

**CPI INFLATION EASES ON THE BACK OF EASING OF SUPPLY SIDE CONSTRAINTS: DEMAND PULL INFLATION CONTRIBUTION HAS RISEN**

Issue No. 25, FY23  
Date: 12 August 2022

CPI inflation moderated to 5-months low to 6.71% in Jul'22 due to easing of food inflation. Fuel CPI, however, increased by 162 bps m-o-m. Core CPI also moderated to 10-months low to 5.79% in July. Our slicing of CPI inflation into Supply/Demand CPI and Neutral indicates that supply side factors which were responsible for 65% of CPI inflation in May now stands at 58% mainly owing to easing of global supply disruptions. Demand factors' contribution has reached 40%.

Though, the overall CPI inflation eased from April to June, among the states, but there are many bigger states, whose inflation continue to be above 7% in July 2022. Among the 23 States, there are 15 States whose inflation is above 6% (21 States in April) and 8 States with inflation rate of below 6%.

Going forward, we now expect inflation trajectory for India to be benign. CPI numbers for March 23 could be even lower than 5%. While the crude has exhibited signs of softening thereby cooling off inflationary concerns further locally, we are in a paradoxical situation where inflation trajectory may not have a cascading effect on runaway exchange rate dynamics as sentiments in South China sea could steer the patchy global sentiments. Also, inflation numbers in US are likely to head lower, though core might remain elevated.

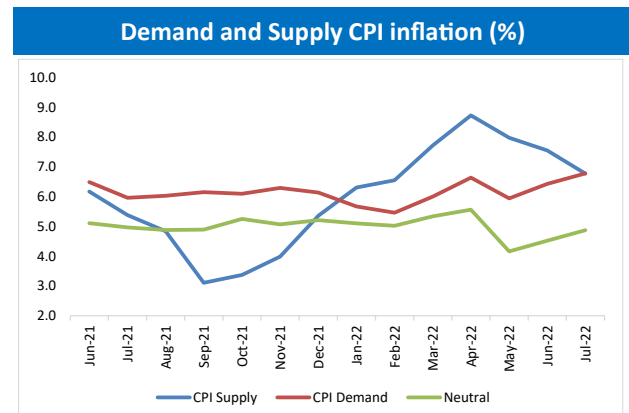
Moderation in the US inflation has increased expectations of slower paces of normalization by US Fed. Going by the past precedence Fed can still aggressively rise rates. In the short run the dollar will appreciate due to falling US inflation and Fed's hawkish stance. There will be flight to safety and the FII flows will be driven by sentiments. The appreciation of the US dollar can feed into imported inflation pressures in India leading to slower correction in CPI reading, and that remains as an upside risk. Under the evolving situation the repo rate will tend to be at 6% +/- 25 bps by end of FY23.

**CPI INFLATION MODERATED**

- ◆ CPI inflation moderated to 5-months low to 6.71% in Jul'22 as compared to 7.01% in Jun'22 due to moderation in food inflation. Fuel CPI, however, increased by 162 bps m-o-m due to increase in crude oil prices. Though July print is above RBI's target for the 7th straight month, we firmly believe that the downward trajectory of inflation has started in India (and possibly in US also). Core CPI also moderated to 10-months low to 5.79% in July. Both Rural and Urban CPI decelerated in July as compared to June.
- ◆ Using the idea from the recent paper by Shapiro (How Much Do Supply and Demand Drive Inflation? FRBSF Economic Letter, June 21, 2022), we have sliced CPI inflation into Supply/Demand CPI and Neutral. Our analysis shows that out of 299 commodities in CPI, 171 are categorised as supply driven, 99 as demand driven and 29 are neutral.
- ◆ Our results show that supply side factors which were responsible for 65% of CPI inflation in May now stands at 58%. This is a good news and in part reflects the easing of global supply disruptions related to the pandemic and the war in Ukraine. Demand factors' contribution has reached 40% from 33%.

Demand & Supply Inflation: Weighted Contribution (%)					
	# of Items		May-22	Jun-22	Jul-22
Demand CPI	99	%	2.3	2.5	2.6
		Share	33%	36%	39%
Supply CPI	171	%	4.6	4.3	3.9
		Share	65%	62%	58%
Neutral	29	%	0.1	0.2	0.2
		Share	2%	2%	3%
Overall CPI	299	%	7.0	7.0	6.7

Source: SBI Research



Source: SBI Research

**STATE-WISE INFLATION**

- ◆ Though, the overall CPI inflation eased from April to June, among the states, but there are many bigger states, whose inflation is continue to above 7% in July 2022. Telangana clocked the highest inflation rate of 8.58% in July, compared to 10.05% in June. Further, Telangana’s rural inflation is above the urban inflation.
- ◆ Among the 23 States, there are 15 States whose inflation is above 6% (21 States in April) and 8 States with inflation rate of below 6%.

**IMPACT OF US FED INFLATION AND RATE ON EMERGING MARKETS**

- ◆ Moderation in the US inflation has increased expectations of slower paces of normalization by Federal Reserve. Going by the past precedence Fed can still aggressively rise rates. Another rate hike in the range 50-75 bps is likely.
- ◆ In the short run the dollar will appreciate due to falling US inflation and Fed’s hawkish stance. There will be flight to safety and the FII flows will be driven by sentiments. The appreciation of the US dollar can feed into imported inflation pressures in India leading to slower correction in CPI reading.

