

CPI INFLATION DECLINE REFLECT CHANGING CUSTOMER PURCHASING BEHAVIOUR ?...THOUGH FOOD PRICES ELEVATED..GLOBALLY, IT'S THE TIGHTROPE WALKING STILL

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India's retail inflation eased to 3-month low of 5.10% (SBI Estimate: 4.87%) in January 2024, compared to 5.69% in December, due to the decline in food inflation, which has declined to 7.58%. While, prices of intoxicants, clothing & footwear has declined marginally to 3.28% and 3.37% respectively.

While headline retail inflation cooled in January, it has now spent 52 consecutive months above the RBI medium-term target of 4%. On a positive side, inflation has now been within the tolerance range of 2%-6% for the fifth month in a row.

At all-India level, while CPI inflation declined by 270 bps to 5.10% in Jan'24 as compared to Apr'22 level, during the same period the weighted contribution of core CPI declined by 170 bps. Of this decline, the three segments (transportation & communication, clothing and footwear and household goods) contributed 77% of total decline in core inflation: (a) In Rural, these segments contribute 78% decline in core CPI, (b) In Urban these segments contribute 85% decline in core CPI.

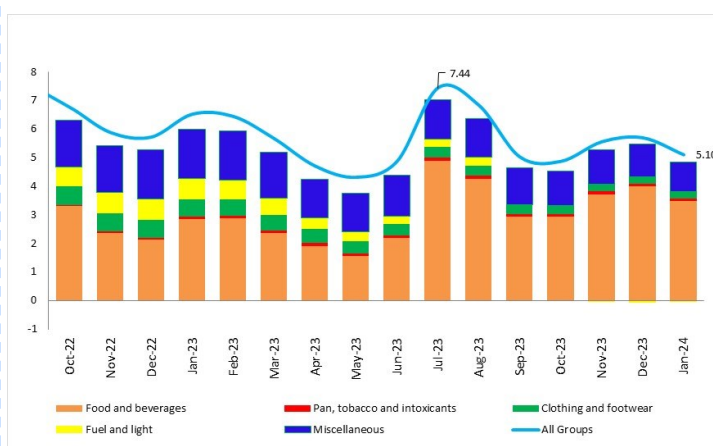
When we analyze the item-wise decline in weighted contribution of core CPI, the results are perplexing. Since the decline in core is visible in both rural and urban areas and in goods and services that are quintessential to the day-to-day living, to confer that core decline is a proxy for decline in demand or rural slowdown is misleading. For example, the 41-bps decline in weighted contribution in clothing and footwear/household goods & services is due to decline in items like saree, shirt, trouser, clothing material, washing soap, bedsheet, etc. that are part of daily living and hence don't indicate that demand is not happening. The only reason for this phenomena could be the changing purchasing behaviour of customers. We believe that peoples are actively using e-commerce websites to buy these essentials (preferably at discounted price) & hence demand is migrating from offline to online mode. if this is durable, then core inflation decline could be enduring. Further, if this is sustained the decline in core could become more enduring in nature opening up space for policy rate cuts. CPI inflation is expected to remain slightly above 5.0% in the remaining two months of this fiscal leading to an average inflation of 5.4% in FY24. Inflation is then expected to decline till Jul'24 (close to 3% in July'24)but increase thereafter to reach a peak of 5.4% in Sep'24, followed by a deceleration. For FY25, CPI inflation is likely to average to 4.6%. In the cereal's subcomponent, the highest price build up is in rice. There is an expected sharp decline in rice production for FY24 to 1063 lakh tones as per the 1st advanced estimate.

Based on alternate scenarios, our ANN model reveals that there is no reason for RBI to cut rates from 6.5%. We continue to maintain that the first rate cut will happen by Q2FY25.

CPI INFLATION EASED TO 3-MONTH LOW OF 5.10% IN JANUARY 2024

- ◆ India's retail inflation has eased to 3-month low of 5.10% (SBI Estimate: 4.87%) in January 2024, compared to 5.69% in December, due to the decline in food inflation, which has decline to 7.58%. While, prices of intoxicants, clothing and footwear has declined marginally to 3.28% and 3.37% respectively.
- ◆ While headline retail inflation cooled in January, it has now spent 52 consecutive months above the RBI medium-term target of 4%. However, inflation has now been within the tolerance range of 2% to 6% for the fifth month in a row.

