Inflation Watch: Food inflation continued to weigh on headline CPI in January; core inflation near decade low

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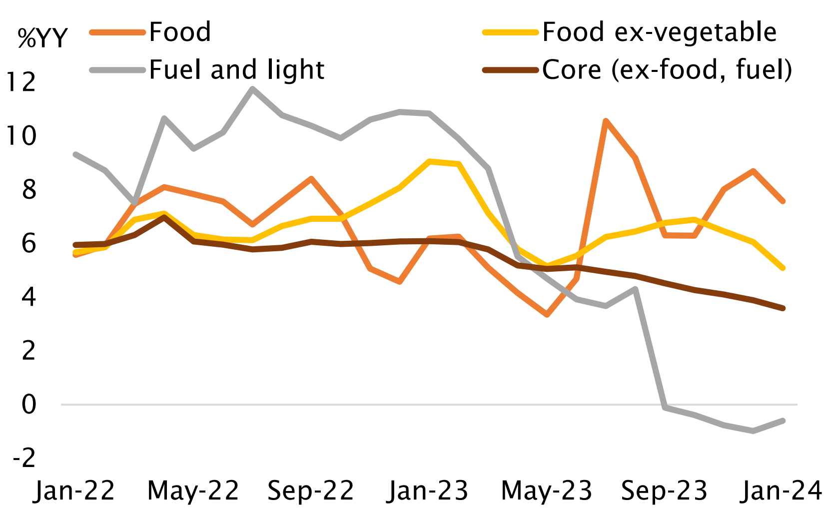
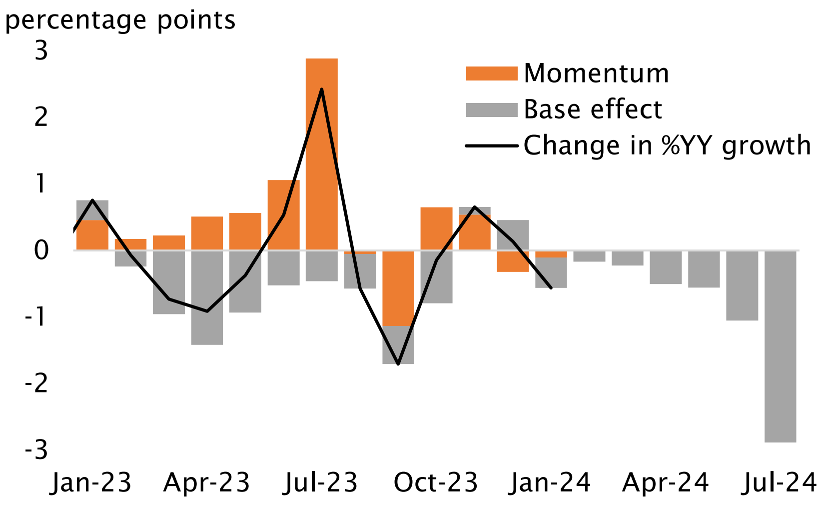
Key takeaways

- **Headline CPI inflation eased to 5.1%YY in January from 5.7% in December, but was marginally higher than market expectations (Bloomberg survey: 5.0%).** The moderation was supported by a favorable base effect and an easing monthly momentum. **Internal details stayed favorable**, with further moderation in core inflation, and fuel prices remaining in deflation for the fifth straight month. Despite easing, **food inflation remained elevated** and continued to keep the pressure high on overall headline inflation.
- Going forward, **base effect is expected to remain favorable till July 2025. Global commodity prices remain well behaved.** Also, waning El Nino conditions paving the way for a potential La Nina event in June-August bodes well for India's agriculture output outlook. **Progress in Rabi sowing, favorable macroeconomic factors such as a stable exchange rate, lower deficits on the current and fiscal accounts are likely to support the disinflationary process.**
- **However, ongoing food price pressures, climate-related risks to agriculture output, strong domestic growth and geopolitical tensions such as the Red Sea disruption pose upward risks to inflation.**
- **The latest print is unlikely to have a material impact on the upcoming RBI MPC policy decision due in April, though it could impinge on the central bank's CPI inflation forecast of 5.0% for Q4-FY24.**

