INFLATION

13 April 2020

Inflation falls, will ease further

CPI moderated to a 4-month low of 5.9% in Mar'20 led by food inflation. Within food, vegetables and protein based items such as milk, eggs and fish noted considerable deceleration. Core was stable at 4.1%. Given the expected dip in discretionary demand, core inflation is likely to remain muted. Food inflation will see some upside risk in near-term due to supply disruptions. While RBI may reduce rates further, focus of monetary policy will be availability of liquidity with real economy and financial stability.

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KEY HIGHLIGHTS

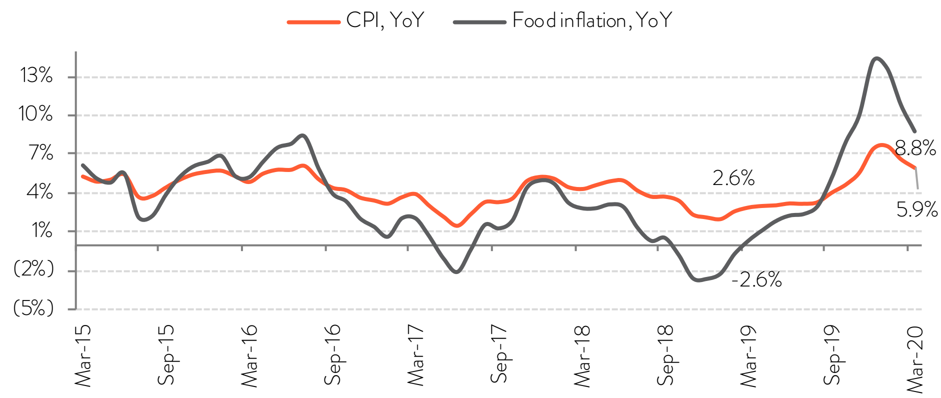
- CPI moderates to 5.9% in Mar'20 compared to 6.6% in Feb'20.
- Led by edging down of food inflation especially vegetables.
- CPI to remain within RBI's 4% target in H2FY21, which opens policy space.

Food inflation softens: Headline CPI eased to a 4-month low of 5.9% in Mar'20 from 6.6% in Feb'20 led by drop in food inflation. Food inflation slipped to 5-month low of 8.8% in Mar'20 from 10.8% in Feb'20 led by vegetables. Vegetable prices increased by 18.6% in Mar'20 compared with a jump of 31.6% in Feb'20. In addition, prices of eggs increased by 5.6% compared with an increase of 7.3% in Feb'20. Other categories such as meat and fish, fruits, pulses and sugar also reported a deceleration.

Core remained stable: CPI inflation excluding food and fuel was stable at 4.1% in Mar'20. Within core, personal care and effects segment saw the maximum increase at 8.9% (+190bps) followed by pan, tobacco and intoxicants (+60bps increase to 4.7%) and clothing and footwear (+6bps increase to 2.1%). On the other hand, considerable decline was visible in transport and communication inflation (-90bps to 4.3%), on account of some pass-through of (-) 39% drop in crude prices in Mar'20. Outlook of core inflation is one of moderation as discretionary demand will be impacted due to lockdown and gradual resumption of economic activity.

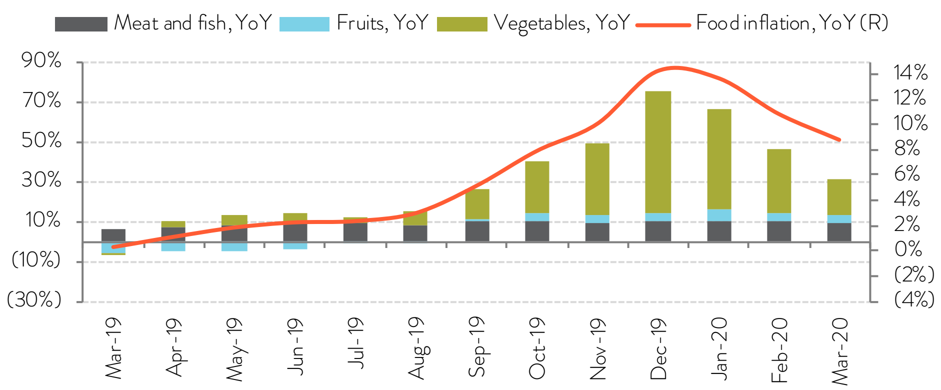
Inflation outlook and monetary policy: RBI's latest forecast for CPI inflation in FY21 is 3.6% with Q4FY21 inflation at 2.4%. Our estimate for FY21 and FY22 is at 3.8% and 3.7% respectively. Minutes from the latest MPC meeting show Dr Dholakia considering further rate cuts to support growth. With a number of states extending lockdown and gradual resumption of economic activity expected, we believe GDP growth for FY21 may fall as low as 1.5% before recovering to 5.3% in FY22. In the above context unconventional monetary policy measures such as extending liquidity lines to banks in order to on-lend to real economy and restructuring of loans may be more relevant along with policy rate reduction.

FIG 1 – CPI FELL BY 70BPS TO 5.9% IN MAR'20 VS 6.6% IN FEB'20



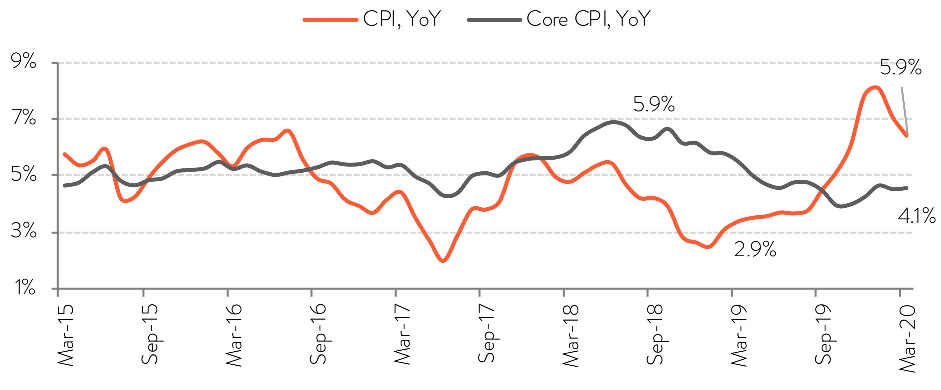
Source: CEIC, Bank of Baroda Research

FIG 2 – LED BY MODERATION IN FOOD INFLATION (8.8% IN MAR'20 VS 10.8% IN FEB'20)



Source: CEIC, Bank of Baroda Research

FIG 3 – CORE INFLATION STABLE AT 4.1%



Source: CEIC, Bank of Baroda Research

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