

## CPI INFLATION CONTINUES ITS DOWNWARD TREND

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CPI inflation moderated to almost 25-months low to 4.25% (SBI estimate: 4.20%) in May'23 as compared to 4.70% in Apr'23, broadly on expected lines driven by base effect. Core CPI although increased marginally to 5.15% in May as compared to 5.12% in Apr, but is still below the one-year average of 5.9%.

The retail inflation remained within the tolerance range of the RBI for the third consecutive month. Nevertheless, continued vigil on the evolving inflation outlook is warranted, especially as the monsoon outlook and the impact of El Niño remains uncertain.

Item wise weighted contribution showed that the 45 bps decline in CPI inflation in May'23 when compared to Apr'23 is attributed majorly to tomato, whose weighted contribution has reduced by 36 bps. Overall, 9 out of top 10 items witnessing decline in weighted contribution in headline inflation are in food and fuel, while one item is under transport and communication.

As per IMDs long range forecast released in May, Southwest monsoon seasonal (June to September) rainfall over the country as a whole is most likely to be normal (96 to 104% of Long Period Average (LPA)). The long-term trends in NOAA's Multi-variate ENSO Index Version 2 shows that ENSO has moved in positive indicating onset of El Niño conditions over the equatorial Pacific Ocean. The Indian Ocean Dipole trends as per NASA IOD index continues to be neutral. Combining the two phenomena, monsoon is expected to be normal.

**Keeping all factors into account, we expect, in FY24 average CPI will be 4.9% compared to 6.7% in FY23.**

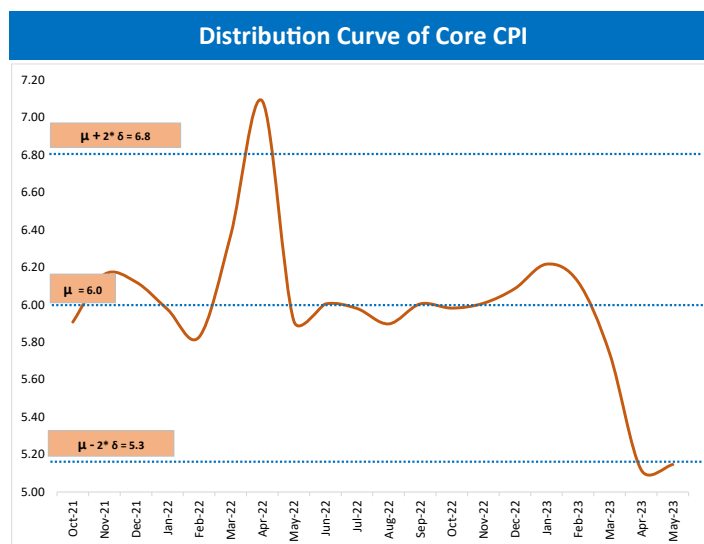
The concurrently released IIP data shows that IIP rose 4.2% yoy in Apr'23 after dipping to 5-months low of 1.7% in Mar'23. While mining increased by 5.1%, manufacturing grew by 4.9%, electricity continued to contract at 1.1%.

Using the AI/ML model the four mutually exclusive scenarios of repo rates constructed by training the data of RBI rate deciding manner for the period of Feb'22 to Nov'22 shows that the current rate of 6.5% is already higher than the required rate of 6.23% (highest among 4 cases).

We expect one more pause by RBI MPC meeting in August 23, while carefully watching the CPI and Core CPI number in ongoing months. While we rule out a rate cut any time soon, we pencil in the first rate cut by RBI in Q4 FY24. The magnitude could be larger than 25 bps.

### CPI INFLATION IS AT 25-MONTHS LOW OF 4.25%

- ◆ CPI inflation moderated to almost 25-months low to 4.25% (SBI estimate: 4.20%) in May'23 as compared to 4.70% in Apr'23 and 7.04% in May'22, driven by base effect. The deceleration in CPI is broad-based, except an increase in few major items. Cereals, spices and milk CPI are still at elevated levels.
- ◆ Core CPI although increased marginally to 5.15% in May as compared to 5.12% in Apr, yet it is still below the one-year average of 5.9%. Fuel and light CPI though decelerated sequentially, on a yoy basis it shows some uptick.
- ◆ **A distribution of core CPI (since Oct-21) indicate that despite the marginal increase, the recent print is below the mean-2\*SD mark. This is a highly optimistic number and may impact the future policy trajectory of RBI.**



