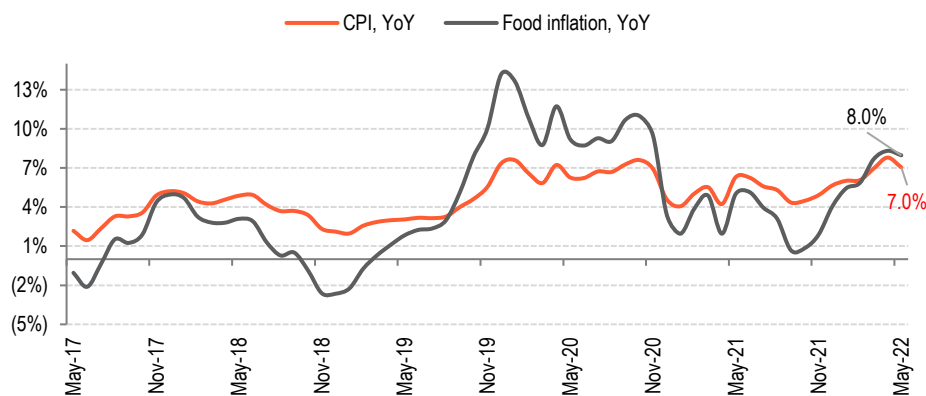


Favourable base supported CPI

Headline CPI in May'22 edged down from its current peak of 7.8% (last seen in Oct'14) to 7%, supported by favourable base. However, what has stood out in this current print is the sequential pickup in food inflation. On the other hand, core inflation has provided some comfort. But going forward we expect CPI to remain elevated at 6.5% in FY23. Keys risks are uneven distribution of monsoon, supply side hindrances and demand picking pace on the back of recovery. Thus RBI is likely to be watchful of these factors and be hawkish regarding future rate hikes.

CPI print supported due to base: India's headline CPI edged down to 7.04% against our expectation of 7% and compared to 7.8% in Apr'22. This was driven by favourable base (6.3% in May'21). Food inflation moderated to 8% from 8.3% in Apr'22. CPI excl. food and fuel edged down to 6% from 7% in Apr'22.

Fig: 1 CPI edged down in May'22 supported by favourable base

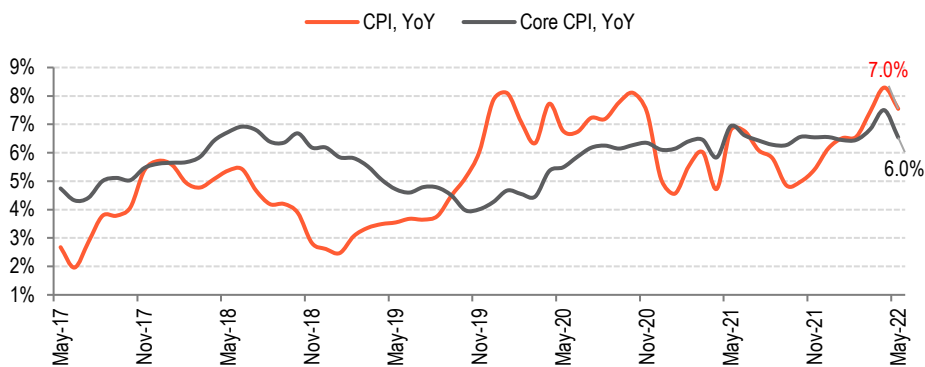


Source: Bloomberg, Bank of Baroda Research

Food inflation accelerates on a MoM basis: If we see the sequential momentum of food inflation, the narrative shows price pressure is building up. On a sequential basis, food inflation increased by 1.6% in May'22 from 1.5% in Apr'22. Among major items which noted a considerable MoM jump within food includes vegetables (5.2% against -0.4% in Apr'22), meat and fish (2.5% versus 0.5% in Apr'22) and sugar (0.6% versus 0.2%).

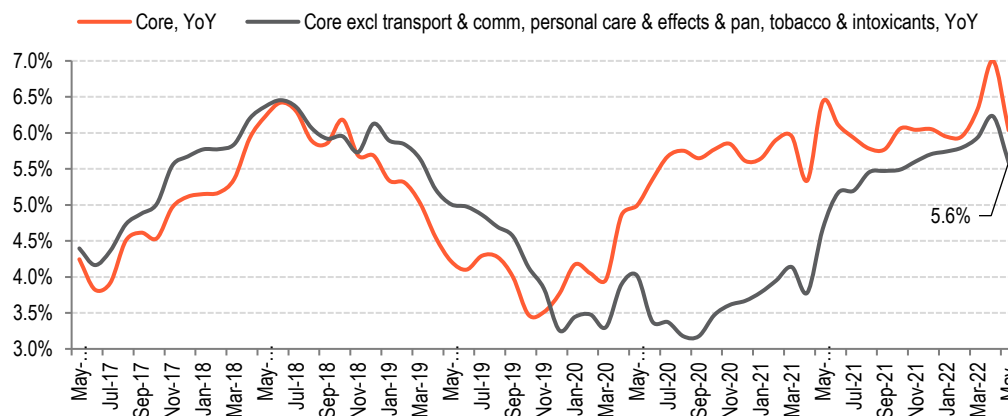
Core inflation showed some moderation: Supported by transport and communication inflation (9.5% against 10.9%, YoY; 0.3% versus 3%, MoM), CPI excluding food and fuel moderated both on MoM and YoY basis. Within the miscellaneous component, governments' excise duty cut and lower gold prices supported lower print in transport and communication and personal care and effects inflation.

Fig: 2 Core inflation moderated to 6%



Source: Bloomberg, Bank of Baroda Research

Fig: 2 Even core excluding volatile items also edged down



Source: Bloomberg, Bank of Baroda Research

Our forecast on inflation: We expect CPI to be ~ 6.5% in FY23. Significant risks emanate from rising crude prices, which are currently at +US\$ 120/bbl. Even the spatial distribution of monsoon plays a significant role in the upcoming days on cereal inflation. Further on a sequential basis, some items of food inflation are still inching up. So a combination of these factors along with supply side bottlenecks will continue to pose upward pressure on headline CPI print. Apart from this depreciating currency will also pose risks in terms of imported inflation Thus, RBI will be more hawkish and aggressive in its pace of rate hikes in the coming months.

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