

INFLATION

13 August 2020

Accelerating inflation, RBI to maintain status quo

CPI inflation accelerated to 6.9% in Jul'20 (6.2% in Jun'20) led by higher food and core inflation. Only 3 food items have reported an inflation level below 4%. The drivers of core inflation are personal care at 13.6% and transport and communication at 10%. Housing and recreation are muted and expected to remain so. However, core tends to be sticky and supply bottlenecks are impacting food. This implies that CPI inflation is likely to remain above RBI's target of 4% making further rate cuts difficult for now.

Sameer Narang

Dipanwita Mazumdar | Aditi Gupta

chief.economist@bankofbaroda.com

CPI accelerates further: CPI surprised negatively at 6.9% in Jul'20 compared with 6.2% in Jun'20. Notably, Jun'20 estimate has been revised upwards from 6.1%. Both food and core inflation inched up. While food inflation went up 80bps MoM, core increased by 50bps MoM.

Food inflation picks up: Food inflation increased to 9.6% in Jul'20 from 8.7% in Jun'20 led by higher vegetable prices (11.3% from 4% in Jun'20). One can see a broad based increase in food inflation. Out of 12 food and beverages items, as many as 5 are showing double digit growth led by meat and fish at 18.8% and pulses at 15.9%. Egg at 8.8%, cereals at 7%, milk at 6.6% and beverages at 4.4% are in the range of 4-10%. Only 3 items, have reported an inflation less than 4%. Given the above backdrop, we see relatively elevated food inflation in coming months before easing in winter when base effect plays out.

Core inflation also rises: CPI excluding food and fuel rose by 50bps to 5.9% in Jul'20 from 5.4% in Jun'20. The upward momentum was led by household goods and services (3.1% from 1.8%), transport and communication (10% from 8.3% in Jun'20), education (3.2% from 2.6%) and personal care items (13.6% from 12.9%). Rising crude (6% in Jul'20), gold (6.3%) and other commodity prices (4.9%), contributed towards higher core. In the last 8 years, core inflation has been at 4% or less only once, that too in FY20. The current trajectory shows it is unlikely to average 4% this year.

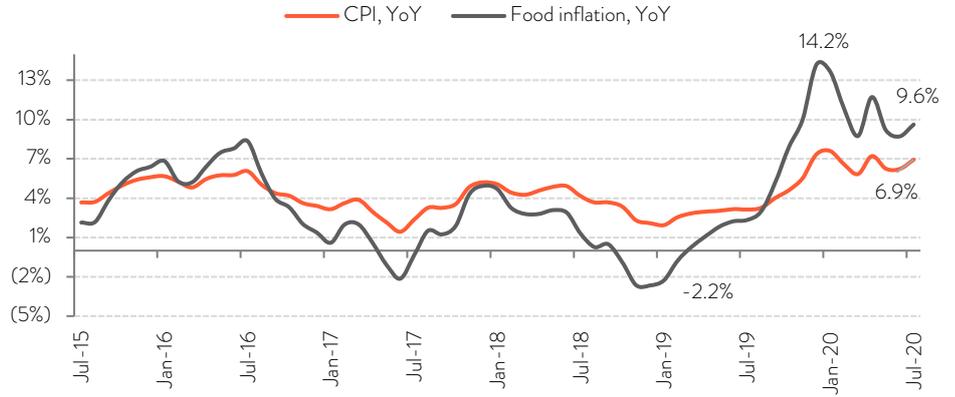
Further easing difficult: The current trajectory of inflation implies a low probability of any further rate cut. CPI inflation for this and next year is estimated at 5.5% and 4.5% which is higher than RBI's target of 4%. Only a sharp fall in both core and food inflation can change our view. We believe, supply side bottlenecks are likely to ensure food inflation remains elevated in the near-term. Core inflation is also expected to remain sticky.

KEY HIGHLIGHTS

- CPI rose to 6.9% in Jul'20 from 6.2% in Jun'20.
- Led by food inflation, fuel and light and core inflation.
- RBI's rate cut cycle seems to be behind us.

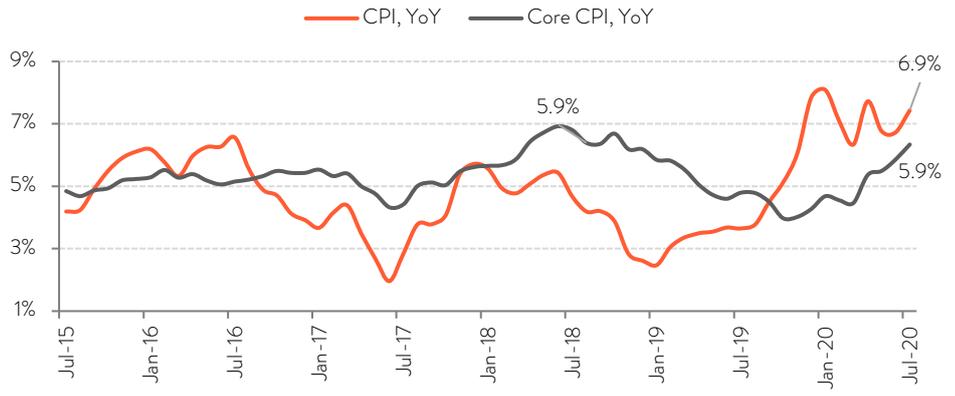


FIG 1 – CPI ROSE TO 6.9% IN JUL'20 FROM 6.2% IN JUN'20, LED BY FOOD (9.6% FROM 8.7% IN JUN'20)



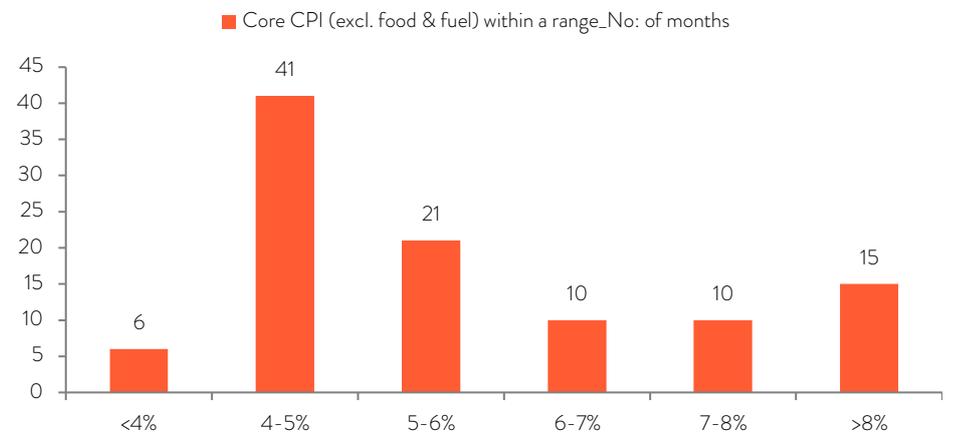
Source: CEIC, Bank of Baroda Research

FIG 2 – ...CORE ALSO CONTRIBUTED TO THIS ACCELERATION (5.9% FROM 5.4% IN JUN'20)



Source: CEIC, Bank of Baroda Research

FIG 3 – CORE MOSTLY SETTLES ABOVE 4%



Source: CEIC, Bank of Baroda Research

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Economics Research Department

Bank of Baroda

chief.economist@bankofbaroda.com