Source: SBI Research

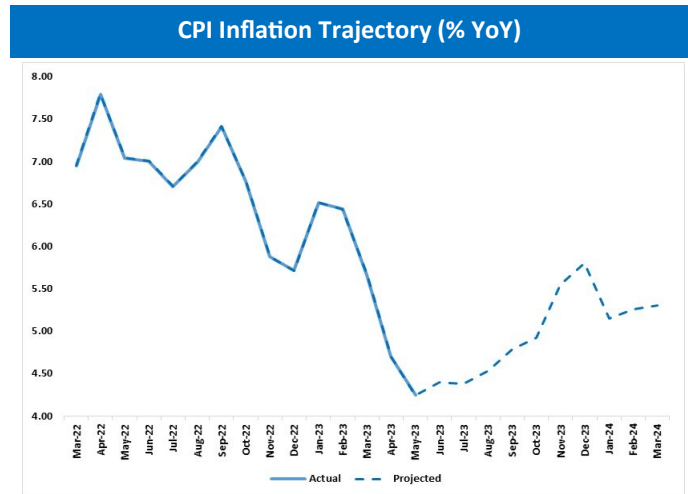
- ◆ Though, the retail inflation remained within the tolerance range of the RBI for the third consecutive month, continued vigil on the evolving inflation outlook is warranted, especially as the monsoon outlook and the impact of El Nino remain uncertain.
- ◆ **We expect, in FY24 average CPI will be 4.9% compared to 6.7% in FY23.**

**ITEM WISE BREAK –UP**

- ◆ Item wise weighted contribution showed that 45 bps decline in CPI inflation in May’23 when compared to Apr’23 is attributed majorly to tomato, whose weighted contribution has reduced by 36 bps. Refined oil, wheat/atta other sources, LPG and kerosene-PDS are other major items whose CPI has declined more when compared to Apr’23.
- ◆ Overall, 9 out of top 10 items witnessing decline in weighted contribution in headline inflation are in food and fuel, while one item is under transport and communication.

**MONSOON UPDATE**

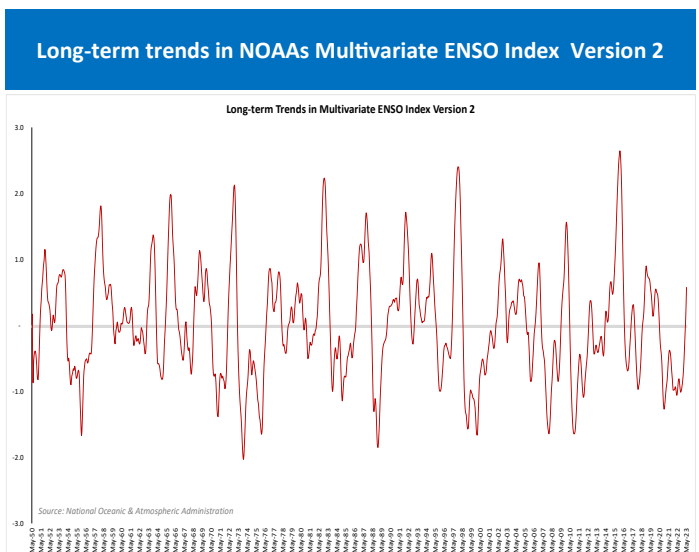
- ◆ As per IMDs long range forecast released in May, Southwest monsoon seasonal (June to September) rainfall over the country as a whole is most likely to be normal (96 to 104% of Long Period Average (LPA)). The LPA of the seasonal rainfall over the country as a whole for the period 1971-2020 is 87 cm.
- ◆ IMDs monsoon forecast for 2023 was based on expectation of high probability for the development of El Niño conditions over the equatorial Pacific Ocean and a positive Indian Ocean Dipole (IOD) condition over the Indian Ocean during the upcoming monsoon season.
- ◆ The long-term trends in NOAAs Multivariate ENSO Index Version 2 shows that ENSO has moved in positive indicating onset of El Niño conditions over the equatorial Pacific Ocean. The IOD trends as per NASA IOD index continues to be neutral.
- ◆ Combining the two phenomena, monsoon is expected to be normal.



Source: SBI Research

Top 10 items contributing to decline in Headline Inflation (May'23-Apr'23)	
Itemwise Contribution	in bps
<b>Food and Fuel Inflation (9 items)</b>	<b>-39 (86%)</b>
<i>of which , wheat/ atta – other sources</i>	-6.6
fish, prawn	-2.1
mustard oil	-4.3
refined oil [sunflower, soyabean, saffola, etc.]	-9.8
banana (no.)	-2.6
<b>tomato</b>	<b>-36.2</b>
cooked meals purchased (no.)	-1.9
LPG [excl. conveyance]	-5.8
kerosene – PDS (litre)	-4.8
<b>Transport and communication</b>	<b>-0.6 (1.3%)</b>
bus/tram fare	-3.1
<b>Overall CPI</b>	<b>-45 (100%)</b>

