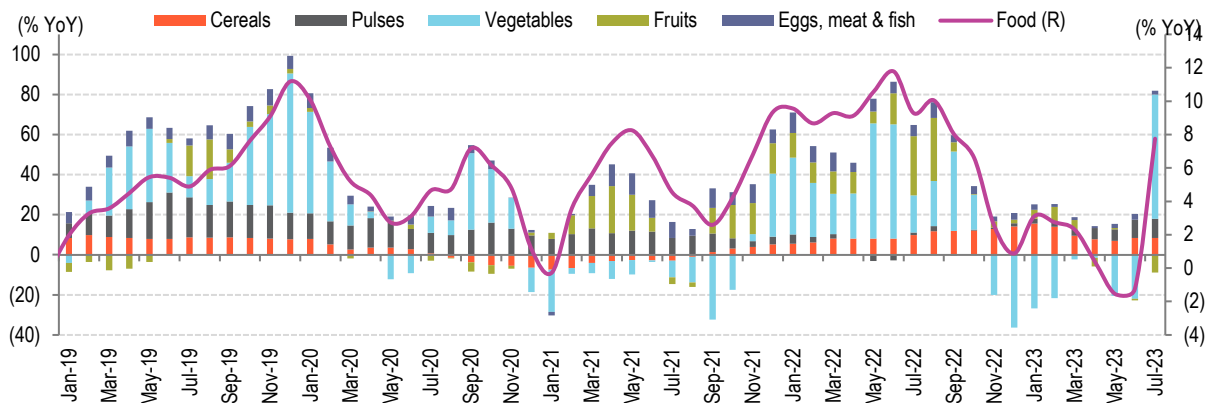
Fuel and Light inflation softened to 3.7% in Jul'23 from 3.9% in Jun'23, but there was a sequential momentum due to increase in price of Kerosene.

Way forward: CPI in Jul'23 overshoot our expectation to a considerable extent. Much of this happened on account of our underestimation of vegetable prices. Not only there is seasonality involved, but even on an adjusted basis, there is considerable risks to vegetables. Even other categories such as edible oils and pulses are posing upside risks to inflation. Monsoon is also running 4% below LPA. With major part of pulses sowing being normally done by this part of the year, we do not see any correction in prices going forward. The entire Q2FY24 and even the spillover to Q3 in terms of inflation expectation would keep the headline CPI trajectory on the upside. Our BoB CPI for Aug'23 is also showing 7.5% YoY increase.

Food impacting WPI as well

Food inflation accelerates: Headline WPI fell less than expected in Jul'23. It was down by (-) 1.4% versus our estimate of (-) 1.7% and (-) 4.1% in Jun'23. Food inflation surprised to reach to a 10-month high at 7.7% in Jul'23 after declining by (-) 1.2% in Jun'23. Within food, most significant jump was noted in price index for vegetables (62.1% versus -22%), led by acceleration in prices of tomato (263% versus -55%), onion (7.1% versus -4.3%), okra (68.5% versus 37.2%), and brinjal (52.8% versus 27%). In addition, food grain inflation edged up tad bit (8.6% versus 8.5%), mainly due to paddy (9% versus 7.7%) and pulses (9.6% versus 9.2%). A similar trend was visible as indicated by World Bank's pink sheet as the global rice prices have risen to 32.1% following 22.7% increase in Jun'23. On the other hand, fruit prices declined sharply to a 5-year low of (-) 8.9% from (-) 0.9% in Jun'23. Additionally, milk prices moderated down to 8.2% (8.6% in Jun'23). Moreover, even for other items such as eggs, meat and fish prices cooled off to 1.8% from 2.7% in Jun'23.

Figure 3: Food inflation rises in Jul'23

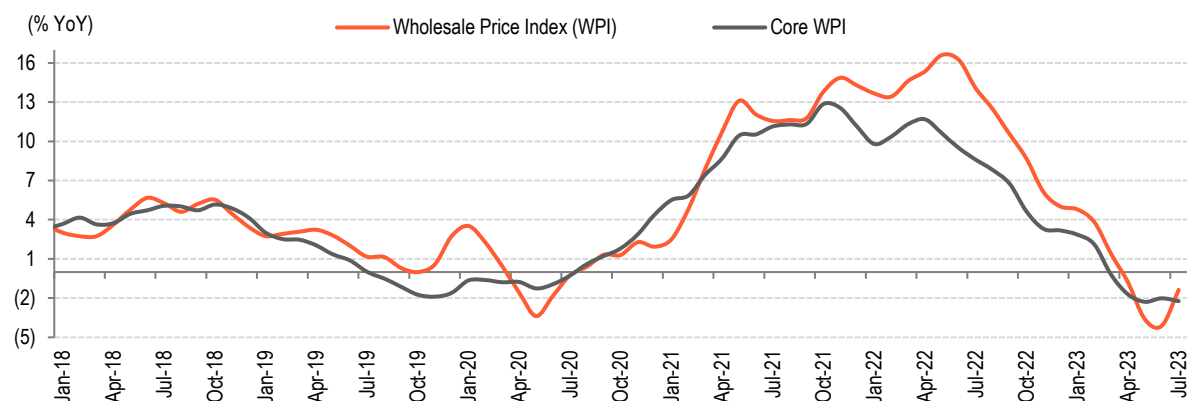


Source: CEIC, Bank of Baroda Research

Fuel and power inflation at 37-month low: Fuel and power inflation contracted further down to (-) 12.8% in Jul'23 from (-) 12.6% in Jun'23. In Jul'23, deflation in mineral oil index continued for the fourth consecutive month (-19.6% versus -19.5% in Jun'23). Within this, except for LPG, Petrol and furnace oil, prices declined for all other sub-categories. Amongst which, most significant drop in prices was seen in case of kerosene (-42.7% versus -33%), bitumen (-11.8 versus -7%) and ATF (-37.6% versus -34.4%). Under the major head of fuel and power, inflation index for coal registered an increase (5% versus 2.5%) while that for electricity cooled off to 0.1% from 0.6% in Jun'23. Going ahead, as global central banks begin to pause rate hike cycle, risk to global demand has begun to recede. As a result, international crude oil prices continues to scale upwards (85.8/bbl) in Aug'23 (MTD) against the similar period last month.

Core WPI maintain its pace: Core inflation remains in deflation in Jul'23 as it fell to (-) 2.2% from (-) 2% in Jun'23. Manufactured products inflation declined at a slower pace to (-) 2.5% from (-) 2.7% in Jul'23. Of the 22 commodity sub-indices, 13 indices registered moderation in Jul'23 than Jun'23 led by paper products, tobacco, wood product, pharma, basic metals and other manufacturing. Inflation index for basic metals declined sharply (-6.1% versus -5.5%). On an international level, as reflected in World Bank's pink sheet, prices of aluminium (-10% versus -15% in Jun'23) and zinc (-23% versus -35% in Jun'23) has contracted at a much slower pace in Jul'23.

Figure 4: Core rebounds in Jul'23



Source: CEIC, Bank of Baroda Research

Table 1: CPI and WPI indicators for Jul'23

Indicator	CPI (%)	WPI (%)
Headline	7.4	-1.4
Food	11.5	7.7
Cereals	13	8.3
Fruits	3.2	-8.9
Pulses	13.3	9.6
Vegetables	37.3	62.1
Spices	21.6	28.2

Source: CEIC, Bank of Baroda Research

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