

## CPI/WPI Inflation: Risks getting entrenched

India's Headline CPI inflation breached RBI's upper tolerance level of 6.0% by printing at 6.30% in May 2021. Pressures on the core CPI are also apparent with items such as healthcare, transportation and entertainment costs rising. Inflation may remain elevated for the next couple of months before showing some moderation. Even as we think that the RBI might be looking through this uptick as it is mostly supply led, the vigilance of the monetary authority on inflation and its containment could increase.

### Highlights

- CPI inflation breached RBI's upper tolerance level to print at 6.3%; WPI inflation at a new record high of 12.9% in May 2021
- Core inflation (ex. food, fuel) rose 1.45% MoM in May, highest MoM increase since June 2013
- The surprise rise in inflation could start to worry RBI; but we think it is too early to think of normalisation

**CPI food prices pick-up sharply:** On sequential basis, food prices increased by 1.71% in May 2021 after rising by 0.83% in April 2021. Out of 12 sub-components in food index, 10 components increased at a faster pace in May vis-à-vis April, indicating a broad-based pressure. Among the heavy-weights, cereals increased by 1.39% MoM, despite the daily mandi price data showing a contraction in June (as well as in the previous 3 months). This is probably indicative of supply disruptions whereby movement of food grains could have been affected due to lockdown-like conditions. Similarly, prices of prepared meals increased by 0.89% MoM, the highest increase after April 2020 when nationwide lockdown had been imposed. Prices of vegetables increased by 2.64% MoM after contracting in the previous five months. On an annualized basis, food prices increased by 5.24% in May 2021 from 2.60% in April 2021 - both due to sequential rise as also unfavorable base.

**Core inflation firms up sequentially:** Core inflation (ex. food, fuel) picked up by 1.45% MoM in May 2021 from 0.54% MoM in April 2021. This is the highest sequential uptick since June 2013. The increase in core inflation was broad-based (excl. Housing): Personal Care and Effects (+2.64% MoM), Health (+2.16% MoM), Household Goods & Services (+2.11% MoM), Clothing & Footwear (+1.97% MoM), Transport & Communication (+1.57% MoM), and Education (+0.94% MoM). Part of the increase could be attributed to a pass-through of the high input costs faced by manufacturers. On the other hand, the rise in healthcare inflation could be reflective of the effect of the 2<sup>nd</sup> COVID wave. On annualized basis, core inflation came at 6.34% in May 2021 vs. 5.17% in April 2021.

**Wholesale prices rise sharply led by fuel & manufactured products:** Headline WPI inflation printed a new record high of 12.94% YoY in May 2021, rising from 10.49% YoY in April 2021. The increase was driven by fuel (37.61% YoY) and manufactured product prices (10.83% YoY), partially supported by unfavorable base. Excluding food (mfg/non-mfg), the Core WPI rose to a record high of 9.97% YoY (1.05% MoM) in May 2021 from 8.31% YoY in April 2021 (0.91% MoM). Looking at the sequential momentum, WPI inflation picked up by 0.79% with contraction in prices of primary goods (-0.86% MoM) marginally offsetting the sharp pick-up in the price of fuel (1.75% MoM) and manufactured products (1.24% MoM).

- Within fuel, except for LPG prices, prices of petrol, kerosene, ATF and HSD saw a sharp increase on sequential basis.
- In manufactured goods, prices of manufactured food, basic metals, fabricated metal products (except machinery & equipment), electrical equipment and furniture increased.

**Rural Inflation rises more than urban inflation:** The sequential increase in rural prices was 2.16% MoM - the highest in the new series. Correspondingly, urban inflation rose by 1.08% MoM. In the rural districts, prices of clothing & footwear (+2.94% MoM), fuel & light (+3.27% MoM) and miscellaneous products (+2.03% MoM) posted the largest sequential increase in the series so far. Meanwhile, prices of food and pan, tobacco & intoxicants increased for both urban and rural areas. On annualized basis, rural inflation increased by 6.48% in May 2021 (3.75% in April 2021) while urban inflation rose by 6.04% in May 2021 (4.71% in April 2021).

Importantly, within core inflation, broad based increase was noticed across categories like education, transport & communication, household and personal care products for both urban and rural areas. Health expenditure increased sharply by 9.8% YoY for urban districts - posting the largest sequential increase so far. Education expenditure increased sharply for rural areas while for urban areas the increase was negligible. We reckon that the sequential increase in prices of books & journals (1.8% MoM), stationery (1.7% MoM), & tuition fees (1.0% MoM) were more pronounced in the rural districts than in the urban districts.

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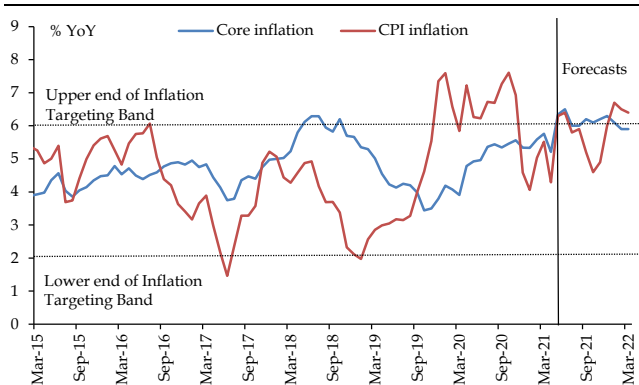
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**Choice for the RBI getting extremely limited:** This month's print clearly highlights the worsening growth-inflation dynamics. Excluding the impact of the temporary shock of 2<sup>nd</sup> wave of COVID-19 on food prices and health expenditure, the trend in core inflation is worrisome to say the least. Additionally, the problem has also worsened from the perspective of regional divergence in services inflation.

