

## INFLATION

14 September 2020

### Food inflation moderates, core persists

**CPI eased to 6.7% in Aug'20 driven by lower food inflation at 9.1%. Core remains sticky at 5.8% despite sharp deceleration in education. Housing inflation is also muted. Core should have moderated but higher fuel and gold prices kept it elevated. While demand conditions call for lower interest rates, negative real rates and risk of supply side cost pressures from higher international commodity prices and vegetable prices imply RBI has limited room to cut rates. Liquidity and financial stability will be focus areas.**

Sameer Narang

Dipanwita Mazumdar | Jahnavi

chief.economist@bankofbaroda.com

**CPI moderates:** CPI inflation surprised positively and eased to 6.69% in Aug'20 from a revised estimate of 6.73% (previously 6.9%) in Jul'20. Last month's revision is due to 30bps dip in food inflation to 9.3% from 9.6% earlier.

**Food inflation decelerates:** Food inflation edged down to 9.1% in Aug'20 from 9.3% in Jul'20 led by decline in cereal inflation (5.9% in Aug'20 from 6.9% in Jul'20), meat and fish (16.5% from 17.3%) and pulses (14.4% from 15.7%). However, acceleration was visible in eggs (10.1% from 7.7%), fruits (1% from 0.1%) and sugar (3.9% from 3.6%). Vegetable prices remain uncomfortably high at 11.4% compared with 11.1% in Jul'20. Out of twelve, six food items reported double digit inflation.

**Core inflation remained firm:** CPI excluding food and fuel rose to 5.84% in Aug'20 from 5.78% in Jul'20. This was led by higher inflation in the personal care items (14.5% in Aug'20 from 13.7% in Jul'20). Higher gold prices (6.7% MoM) contributed towards this. Transport and communication inflation was also higher at 11% from 10.3% in Jul'20 led by higher retail fuel prices due to increase in dealer commissions and local taxes. The growth slowdown had an impact on education inflation which fell to 1.6% from 2.9% in Jul'20. Housing inflation too remained muted at 3.1%.

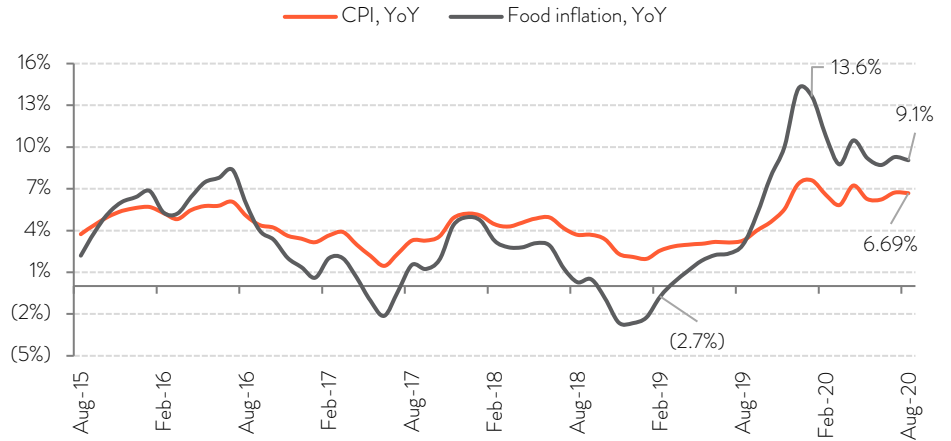
**Inflation concerns persist:** Current inflation trajectory points to decline in inflation to 4.5% in H2FY21 from 6.6% in H1FY21. The decline will be on account of base effect. On the other hand, there is an upside risk which can come from higher commodity and oil prices in the event a vaccine is launched. In the near term, vegetable inflation is still on an uptrend (7.2% MoM in Sep'20 led by tomato prices) and global commodity prices have gone up (1.1% in Sep'20 MoM). Thus, we don't see RBI cutting policy rates any further. The focus of the policy will be on liquidity and financial stability.

#### KEY HIGHLIGHTS

- CPI moderated to 6.7% in Aug'20 led by food inflation at 9.1%.
- Core remains elevated at 5.8%.
- CPI to moderate on base effect. Upside risks may emerge from higher international commodity prices.

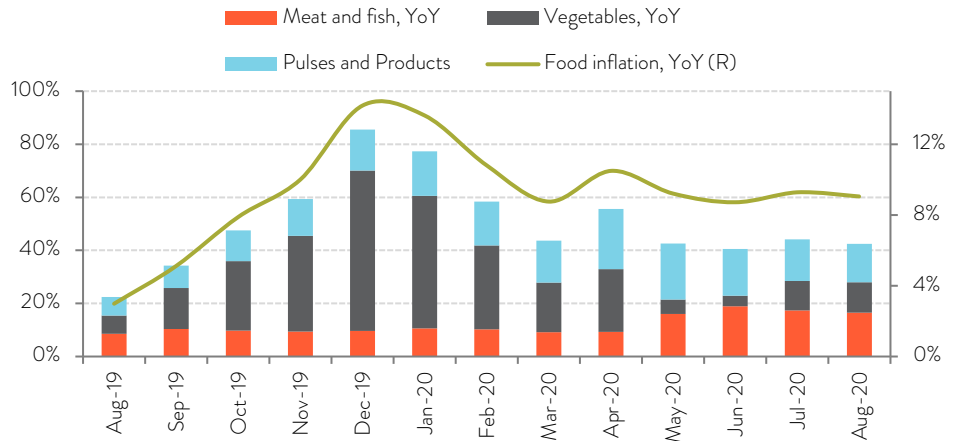


**FIG 1 – CPI EDGED DOWN TO 6.69% IN AUG'20 LED BY FOOD**



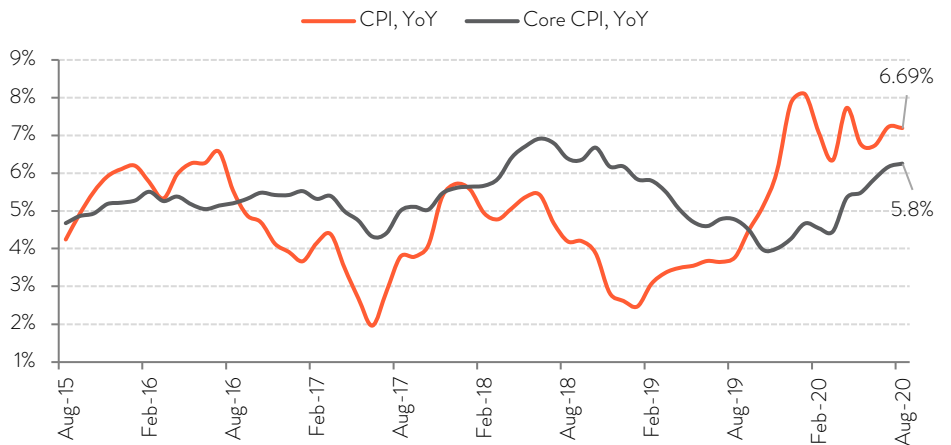
Source: CEIC, Bank of Baroda Research

**FIG 2 – MODERATION SEEN IN PULSES, MEAT AND FISH**



Source: CEIC, Bank of Baroda Research

**FIG 3 – CORE INFLATION ELEVATED AT 5.8%**



Source: CEIC, Bank of Baroda Research

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### **Economics Research Department**

Bank of Baroda

[chief.economist@bankofbaroda.com](mailto:chief.economist@bankofbaroda.com)