Source: SBI Research



Source: NOAA

**SCENARIOS OF REPO RATES BASED ON ARTIFICIAL NEURAL NETWORK (ANN) MODEL OF MACHINE LEARNING**

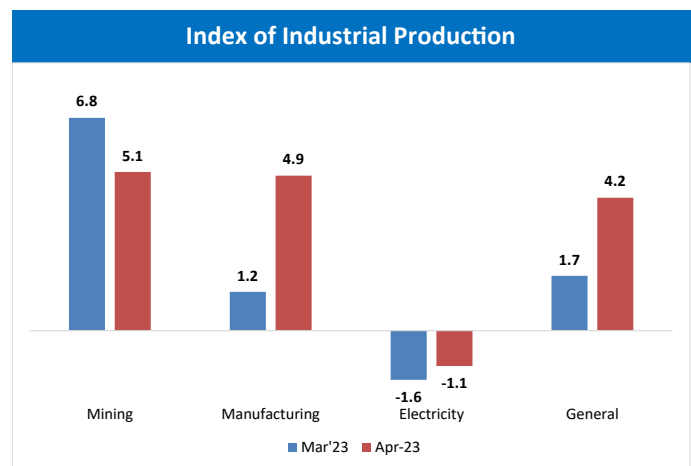
- ◆ We have constructed 4 mutually exclusive scenarios of repo rates by training the data of RBI rate deciding manner for the period of Feb 22 to Nov 22. Data has been trained with 1 month lag.
- ◆ In the first scenario wherein if MPC had only considered domestic CPI headline inflation numbers, while taking a call on repo rate, the peak rate in the cycle would have been at 5.2% and the current rate at 2.14%.
- ◆ In the second scenario wherein if MPC had considered only Fed rate hikes, while taking a call on repo rate, the peak rate in the cycle would have been at 6.21% and the current rate also at 6.21%.
- ◆ In the third scenario wherein if MPC had considered both domestic CPI headline inflation & Fed rate hikes, while taking a call on repo rate, the peak rate in the cycle would have been at 6.23% and the current rate also at 6.23%.
- ◆ In the fourth and most important scenario wherein if MPC had considered domestic CPI headline inflation, CPI Core inflation & Fed rate hikes, while taking a call on repo rate, the peak rate in the cycle would have been 6.27% and the current rate is at 6.18%.
- ◆ **The highest required repo rate among the aforesaid 4 cases is 6.23%. Given that the current repo rate of 6.5% is already higher by 25 basis points than the required rate of 6.23%. Therefore, we expect one more pause by RBI MPC meeting in August 23, while carefully watching the CPI and Core CPI number in ongoing months.**

**INDEX OF INDUSTRIAL PRODUCTION**

- ◆ India’s industrial production rose 4.2% yoy in Apr’23 after dipping to 5-months low of 1.7% in Mar’23. While mining increased by 5.1%, manufacturing grew by 4.9%, while electricity continued to contract at 1.1%.
- ◆ Use-based classification showed that decline in consumer durables persisted, while infrastructure/construction good recorded a healthy growth of 12.8% yoy.

Repo Rate Decomposition (%)					
Month	Repo Rate	Optimal Repo Rate based on mutually exclusive scenario			
		Scenario 1: If the MPC had considered only CPI for deciding Repo rate	Scenario 2: If the MPC had considered only Fed Rate for deciding Repo rate	Scenario 3: If the MPC had considered both CPI and Fed Rate for deciding Repo rate	Scenario 4: If the MPC had considered CPI, Core CPI and Fed Rate for deciding Repo rate
Feb-22	4	3.94	4.01	3.98	3.92
Mar-22	4	4.21	4.01	3.99	4.02
Apr-22	4	5.15	4.23	4.25	4.24
May-22	4.4	5.20	4.23	4.30	4.27
Jun-22	4.9	5.15	4.65	4.64	4.74
Jul-22	4.9	5.15	5.20	5.17	5.15
Aug-22	5.4	5.06	5.60	5.59	5.46
Sep-22	5.9	5.15	5.60	5.60	5.61
Oct-22	5.9	5.19	5.88	5.90	6.02
Nov-22	5.9	5.10	5.88	5.89	5.86
Dec-22	6.25	3.66	6.05	6.07	5.93
Jan-23	6.25	3.11	6.13	6.16	6.04
Feb-23	6.5	4.91	6.13	6.17	6.19
Mar-23	6.5	4.79	6.16	6.20	6.27
Apr-23	6.5	3.01	6.19	6.22	6.26
May-23	6.5	2.17	6.19	6.21	6.20
Jun-23	6.5	2.14	6.21	6.23	6.18

Source: SBI Research



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