

RETAIL INFLATION

13 November 2019

CPI accelerates but core moderates

Retail inflation rose to a 16-month high of 4.6% in Oct'19, breaching MPC's target of 4%, led by food inflation (especially vegetables at 26% and pulses at 11.7%). This is on the back of supply disruptions. Muted demand drove core inflation to its lowest in the current series at 3.4%. Health inflation fell by 210bps MoM, personal care by 120bps and household goods and services by 110bps. With growth likely to slip to 4.5% in Q2, MPC members are likely to emphasize on growth and thus cut rates by another 25bps in Dec'19.

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Food inflation jumps further: Headline CPI breached MPC's 4% target at 4.6% in Oct'19 from 4% in Sep'19, led by food. Food inflation rose to a 39-month high of 7.9% in Oct'19 from 5.1% in Sep'19. This was led by sharp increase in vegetable prices at 26.1% versus 15.5% in Sep'19. In addition, prices of fruits accelerated at a 15-month high of 4.1% versus 0.8% in Sep'19. Prices of pulses too rose at a 37-month high of 11.7% versus 8.4% in Sep'19. The bigger question is that is there a structural tailwind to this or is just cyclical. We believe in a backdrop of muted demand, most of this is driven by impact of unseasonal rains and low base and is likely to reverse.

Core dips sharply as demand fades: CPI inflation excluding food and fuel edged down by 50bps to 3.4% in Oct'19 compared with 3.9% in Sep'19 and 6.2% in Oct'18. Except clothing and footwear, all categories of core inflation softened in Oct'19. The sharpest decline was seen in health (down by 210bps on MoM basis), personal care items (120bps) and household goods and services (110bps). The dip in global crude prices (-4.3% on MoM basis) and base effect pushed transport and communication and personal care and effects inflation lower. Given muted consumption and investment demand, we expect core inflation to remain below 4% in H2FY20.

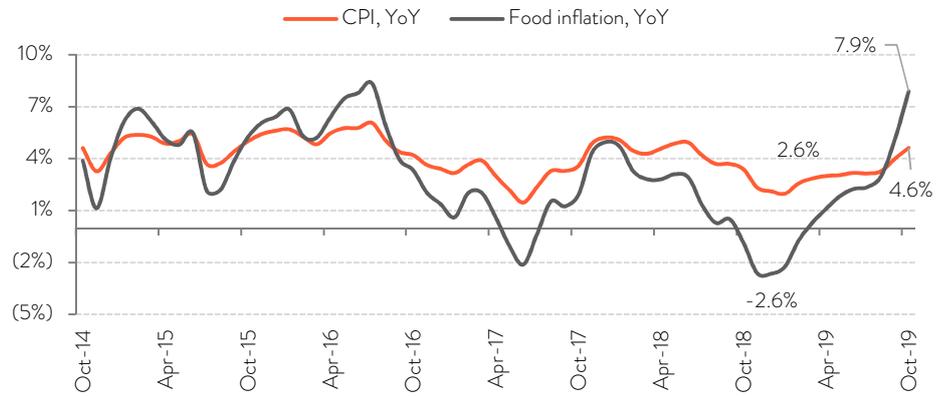
Rate cut on the cards: Despite headline CPI above MPC's 4% target, we expect another rate cut in Dec'19 as growth in Q2 is likely to dip to 4.5% from 5% in Q1. Growth in FY20 is now expected at 5.2% from our earlier estimate of 6.2% with a gradual pick-up to 6.2% in FY21. While MPC members will raise concerns on inflation, the focus will remain on growth and thus the 25bps rate cut. Rate trajectory post Dec'19 policy depends upon fiscal outlook for FY21. Subdued growth and fiscal restraint may warrant another rate cut in Feb'20 or Apr'20 policy to bring real rates lower.

KEY HIGHLIGHTS

- CPI inflation rises to 4.6% in Oct'19 led by food.
- Food inflation jumps to 7.9% in Oct'19 from 5.1% in Sep'19 led by vegetables (26.1%) and pulses (11.7%).
- Core inflation drops to its lowest in the current series to 3.4% in Oct'19.

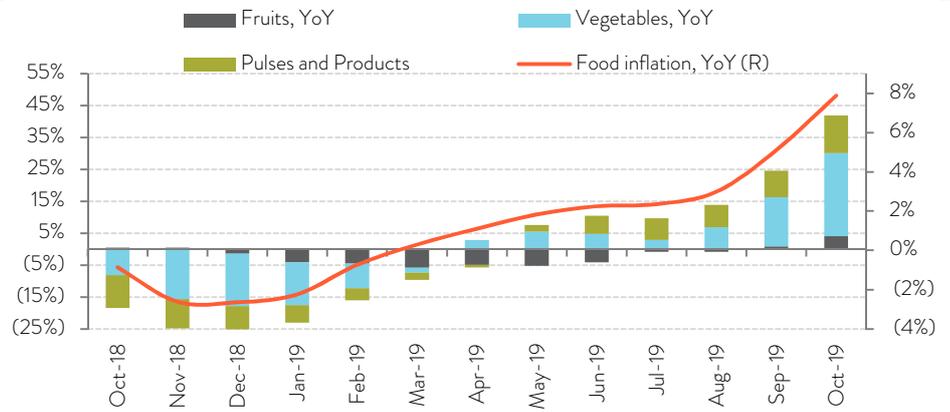


FIG 1 – FOOD INFLATION INCHES UP TO A 39-MONTH HIGH



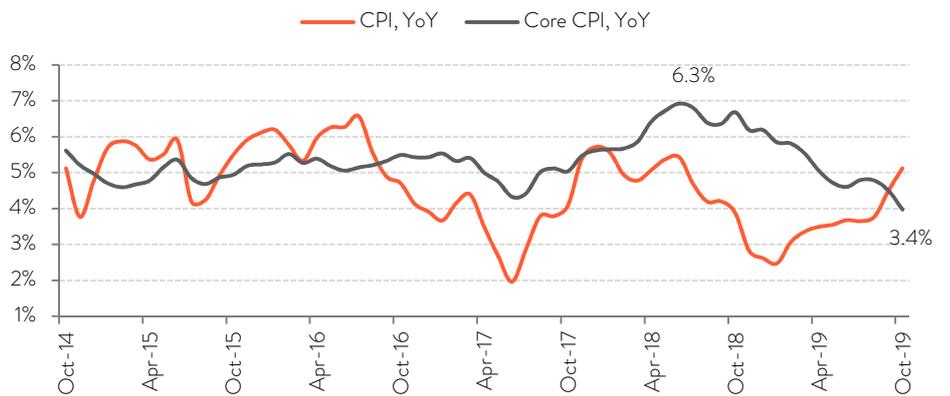
Source: CEIC, Bank of Baroda Research

FIG 2 – LED BY HIGHER VEGETABLE PRICES



Source: CEIC, Bank of Baroda Research

FIG 3 – CORE CPI EASES TO 3.4% IN OCT'19



Source: CEIC, Bank of Baroda Research

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