Food ex-vegetable inflation continues to moderate



Base effect to remain favorable till July 2025



Muted seasonal easing in vegetable prices weighed on food basket

- Food and beverages inflation eased to 7.6%YY in January from 8.7% in December. The sharpest contribution was from vegetable prices followed by cereals, pulses and spices. **The seasonal softening in vegetable prices was lower than historical trends, so that vegetable inflation remained high at 27.0%YY versus 27.6% in December.** Vegetable prices fell 11.7%YY in Jan-2023 and were up 5.1% in Jan-2022. High frequency data for main vegetable prices indicates price pressures to persist in February.
- Over the past decade, food inflation was the highest in Dec-2019 at 12.2% due to a steep increase in vegetable prices at 60.5%YY (onion prices had surged over 300%YY) and double-digit inflation in pulses.
- **While high inflation in pulses is not a new phenomenon with the decade high at 46.1%YY in Nov-2015, the latest spike in cereals inflation at 16.7% in Feb-2023 marks the highest since 2014.** Persistent high inflation in cereals and pulses remains a cause of concern due to their sticky nature and spillover effects. Within cereals, index heavyweights – rice and wheat – have contributed to high inflation.

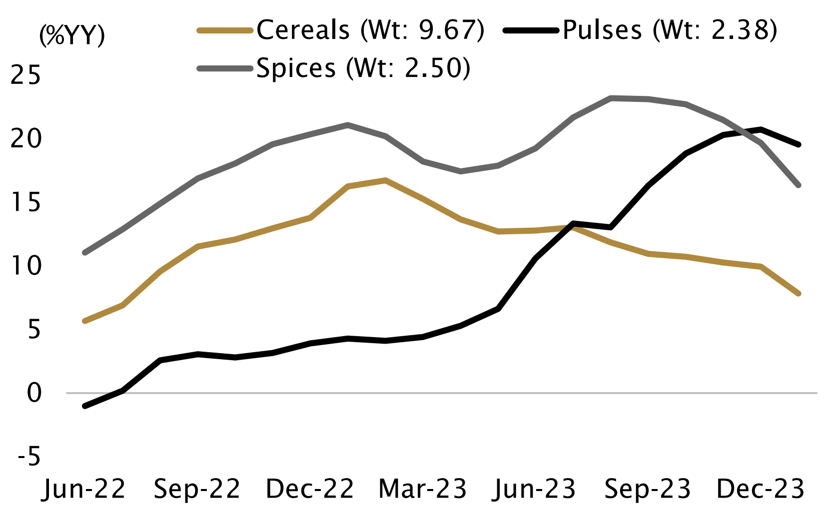
Muted seasonal easing in vegetable prices

%YY	Tomato	Onion	Potato	Vegetables
Wt. in CPI	0.57	0.64	0.98	6.04
Aug-23	179.2	23.3	-14.3	26.1
Sep-23	-21.4	35.9	-15.6	3.4
Oct-23	-43.9	42.4	-17.7	2.8
Nov-23	11.3	86.3	-15.6	17.7
Dec-23	33.5	74.0	-8.8	27.6
Jan-24	38.3	29.6	-1.9	27.0
Feb-24*	60.5	34.1	11.6	

%MM	Tomato	Onion	Potato	Vegetables
Wt. in CPI	0.57	0.64	0.98	6.04
Aug-23	-22.0	12.4	2.3	-5.9
Sep-23	-64.9	10.0	-1.9	-15.7
Oct-23	-18.6	15.7	0.4	3.5
Nov-23	40.9	47.7	-1.1	5.0
Dec-23	-9.4	-16.1	-5.9	-5.3
Jan-24	-8.2	-25.3	-10.7	-4.2
Feb-24*	2.3	-15.6	-5.0	

Note: *All India retail price till February 12.
Source: Department of Consumer Affairs

