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Aditi Gupta
Economist

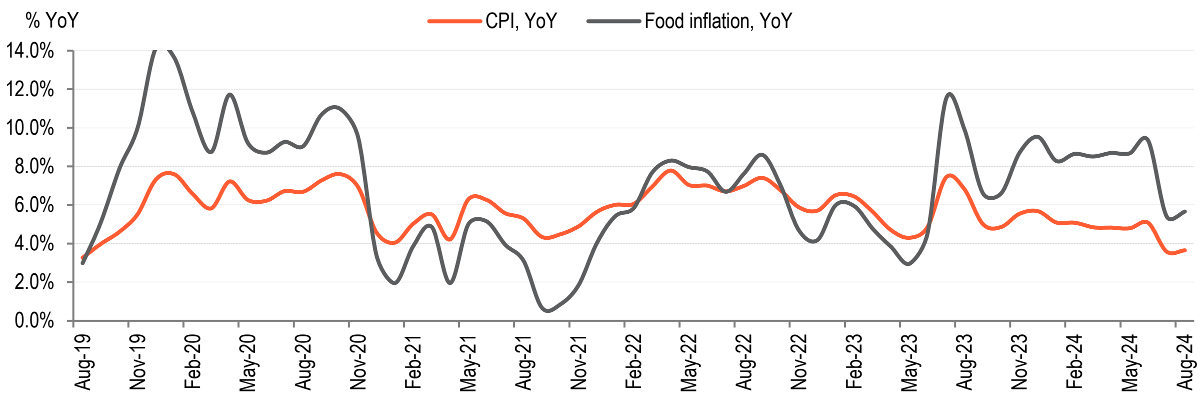
Inflation inches up marginally

CPI inflation inched up marginally to 3.7% from a 59-month low of 3.5% in Jul'24. Food inflation picked up on a YoY basis led by vegetables. However, sequentially there was a significant moderation in food inflation due to lower vegetable prices. Core inflation remained stable at 3.4%, as lower inflation in personal care and effects category offset the marginal increase seen in other categories. The outlook for food inflation is positive as the progress of monsoon has been adequate. Soft global commodity prices will also impart a sobering effect on core inflation which is likely to remain at comfortable levels. Overall, we continue to expect inflation in the range of 4.5%-5% in FY25. RBI is likely to be cautious and wait for a durable moderation in inflation before cutting rates. We see the possibility of rate cut only in Dec'24 provided the durability of low inflation is established by data.

Favorable base pushes inflation lower

CPI inflation: CPI inflation for Aug'24 printed at 3.7% (BoB estimate 4%) , inching up marginally from 3.5% in Jul'24. However, this is the second straight month in which inflation has stayed below RBI's target of 4%. Much of the moderation in inflation can be attributed to a favorable base as inflation had increased by 6.8% in Aug'23. Food inflation inched up marginally from 5.4% in Jul'24 to 5.7% in Aug'24. Inflation in the fruit and vegetables category accelerated led by a waning base effect. This was offset by lower prices in the cereals and pulses. Prices of spices fell sharply by 4.4% after declining by 1.4% in Jul'24.

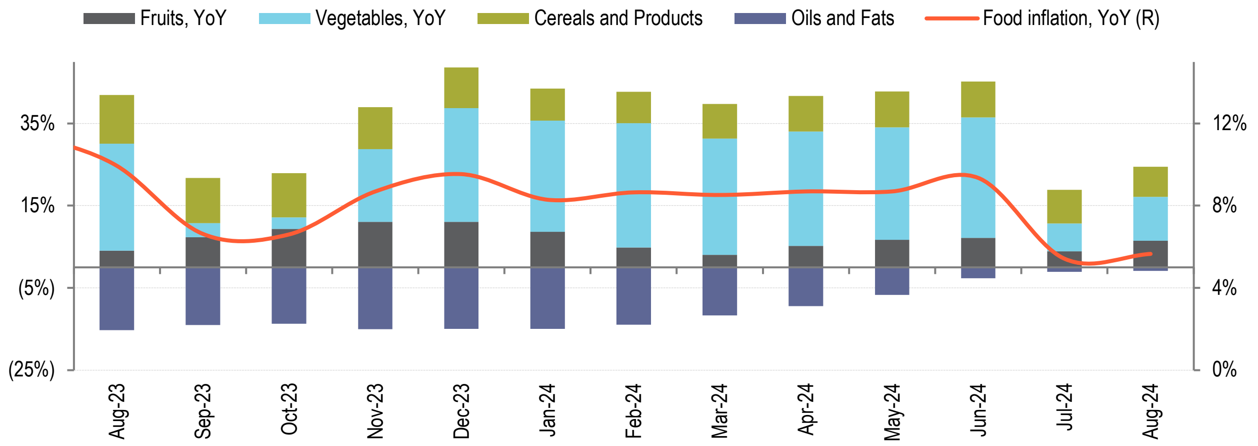
Figure 1: CPI inflation inches up marginally



Source: CEIC, Bank of Baroda Research

On a sequential basis, CPI inflation moderated to 0.05% in Aug'24 after increasing by 1.4% in Jul'24. This in turn was led by a substantial moderation in food inflation. In fact, on a MoM basis, food inflation declined by 0.4% compared with an increase of 2.8% in Jul'24. This was led by a significant correction in prices of vegetables which declined by 2.5%, after increasing by 14.8% in Jul'24. Prices of other categories of food such as eggs and meat and fish also exhibited significant declines sequentially.

Figure 2: Food inflation also marginally higher



Source: CEIC, Bank of Baroda Research

Core CPI (excl. food and fuel) inches up: After inching up in Jul'24, core inflation remained stable at 3.4% in Aug'24. However, all subcomponents of core noted an increase in Aug'24, which was offset by moderation in the personal care and effects category. Inflation in the personal care and effects category eased significantly to 7.9% in Aug'24 from 8.4% in Jul'24. Amongst others, inflation in education and transport and communication inched up the most.

Fuel and light: Deflation in the fuel and light category narrowed to 5.3% in Aug'24, compared with a decline of 5.5% in Jul'24. This can be attributed to higher kerosene prices in the period, even as global oil prices were lower.

Way forward: The recent CPI print cements the view that the inflation trajectory is likely to evolve broadly in line with RBI's estimates. Monsoon has progressed well, even though there are regional disparities. Kharif sowing is tracking higher than last year which is also positive for the outlook on food inflation. Excess rainfall in some parts of the country has led to fears of another round of shock on vegetable prices. However, high frequency price data shows that prices of potato and onion have continued to decline even in Sep'24. While onion prices have continued to increase due to excess rainfall in Maharashtra, the situation is likely to correct in the coming days as there has been a reduction in severity of rainfall in the state. Overall, we believe that the food inflation outlook remains favorable. However, rainfall during the withdrawal of monsoon and possibility of unseasonal rainfall could impart a degree of upward bias to the trajectory. This should be offset largely by muted core inflation. Despite the recent uptick in core inflation due to one-off factors, it is unlikely to inch up significantly. Overall, we believe that CPI inflation is likely to average 4.5-5% in FY25. We do not expect the RBI to cut policy rates before Dec'24.

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For further details about this publication, please contact:

Economics Research Department
Bank of Baroda
chief.economist@bankofbaroda.com