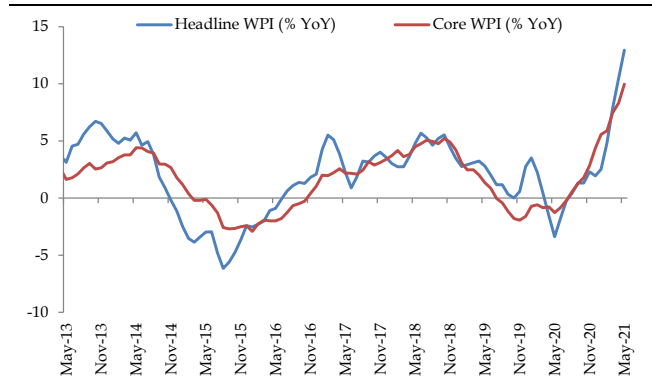
With a galloping WPI inflation, the moot point is how long the manufacturers will be able to hold back from passing on the same to the end users. For now, manufactures might absorb most of the increase in the input costs as the demand side story remains weak. However, if demand tends to normalize with consumer sentiments improving due to wider vaccination, core CPI could tend to remain sticky at a higher level. Thus, with growth lagging inflation, the policy choices for the RBI may get constricted in a very significant way. Having said, we think that the RBI will continue to watch over inflation and stick to its easy monetary policy over the next couple of meetings. This is also on the back of our CPI model that expects inflation to once again comfortably moderate below the 6% threshold by September 2021. **Overall, we expect Headline CPI inflation for FY22 to be at 5.8% (5.0% previously) and the core CPI inflation to be at 6.1% (5.5% previously).**

Exhibit 1: Trend in Headline and Core CPI inflation



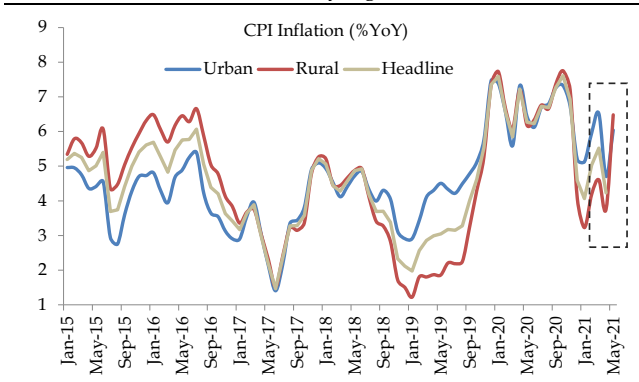
Source: CEIC, Yes Bank Economics Research

Exhibit 2: Trend in Headline & Core WPI inflation



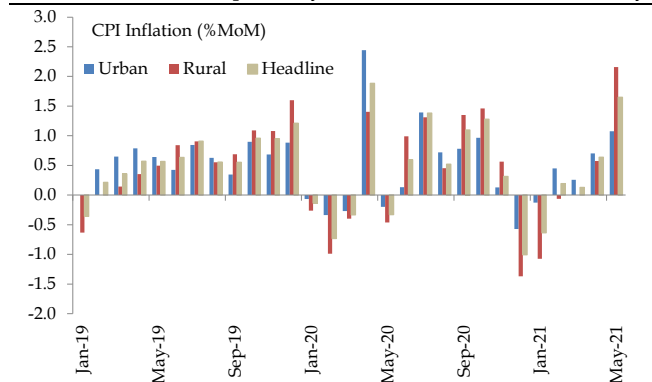
Source: CEIC, Yes Bank Economics Research

Exhibit 3: Trend in CPI inflation by region-Urban & Rural



Source: CEIC, Yes Bank Economics Research

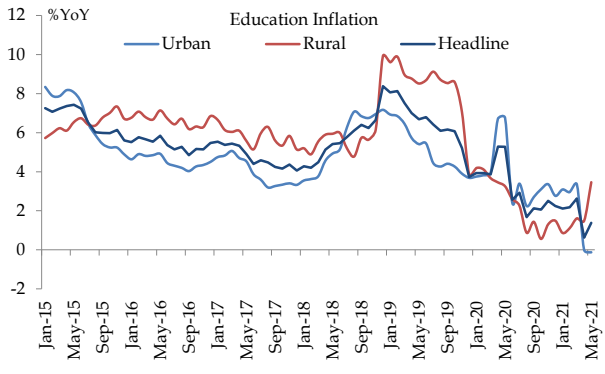
Exhibit 4: Rural CPI sequentially rises more than urban CPI in May



Source: CEIC, Yes Bank Economics Research

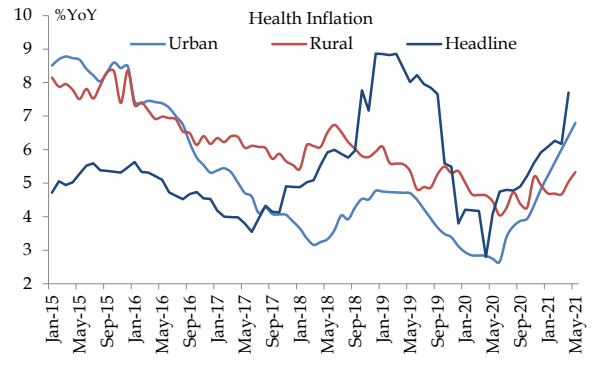
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**Exhibit 5: Education spending in rural districts picks up pace**



Source: CEIC, Yes Bank Economics Research

**Exhibit 6: Health spending in urban areas increased sharply in May**



Source: CEIC, Yes Bank Economics Research

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