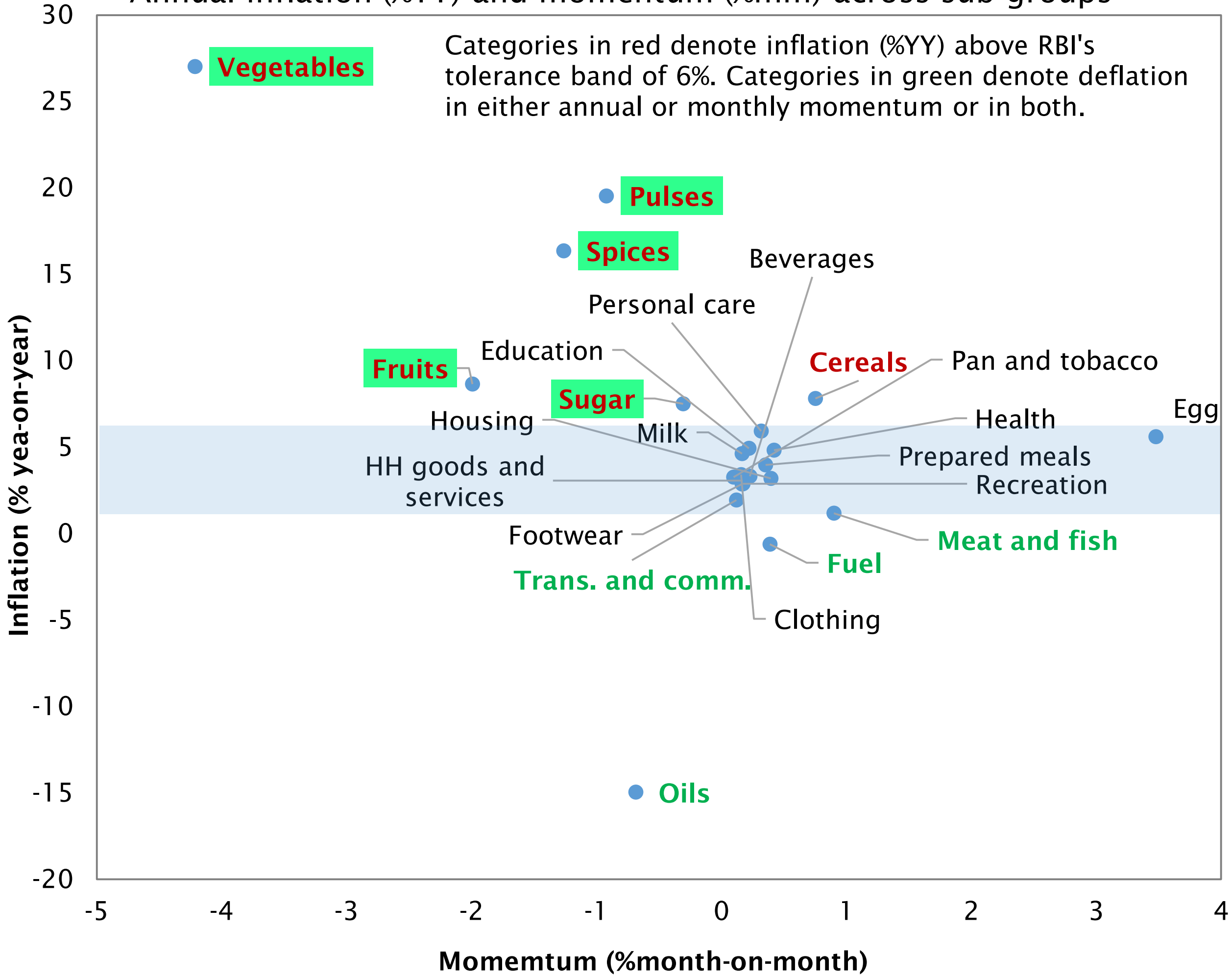
Cereals, pulses inflation has been easing but stays high



Monthly momentum in food inflation eased in January

- **Though food inflation continued to roil the headline print in January in annual terms, vegetable prices have been declining month-on-month since December due to seasonal factors.** This decline or moderation also holds true for other major items within the food basket and has supported month-on-month decline in headline inflation over the past two months.