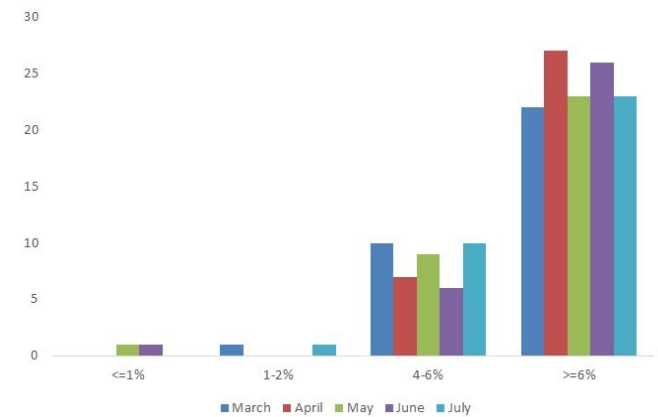
**INFLATION TRAJECTORY & RATE CYCLE**

- ◆ We believe inflation in FY23 is likely to come around 6.4 -6.5% (below RBI projection of 6.7%) with inflation moving below 6% only in Nov’22. For FY24 it should come at 4.8%.
- ◆ However, there is another aspect that RBI would have to consider while increasing rates which is the impact of higher rates on growth. By Dec’21 around 39.2% of the loans are benchmarked to external benchmarks (EBR), so the increase in repo rate of 140 bps will eventually increase interest cost on consumers ~ Rs 42,500 crore on Retail & MSME consumers and demand is likely to be impacted. This may have an impact on growth. Rural demand has also been impacted going by the results of FMCG companies.
- ◆ Under the current situation interest rates will rise including in India. If the rate hike is aggressive in USA and EU in subsequent cycles, then rate hike will reflect in India. Under the evolving situation the repo rate will tend to be at 6% +/- 25 bps by end of FY23.

State-Wise Inflation Rates					
States	Mar-22	Apr-22	May-22	Jun-22	Jul-22
Telangana	7.66	9.02	9.45	10.05	8.58
Assam	8.19	8.54	7.43	7.60	7.91
Gujarat	7.01	8.20	7.35	7.50	7.85
Haryana	7.43	8.95	7.25	8.14	7.83
West Bengal	8.85	9.12	8.27	7.34	7.80
Maharashtra	7.62	8.72	8.52	7.97	7.75
Madhya Pradesh	7.89	9.10	7.16	7.77	7.41
Andhra Pradesh	6.28	7.36	8.55	8.63	7.38
Jammu and Kashmir	7.47	8.03	6.97	7.97	6.95
Rajasthan	7.61	8.12	7.36	7.34	6.93
Uttar Pradesh	8.19	8.52	6.70	6.85	6.89
Chandigarh	5.61	7.37	7.46	7.58	6.42
Chhattisgarh	6.88	7.31	5.92	6.60	6.23
Odisha	6.76	8.08	7.28	7.71	6.13
Uttarakhand	6.66	6.77	6.04	6.88	6.11
Jharkhand	7.49	7.73	7.51	6.86	5.65
Punjab	4.39	7.31	5.77	6.23	5.64
Kerala	4.70	5.08	4.82	5.41	5.36
Bihar	7.56	7.56	5.97	4.68	5.21
Karnataka	5.59	6.39	6.41	6.20	4.86
Tamil Nadu	4.36	5.37	5.72	5.08	4.78
Himachal Pradesh	6.32	6.54	5.63	5.61	4.58
Delhi	5.75	6.58	5.57	5.06	4.13
<b>All India</b>	<b>6.95</b>	<b>7.79</b>	<b>7.04</b>	<b>7.01</b>	<b>6.71</b>

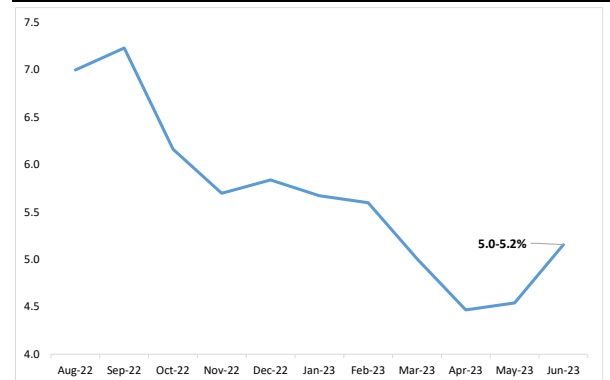
Source: NSO, SBI Research

**Inflation in States (Number of States)**



Source: SBI Research

**Inflation Trajectory (%) - SBI Projections**



Source: SBI Research

**Disclaimer:** The Ecowrap is not a priced publication of the Bank. The opinion expressed is of Research Team and not necessarily reflect those of the Bank or its subsidiaries. The contents can be reproduced with proper acknowledgement. The write-up on Economic & Financial Developments is based on information & data procured from various sources and no responsibility is accepted for the accuracy of facts and figures. The Bank or the Research Team assumes no liability if any person or entity relies on views, opinion or facts & figures finding in Ecowrap.

**Contact Details:**

Dr. Soumya Kanti Ghosh  
Group Chief Economic Adviser  
State Bank of India, Corporate Centre  
M C Road, Nariman Point, Mumbai - 400021  
Email: soumya.ghosh@sbi.co.in,  
gcea.erd@sbi.co.in  
Phone:022-22742440  
 : kantisoumya