Weighted Contribution of Retail Inflation (%)



Source: SBI Research

HOW CHANGING SPENDING BEHAVIOR IMPACTS CORE CPI INFLATION

- ◆ At all-India level, while CPI inflation declined by 270 bps to 5.10% in Jan'24 as compared to Apr'22 level, during the same period the weighted contribution of core CPI declined by 170 bps.
- ◆ Of this decline, the three segments (transportation & communication, clothing and footwear and household goods) contributed 77% of total decline in core inflation: (a) In Rural these segments contribute 78% decline in core CPI, (b) In Urban these segments contribute 85% decline in core CPI.
- ◆ When we analyze the item-wise decline in weighted contribution of core CPI, the results are astounding.
- ◆ Since the decline in core is visible in both rural and urban areas and in goods and services that are quintessential to the day-to-day living, to confer that core decline is a proxy for decline in demand or rural slowdown is misleading.
- ◆ For example, the 41-bps decline in weighted contribution in clothing and footwear/household goods & services is due to decline in items like saree, shirt, trouser, clothing material, washing soap, bedsheet, etc. that are part of daily living and hence don't indicate that demand is not happening.
- ◆ The only reason for this phenomena is the changing behaviour of customers in buying things. We believe that peoples are actively using e-commerce websites to buy these essentials (preferably at discounted price) & hence demand is migrating from offline to online mode. if this is durable, then core inflation decline could be enduring.
- ◆ The 14-bps decline in health (non-institutional) is indicative of the fact that peoples are using services at Government hospitals. This is a triumph for Government that trying hard to provide medical facilities to poor at reasonable cost/

Item-wise Decomposition of Weighted Average of Major Core Items				
Item	Combined			
	Weight (%)	Apr-22	Jan-24	Change in bps
Clothing and footwear	6.5	0.64	0.23	-41
<i>of which,</i>				
saree	0.9	0.09	0.03	-6
shirts, T-shirts	0.6	0.06	0.02	-4
baniyan, socks, other hosiery and undergarments, etc	0.5	0.05	0.01	-4
cloth for shirt, pyjama, kurta, salwar, etc	0.7	0.08	0.03	-5
shorts, trousers, bermudas	0.6	0.05	0.02	-3
cloth for coat, trousers, suit, etc.	0.4	0.04	0.02	-2
rubber / PVC footwear	0.3	0.04	0.01	-4
Transport and communication	8.6	0.87	0.16	-72
<i>of which,</i>				
petrol for vehicle	2.2	0.37	0.00	-37
telephone charges: mobile	1.8	0.16	0.03	-13
bus/tram fare	1.4	0.08	0.03	-5
taxi, auto-rickshaw fare	0.6	0.05	0.02	-3
motor cycle, scooter	0.8	0.06	0.04	-2
Household goods and services	3.8	0.29	0.11	-18
<i>of which,</i>				
washing soap/soda/powder	0.9	0.07	0.02	-5
domestic servant/cook	0.6	0.06	0.02	-4
bed sheet, bed cover	0.2	0.02	0.01	-1
Health	5.9	0.44	0.29	-14
<i>of which (non-institutional),</i>				
medicine	4.0	0.31	0.22	-9
doctor's/ surgeon's fee-first consultation	0.8	0.06	0.04	-2
Personal care and effects	3.9	0.33	0.23	-10
<i>of which,</i>				
toilet soap	0.6	0.08	0.02	-7
toothpaste, toothbrush, comb, etc.	0.4	0.02	0.01	-1
powder, snow, cream, lotion and perfume	0.4	0.03	0.01	-2
hair oil, shampoo, hair cream	0.5	0.03	0.01	-2
barber, beautician, etc.	0.6	0.04	0.03	-1

Source: SBI Research

All-India, Rural and Urban core Inflation (%)												
Item	Combined				Rural				Urban			
	Weight(%)	Apr-22	Jan-24	Change in bps	Weight(%)	Apr-22	Jan-24	Change in bps	Weight(%)	Apr-22	Jan-24	Change in bps
Overall CPI	100	7.79	5.10	-270	100	8.38	5.34	-303	100	7.09	4.92	-217
Weighted Contribution												
Core CPI	47.3	3.36	1.66	-170	37.9	3.04	1.42	-162	58.1	3.60	2.01	-159
<i>of which,</i>												
Clothing and footwear	6.5	0.64	0.23	-41	7.4	0.80	0.25	-55	5.6	0.45	0.21	-25
Household goods and services	3.8	0.29	0.11	-18	3.8	0.29	0.12	-17	3.9	0.30	0.11	-19
Health	5.9	0.44	0.29	-14	6.8	0.51	0.33	-18	4.8	0.35	0.25	-10
Transport and communication	8.6	0.87	0.16	-72	7.6	0.70	0.16	-54	9.7	1.06	0.14	-91
Recreation and amusement	1.7	0.12	0.05	-7	1.4	0.07	0.04	-3	2.0	0.17	0.05	-12
Personal care and effects	3.9	0.33	0.23	-10	4.3	0.39	0.24	-14	3.5	0.26	0.22	-4
Core of Core CPI	36.4	2.48	1.50	-98	30.3	2.34	1.26	-108	48.4	2.54	1.86	-68

Source: MOSPI, SBI Research, Core of Core CPI excludes transport and communication

CPI INFLATION TRAJECTORY

- ◆ With moderate fuel prices, inflation is currently being driven by food price dynamics. Looking ahead evolving food prices will determine domestic inflation. CPI inflation is expected to remain slightly above 5.0% in the remaining two months of this fiscal leading to an average inflation of 5.4% in FY24. Inflation is then expected to decline till Jul'24 but increase thereafter to reach a peak of 5.4% in Sep'24, followed by a deceleration. For the whole FY25, CPI inflation is likely to average to 4.6%.