Annual inflation (%YY) and momentum (%mm) across sub-groups

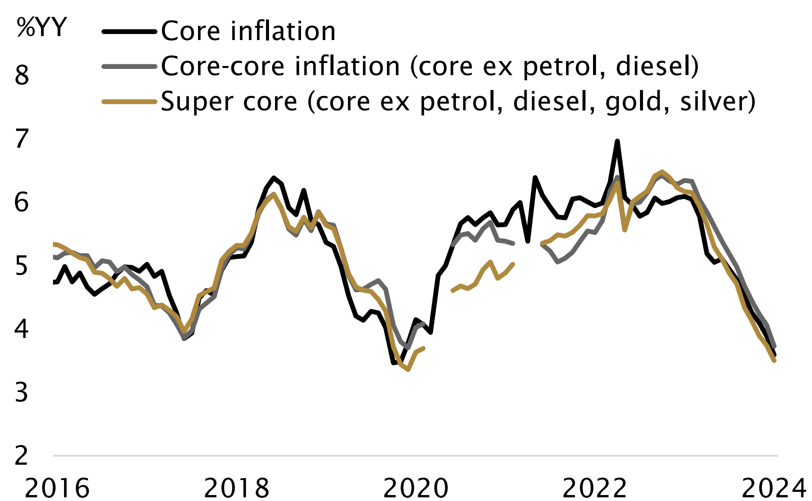


Core inflation close to decade low of 3.5%YY reached in Oct-19

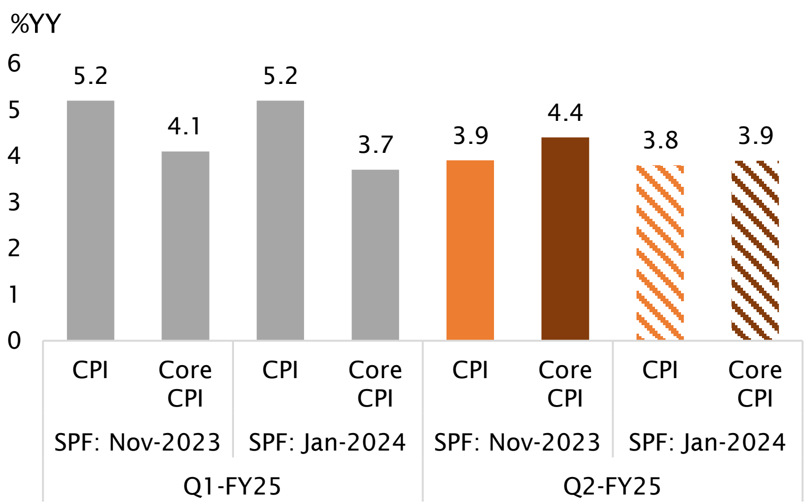
- Core inflation (ex-food and fuel) continued to its downward trajectory, printing at 3.6%YY in January, down from 3.9% in December. **Easing price pressures in housing and miscellaneous basket contributed to the moderation in core inflation close to the decade low of 3.5% touched in Oct-2019.**
  - Post Oct-2019, core inflation started its uptrend amid COVID-related disruptions and supply-side pressures, **peaking at 7.0% in Apr-2022** due to higher transport, communication and healthcare costs.
  - In Oct-2019, housing inflation was relatively higher at 4.6%YY versus 3.2% in Jan-2024. In the current context, **housing inflation has been moderating from 5.0%YY reached in Mar-2023. However, anecdotal evidence suggests 25-30% increase in housing rents across major cities since 2019, while the latest index data suggests around 17% increase, thereby undermining actual housing inflation.**
  - Compared to Oct-2019, inflation in miscellaneous items was higher by 0.4 percentage points at 3.8%YY in Jan-2024, driven by household goods and services, and transport and communication.

- Going forward, **core inflation is expected to gradually pick up**. In the recent rounds of RBI's Survey of Professional Forecasters, respondents' median forecasts suggests **core inflation to exceed headline CPI by Q2-FY25**, though the latest survey indicates lower gap vs. the November survey.

Various measures of core inflation continue to moderate



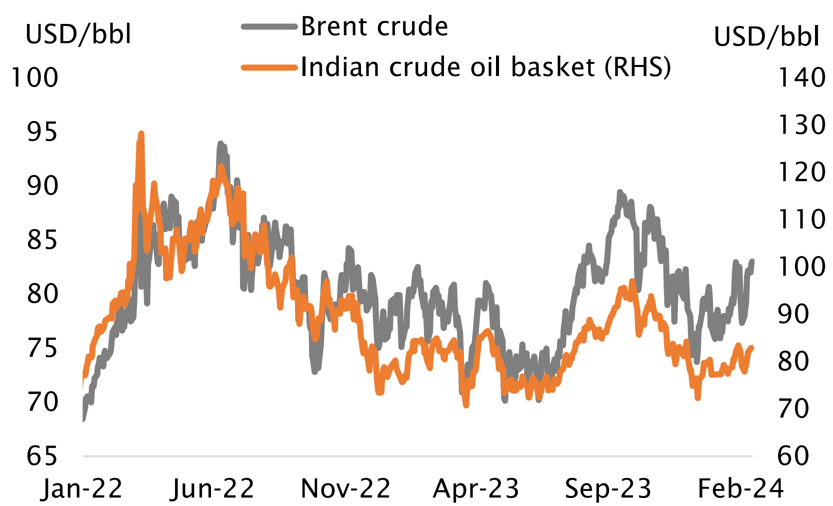
RBI Survey of Professional Forecasters: Headline vs Core CPI



