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CPI Inflation Outlook

MPC to revise FY2023 inflation forecast to 6.5% with upward bias

JUNE 2022

Highlights

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Inflationary pressures have broad-based in recent months

GoI's recent measures on critical items such as wheat and edible oils are likely to provide some respite

ICRA projects CPI inflation at 6.5% in FY2023, likely to reach the highest level since FY2014

With crude now seen in the range of US$100-120/bbl, we see an upward bias to our CPI inflation forecast

- The CPI inflation had surged to a 95-month high of 7.8% in April 2022, printing above the 6.0%-mark for the fourth straight month. Moreover, the core-CPI inflation hardened to 6.5% in April 2022, reflecting the rise in input price pressures and higher logistics costs amidst geopolitical developments.
- Inflationary pressures have become broad-based; almost 60% of the 299 items in the CPI basket reported a year-on-year (YoY) inflation rate higher than the MPC's upper limit of 6.0% in April 2022. Besides, the share of items reporting a sequential increase in prices has increased continuously and remains above the average levels seen in the pre-pandemic period.
- Industrial raw material and farm input cost inflation has risen quite sharply and a moderation on this front would be critical in tempering CPI inflation. As per the RBI's IOS* and SIOS~ rounds, manufacturing and services companies expect input cost pressures to remain elevated through Q1 –Q3 FY2023, with a likely transmission to selling prices during this period, thereby putting upward pressure on inflation. Inflation in segments such as services (excl. house rent) and clothing is likely to exert pressure on the CPI inflation prints.
- While household inflation expectations have remained elevated compared to the pre-pandemic period, wage growth is not high at present, implying that India is not witnessing a broader demand-led inflation. Further, consumer demand is likely to be adversely impacted by high inflation, limiting the transmission of input costs to output prices going ahead.
- The GoI's recent measures (such as banning wheat exports, limiting sugar exports, scrapping import duties on the import of crude soyabean and sunflower oils for two years) and the cut in excise duty on fuels is expected to provide some respite.
- ICRA projects headline CPI inflation at 6.5% in FY2023 (+5.5% in FY2022), reaching the highest level since FY2014. The reopening of Chinese cities and improved demand outlook have pushed up crude oil prices. With the price of the Indian basket of crude oil now seen in the range of US$100-120/bbl, and lack of clarity on how much volume and discount at which Indian companies may be purchasing Russian crude, we see an upward bias to our CPI inflation forecast.

*IOS: Industrial Outlook Survey; ~SIOS: Services and Infrastructure Outlook Survey

CPI inflation spiked to 7.8% in April 2022, highest since May 2014

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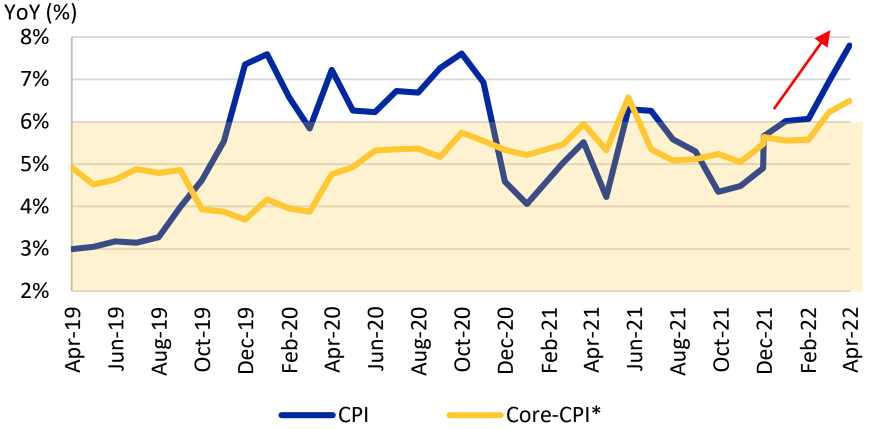
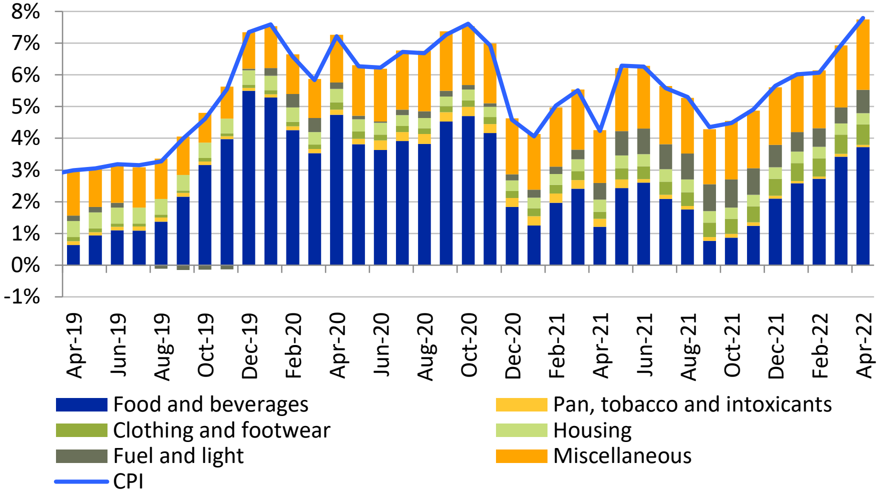
EXHIBIT: YoY trends in headline CPI and core-CPI inflation



