

RESEARCH
BOB Economics Research | Weekly Wrap

Inflation data to guide markets

BOB Economics Research | CPI

Food inflation drives CPI lower

SUMMARY
India Economics: Weekly Wrap

Global yields inched up led by China where producer prices increased at the highest pace since Aug'08. Yields rose in US and Europe with both central banks looking at tapering in CY21. DXY rose by 0.5% as weekly Covid-19 cases in US fell to 1mn and are seeing an upward trajectory in UK and Germany. India's Covid-19 cases fell. Rainfall picked up (now 6% below LPA from 9% below LPA last week). Despite this, 10Y yield rose by 2bps. India's retail (our est.: 5.45%) and wholesale inflation (our est.: 10.5%) data will be released today and tomorrow respectively.

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India Economics: CPI

CPI inflation moderated to 5.3% in Aug'21 led by food inflation which softened to 3.1% (4% in Jul'21). Core inflation eased by 10bps to 5.9%. A favourable base and uptick in rains in Sep'21 bodes well for inflation outlook. We expect CPI inflation to average 5.5% in FY22 (RBI: 5.7%). However, core inflation is likely to remain sticky with an impending increase when contact intensive services sector opens up. We expect RBI to remain on hold this year and raise reverse repo rate in Q4FY22.

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Daily macro indicators

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	1.34	4bps	(2bps)	68bps
India 10Y yield (%)	6.18	(1bps)	(5bps)	14bps
USD/INR	73.50	0.1	1.0	0.1
Brent Crude (US\$/bbl)	72.92	2.1	2.3	83.1
Dow	34,608	(0.8)	(2.5)	25.1
Shanghai	3,703	0.3	5.1	13.6
Sensex	58,305	0.1	6.3	50.1
India FII (US\$ mn)	08-Sep	MTD	CYTD	FYTD
FII-D	(42.9)	170.3	(1,243.5)	783.7
FII-E	(112.7)	216.1	7,606.6	280.3

Source: Bank of Baroda Economics Research

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WEEKLY WRAP

13 September 2021

Inflation data to guide markets

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Markets

- **Bonds:** Global 10Y yields closed higher. China's 10Y yield rose the most by 4bps (2.87%) as PPI rose by highest level since Aug'08. Germany's 10Y yield rose by 3bps (-0.33%) as ECB indicated tapering of its asset purchase program. US 10Y yield rose by 2bps (1.34%) as Fed presidents signalled tapering to begin in CY21. Crude prices rose by 0.4% (US\$ 73/bbl) amidst supply concerns in the US. India's 10Y yield rose by 2bps (6.18%). System liquidity surplus was at Rs 7.8tn as on 9 Sep 2021 versus Rs 9.1tn last week.
- **Currency:** Except China, global currencies closed lower this week. DXY rose by 0.6% on the back of stronger than expected jobs data (jobless claims fell), signalling early signs of recovery. EUR fell by 0.6%. ECB noted that it will begin trimming of PEPP program in the coming quarter. INR fell by 0.7% as oil prices rose by 0.4%. FPI inflows were US\$ 43mn in the week.
- **Equity:** While Nikkei rose by 4.2% followed by Shanghai Comp at 3.4%, Dow and European indices ended in red. US Fed and ECBs tapering seems to have had an impact on equity markets in US and Europe. Sensex rose by 0.3% led by gains in consumer durables and real estate stocks.
- **Covid-19 tracker:** Global Covid-19 cases rose at a slower pace of 4mn versus 4.3mn last week. Cases showed moderation in the US (1mn increase versus 1.1mn) and Japan (66K versus 110k) and France (69K versus 94k). In India, cases rose by 0.25mn versus 0.29mn. Our weekly economic activity tracker index moderated to 97 (100=Feb'20) from 98. UK has fully vaccinated 64% of its population, Germany at 61% and US at 53%. India is at 13%.
- **Upcoming key events:** Major events this week include US CPI, retail sales, and industrial production and China's retail sales, industrial production and FAI data. In addition, UK and Euro Area CPI are also due. In India, CPI and WPI data will be released.



CPI

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Food inflation drives CPI lower

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CPI moderated led by food: CPI inflation eased to 5.3% in Aug'21 from 5.6% in Jul'21 led by moderation in food inflation to 3.1% in Aug'21 compared with 4% in Jul'21. This was led by sharp drop in vegetable prices which declined by -11.7% (-7.8% in Jul'21). Inflation in eggs moderated to 16.3% (from 20.8% in Jul'21), fruits to 6.7% (from 9% in Jul'21) pulses to 8.8% (from 9% in Jul'21) and sugar to -0.6% (-0.5% in Jul'21). However, inflation in milk rose marginally to 2.9% (2.7% in Jul'21) and oils and fats to 33% (from 32.5% in Jul'21).

Core inflation softens a bit: CPI excluding food and fuel edged down by 10bps to 5.9% in Aug'21 (6% in Jul'21). This was led by 30bps drop in transport and communication index to 10.2% (from 10.5% in Jul'21). Personal care and effects inflation also softened by 275bps to 1% from 3.8% due to decline in gold prices. Inflation in Pan, tobacco etc. also moderated to 4% from 4.7% in Jul'21. However, other components of core showed an increase led by education at 3.8% (from 3% in Jul'21), household goods and services at 5.4% (from 5.0% in Jul'21) and clothing and footwear at 6.8% (from 6.4% in Jul'21). Housing inflation was stable at 3.9%. Fuel and light index has now risen to a high of 12.9% from 12.4% in Jul'21.

CPI Inflation estimated at 5.5%: The uptick in rainfall in Sep'21 is positive for sustaining the current trend of decline in food inflation. Reduction in customs duties on edible oils is also a positive. Base effect for vegetables is also favourable till Nov'21 after which food inflation is likely to edge upwards. Notably, vegetable inflation during Apr-Nov'20 was 14.3% before falling to -9.4% in the remaining four months of the previous financial year.

While core inflation has softened a tad in Aug'21, elevated crude oil prices and impending pass-through when services economy opens up implies core inflation is likely to remain elevated in coming months and quarters. For now, this inflation print sets the background for RBI to maintain its policy rate at current levels in FY22 and look at gradually reducing excess liquidity in the coming months. We do see RBI reducing the gap between repo and reverse repo rate in Q4FY22 unless growth disappoints from our current projection of 9.7% (RBI: 9.5%).

Key highlights

- CPI edged down to 5.3% from 5.6% in Jul'21.
- Food inflation softened to 3.1% from 4%, led by vegetables.
- Core inflation remained sticky at 5.9% against 6% in Jul'21.



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