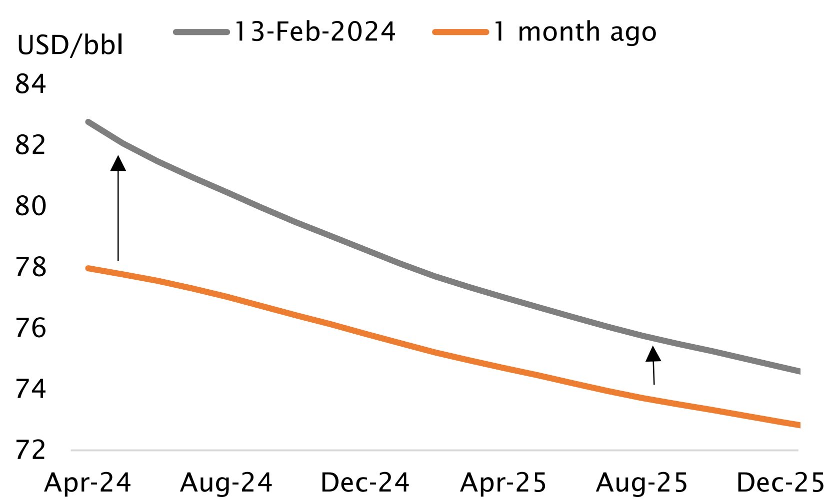
Fuel index remains in deflation

- The **fuel index remained in deflation for the fifth consecutive month**, aided by double-digit decline in prices of LPG and kerosene PDS. In August 2023, the government had **slashed LPG prices** and also **raised subsidy** in October. Inflation in electricity and kerosene (other sources) remained in double digits.
- In January, Brent crude oil spot price averaged USD82/barrel, up by USD2/barrel from December, as attacks on vessels around the Red Sea channel increased uncertainty over global oil shipments. In its latest monthly outlook note for February, **the US Energy Information Agency flagged upside risks to global crude oil prices due to geopolitical factors, expecting prices to rise to the mid-USD80/barrel range in the coming months. However, forecast for 2024 was stable from the previous month at USD82/barrel due to an expected increase in inventories in Q2-2024.**
- **Futures prices also indicate crude oil prices to remain range-bound despite some recent gains.**
- In January, the Indian crude oil basket increased by over USD5/barrel from the previous month to USD82.5/barrel and despite some moderation in early February, has resurged above USD82/barrel. Brent prices have also gained to around USD83/barrel.
- However, **with the upcoming general elections, any pass through from global crude oil price increases is unlikely to trickle down to the domestic economy**, particularly amid speculation of populist measures such as fuel price cuts.

Crude oil prices – Indian basket and Brent



Despite an uptick, Brent futures remain range-bound



Global commodity prices remain vulnerable to geopolitical risks

- **Global commodity prices, including crude oil, remain vulnerable to volatility if geopolitical tensions persist and/or escalate further.** The rerouting of shipments due to the Red Sea disruptions are increasing transit times, shipping costs and are adding to risk premiums.

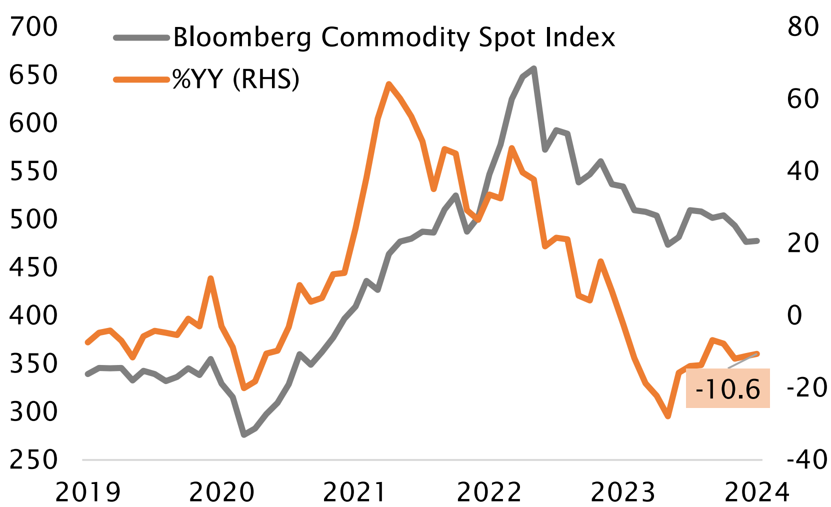
- However, **global commodity prices currently remain contained.** The Bloomberg spot index remained in deflation for the thirteenth consecutive month in January, supported by base effects. The index had peaked in May 2022 after the onset of the Russia-Ukraine war.