Since the detailed data for March-May 2020 is not available, we have not excluded prices for petrol and diesel of vehicles in the calculation of the core-CPI index for the YoY inflation rates in March-May 2021; Source: NSO; CEIC; ICRA Research

EXHIBIT: Composition of CPI inflation (YoY)

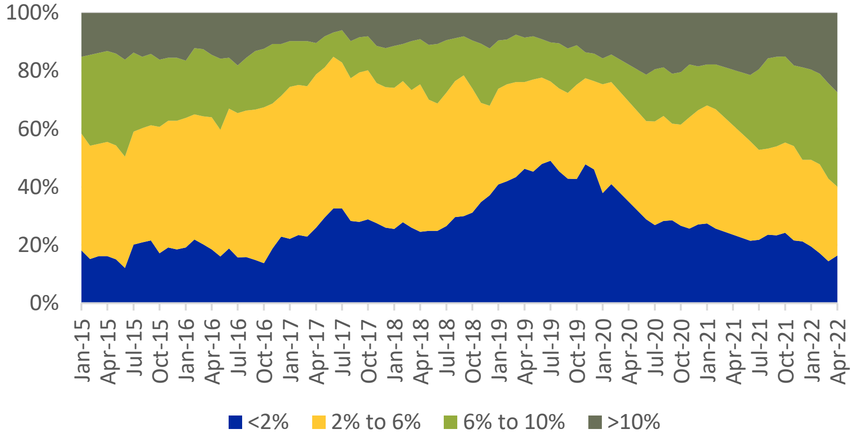


Source: NSO; CEIC; ICRA Research

- The headline CPI inflation has been rising consistently since September 2021 and surged to a 95-month high of 7.8% on a YoY basis in April 2022 from 7.0% in March 2022. The reading was well above the upper threshold of the MPC's medium term forecast range of 2.0-6.0% for the fourth consecutive month.
- The higher-than-expected CPI print for April 2022 was largely driven by the miscellaneous items, fuel and light, and clothing and footwear. Additionally, the inflation for the food and beverages segment rose to a 17-month high of 8.1% in April 2022 from 7.5% in March 2022.
- Moreover, the core-CPI (CPI excluding food and beverages, fuel and light and petrol and diesel index for vehicles) inflation hardened to 6.5% in April 2022 from 6.2% in the previous month, reflecting the rise in input price pressures and higher logistical costs amidst geopolitical developments.

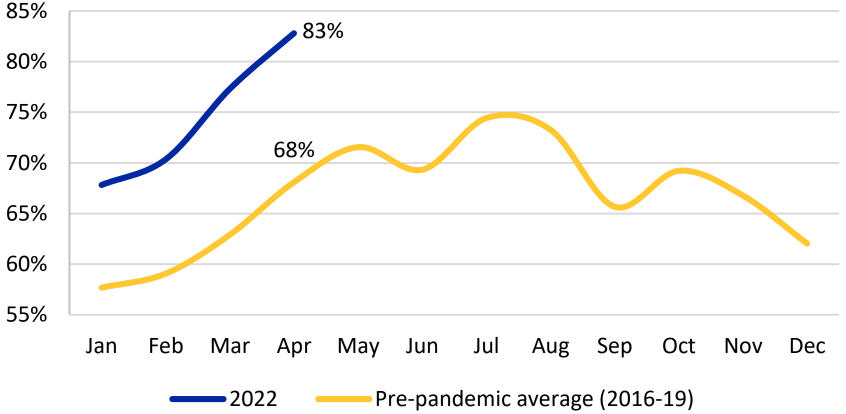
Inflationary pressures have become broad-based with a larger-than-usual share of the CPI basket witnessing a sequential increase in prices

EXHIBIT: Share of items in the CPI basket* as against their specific YoY inflation ranges (% share)



**Based on the 299 items covered in the CPI basket; item-level inflation rates for Apr-Jun 2020 and Apr-Jun 2021 are not available; Source: MoSPI; CEIC; ICRA Research*

EXHIBIT: Share of items in the CPI basket* reporting a sequential increase in prices (%)



**Based on the 299 items covered in the CPI basket; Source: MoSPI, CEIC; ICRA Research*

- The number of items reporting inflation less than 2% has been declining since November 2019, while the number of items recording inflation above 6% has increased persistently during the same period, indicating that inflationary pressures have broad-based.
- Notably, almost 60% of the 299 items in the CPI basket reported a YoY inflation rate higher than the MPC's upper limit of 6.0% in April 2022, suggesting that the recent surge in inflation is not just driven by outliers or a small item set.
- Besides, diffusion in the CPI remained elevated in April 2022, with the share of items in the CPI basket that witnessed a sequential increase in prices increasing to 83% in April 2022 from 78% in March 2022 and 70% in February 2022. These levels are well above the average seen in the pre-pandemic period (2016-2019 for February: 59%, March: 63% and April: 68%), implying that price increases have generalised in the recent months.