FOOD INFLATION AND ITS COMPONENTS

- ◆ The food inflation sub-component of the CPI registered a growth of 8.30% in January 2024. Although it is lower than the reading in previous month, the food inflation continues to be higher than other sub-components of the CPI basket.
- ◆ The higher food inflation in part has kept the CPI reading for the current month higher than expected. Despite some moderation in vegetables the cereals have kept the overall price momentum intact in CPI food subcomponent.
- ◆ In the cereal's subcomponent, the highest price build up is in rice. There is an expected sharp decline in rice production for FY24 to 1063 lakh tones as per the 1st advanced estimate. Thus, climatic factors such as El Nino have impacted the rice production leading buildup of inflation in this subcomponent.

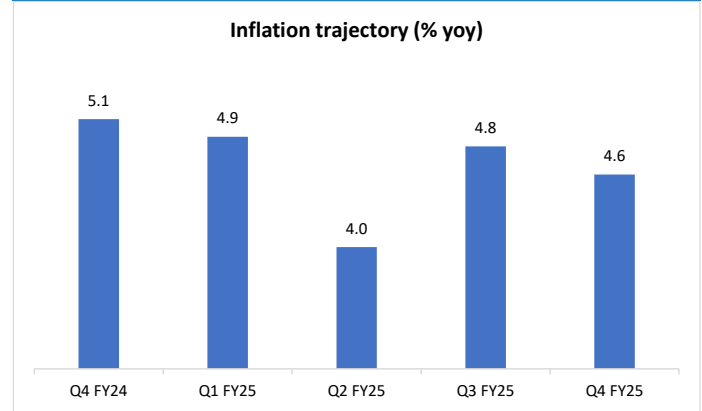
IIP EDGED UP TO 3.8% IN DECEMBER 2023

- ◆ IIP grew by 3.8% in Dec'2023 is up from the November 2023 figure of 2.4%. In December 2022, IIP expanded by 5.1%.
- ◆ Meanwhile, for April-December 2023, industrial growth stood at 6.1% as against 5.5% in April-December 2022.

6.5% REPO RATE CONTINUES TO BE THE NORMAL

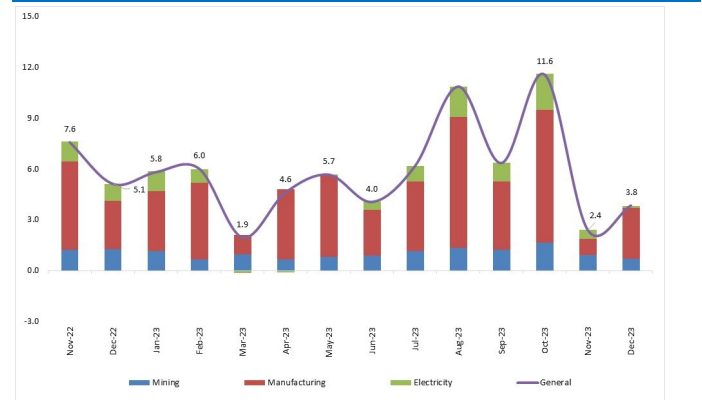
- ◆ Our ANN model upto Aug 23 with lag 1 data of CPI, Core CPI and Fed rate were constructed
- ◆ SCENARIO 1: If the MPC only considers domestic CPI headline inflation numbers, while taking a call on repo rate, the current rate would be at 6.15%.
- ◆ SCENARIO 2: If the MPC had considered only Fed rate hikes, while taking a call on repo rate, the current rate would be at 6.55% .
- ◆ SCENARIO 3: If the MPC had considered both domestic CPI headline inflation & Fed rate hikes, while taking a call on repo rate, the current rate would be at 6.53% .
- ◆ SCENARIO 4: If the MPC had considered domestic CPI headline inflation, CPI Core inflation & Fed rate hikes, while taking a call on repo rate, the current rate would be at 6.57%
- ◆ Based on all the scenarios, RBI may keep the repo rate unchanged at 6.5%, as such the first rate cut is scheduled in Q2FY25.

CPI (%) Inflation Trajectory



Source: SBI Research

IIP & It's Components (%)



Source: SBI Research

Repo Rate Decomposition

		Optimal Repo Rate based on mutually exclusive scenario			
Month	Repo rate	Scenario 1: If only CPI has been considered for deciding Repo rate	Scenario 2: If only Fed rate has been considered for deciding Repo rate	Scenario 3: If both CPI and Fed rate have been considered for deciding Repo rate	Scenario 4: If CPI, Core CPI and Fed rate have been considered for deciding Repo rate
Sep-23	6.5	5.42	6.55	6.51	6.56
Oct-23	6.5	6.21	6.55	6.53	6.68
Nov-23	6.5	6.27	6.55	6.53	6.68
Dec-23	6.5	5.93	6.55	6.53	6.61
Jan-24	6.5	5.84	6.55	6.52	6.53
Feb-24	6.5	6.15	6.55	6.53	6.57

Source: SBI Research

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