- Despite being a safe-have asset, gold prices, including futures prices, have moderated recently.

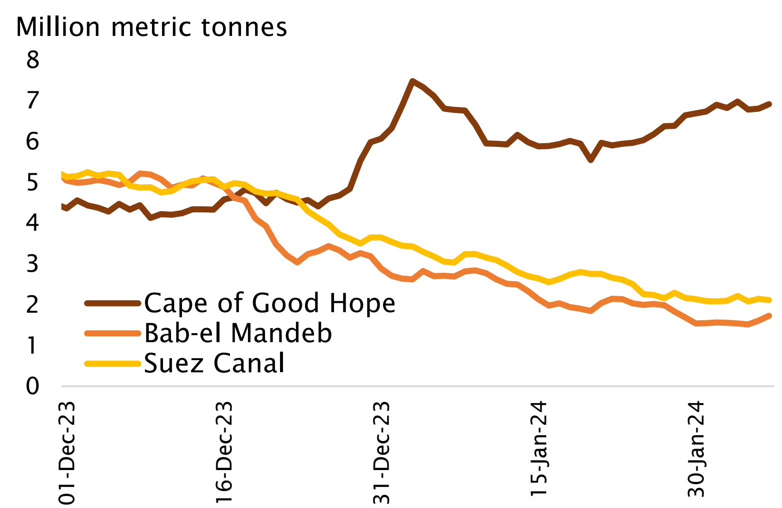
- Even as global growth is likely to remain steady in 2024, **moderation in growth in some of the major economies such as the US and China could cap the upside to commodities demand**, and therefore, prices.

- Global food prices also remain benign, with the **UN FAO index easing further in January** from the previous month level due to lower prices of cereals and meat.

Bloomberg commodity index remained in deflation



Transit trade volume: 7-day moving average



Outlook and policy implication

- **Outlook:**

  - With core inflation close to decade low and the fuel index remaining in deflation, **the inflation trajectory continues to hinge on the outlook for food prices**. Volatility in vegetable prices continues to hinder the disinflationary process, and the latest high frequency data indicates high inflation to persist in February. While this trend in prices of perishables is expected to be seasonal and therefore transient, high inflation in case of cereals and pulses remains worrisome due to its sticky nature.
  - **The central bank woes remain that the recurring food price shocks could become generalized and de-anchor inflation expectations.** RBI's latest survey on households' inflation expectations suggests a higher percentage of respondents expecting an increase in the 3-month ahead food prices.
  - However, the government has actively intervened in the domestic market to ensure food availability and contain prices. The measures implemented have ranged from imposing export and stock limits to selling grains at subsidized rates and extending food subsidies. Such **supply side intervention measures will remain crucial to contain food inflation in the near-term.**
  - **Rabi sowing has progressed well and exceeded last year's levels,** though the winter monsoon remains deficient for the country as a whole amid uneven spatial distribution. Reservoir storage levels remain below previous year's levels.
  - **Reports of waning El Nino conditions and likely emergence of La Nina conditions during June-August augurs well for agriculture output outlook. Also, while core inflation is expected to increase in coming months, favorable base effect could act as a balancing factor. Favorable macroeconomic factors such as a stable exchange rate, lower deficits on the current and fiscal accounts are likely to support the disinflationary process.**
  - **Volatility in commodity prices due to geopolitical conflicts, climate-related risks, strong domestic growth could pose upside risks to inflation.**

- **Policy implication:** In its latest monetary policy meeting in February, the RBI MPC kept policy rates and stance unchanged as its treads the last mile of inflation with caution against premature policy easing that could thwart the ongoing disinflationary process. **With the central bank preference to err on the side of caution, the latest print is unlikely to change the policy path for the central bank**, though it could impinge on its CPI inflation forecast of 5.0% for Q4-FY24. For FY24, RBI's inflation projection was unchanged at 5.4% and was introduced at 4.5% for FY25.

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