

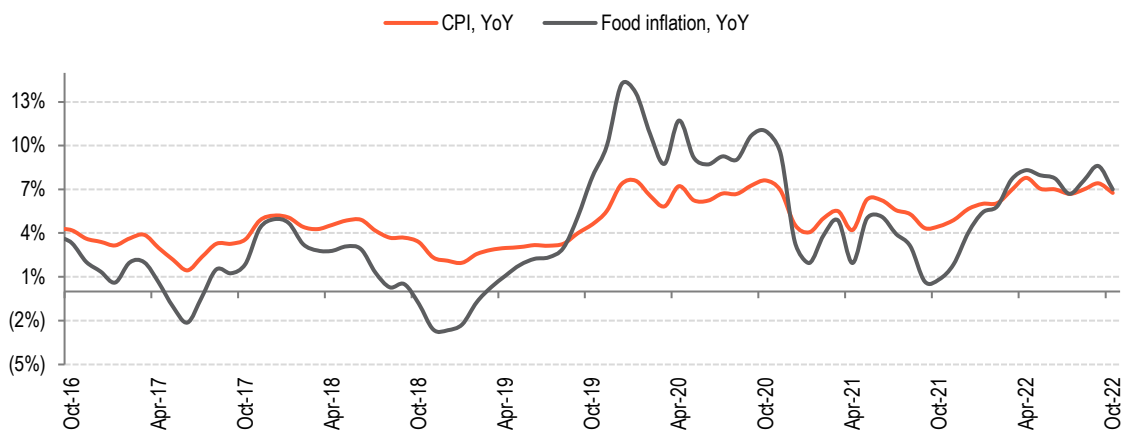
Inflation begins to cool down

Headline CPI moderated to 6.8% in Oct'22 from 7.4% in Sep'22, led by food, fuel and core inflation. Food inflation decelerated to 7% from 8.6% in Sep'22, led by vegetables, fruits, oils and pulses. Core inflation too softened to 5.9% from 6.1%, due to dip in transport & communication segment, as fuel prices cooled down. However, it is expected to remain sticky in the same range as domestic demand indicators remain healthy, also supported by the festive/holiday season. MoM trends in food inflation are showing that risks to food inflation still persist and will have to be watched closely in the coming months. We also expect RBI to continue hiking rates till repo rate reaches 6.5%, with 35bps hike in Dec'22.

CPI inflation cooling down:

In line with our expectations, CPI for Oct'22 came in at 6.8%, down from 7.4% in Sep'22. Food inflation has come down, primarily on account of significant dip in vegetable inflation (7.8% in Oct'22 versus 18.2% in Sep'22), followed by easing prices of oils & fats (-2.2% versus 0.4%), fruits (5.2% versus 5.7%) and pulses (2.8% versus 3%). On the other hand, pressure buildup is visible in cereal inflation (12.1% versus 11.5%), meats & fish (3.1% versus 2.5%), milk & milk products (7.7% versus 7.1%) and eggs (-0.2% versus -1.8%). Going forward, while base effect will be conducive for food inflation, final impact of unseasonal rains on sowing and harvest, movement in international food prices will have to be closely watched.

Figure 1: CPI falls below 7%, aided by food inflation



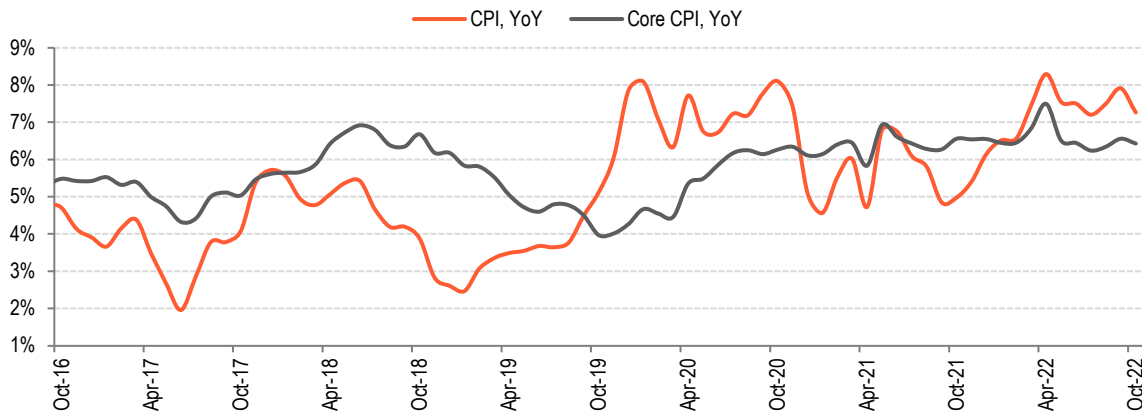
Source: CEIC, Bank of Baroda Research

Core inflation eases:

Core CPI (excl. food and fuel) edged down to 5.9% in Oct'22 from 6.1% in Sep'22. Even RBI's preferred measure of core CPI (core excl. pan, tobacco and intoxicants) eased, albeit at a slower pace of 6.2% versus 6.3% in Sep'22. This was on account of moderation in inflation index for transportation &

communication (4.6% in Oct'22 versus 5.4% in Sep'22) and recreation & amusement (6.1% versus 6.3%). On the other hand, inflation index for clothing and footwear (10.2%), housing (4.6%), household goods and services (7.6%) remained unchanged in Oct'22. Buildup of pressure was seen in index for personal care and effect (7% versus 6.8%), health (5.7% versus 5.6%) and education (5.8% versus 5.7%). Festive season demand could be behind stickiness seen in core inflation data and similar trend can be expected over the next few months as well.

Figure 2: Core CPI too moderates



Source: CEIC, Bank of Baroda Research

Inflationary pressures to come down:

CPI reading for Oct'22 highlights that base effect is beginning to show its impact on headline data. Dip in food and fuel inflation has provided a much needed breather, with food inflation in Oct'22 (7%) slipping to much lower than H1FY23 (7.8%). However, build-up (MoM) in prices of vegetables, fruits, oils & fats, shows that inherent risks in inflation basket still remain. Further, global wheat prices are going up. Domestically too, late rice harvesting has slowed down wheat sowing. In case of core CPI, despite moderation in Oct'22, signs of stickiness remain. Resilient domestic demand, also supported by festive season could be a key reason for this. As we expect consumer demand to remain healthy in coming months as well, pressure on core CPI will be maintained. Despite softening of CPI, we expect RBI to hike rates further, until it is convinced that headline CPI has sustainably fallen within RBI's target range. We expect 25-35bps rate hike in Dec'22 and estimate end-period repo rate at 6.5%.

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