Industrial raw material and farm input cost inflation has surged owing to rising global commodity prices, putting upward pressure on selling prices

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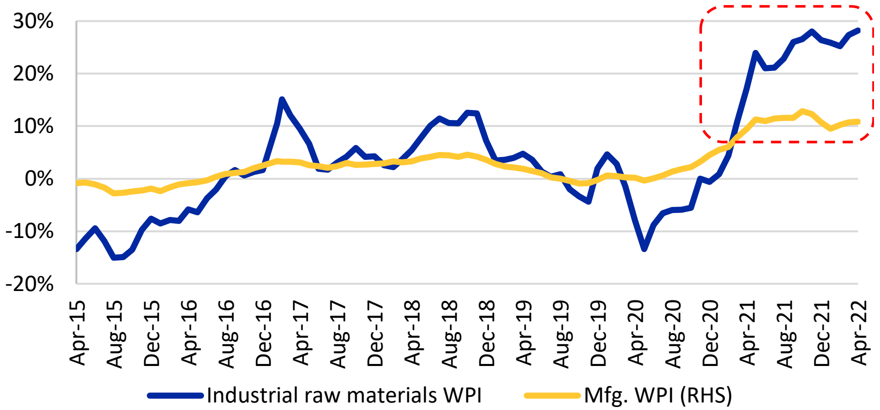
EXHIBIT: Industrial raw materials* and manufacturing WPI (YoY %)



**Comprises primary non-food articles, minerals, coal, aviation turbine fuel (ATF), high speed diesel, naphtha, bitumen, furnace oil, lube oil, petroleum coke, electricity, cotton yarn, and paper and paper pulp from WPI; Source: Office of the Economic Advisor, Ministry of Commerce and Industry, GoI CEIC; ICRA Research*

EXHIBIT: Farm inputs (YoY %)

YoY Growth (%)	Nov-21	Dec-21	Jan-22	Feb-22	Mar-22	Apr-22
Fodder (Wt. in WPI: 0.5%)	0.7	4.3	7.1	11.6	17.7	17.4
Fertilizers/nitrogen compounds (1.5%)	5.4	6.0	7.9	7.9	7.8	7.9
Pesticides/Agrochemical Products (0.4%)	4.5	5.9	8.7	11.6	12.4	11.4
Agricultural/Forestry Machinery (0.8%)	6.7	7.6	7.5	7.9	8.2	8.5
HSD (3.1%)	87.1	70.6	64.0	55.6	52.2	66.1

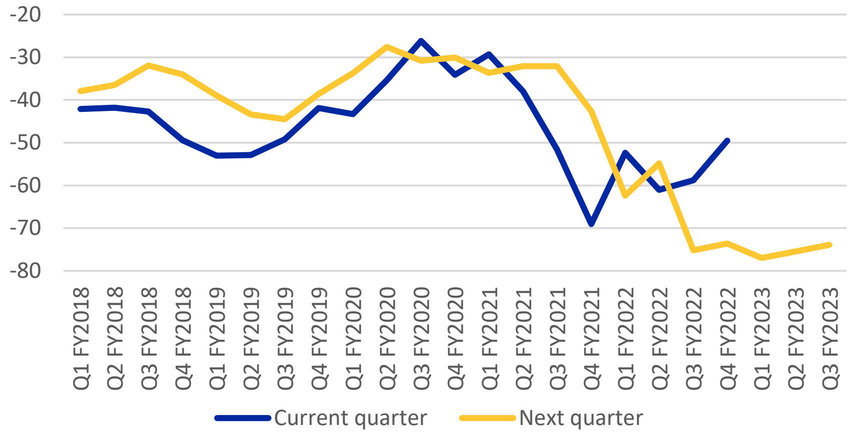
Sequential dip	Sequential pickup	No sequential change

Source: Office of the Economic Advisor, Ministry of Commerce and Industry, GoI CEIC; ICRA Research; HSD: High speed diesel oil

- Input cost inflation, as measured by WPI industrial raw materials has remained elevated even as the base effect has dissipated. Raw materials such as HSD, furnace oil, pet coke, bitumen, electricity, minerals, fibres (such as cotton, silk), oilseeds, etc. continue to witness double-digit inflation.
- Moreover, inflation in farm inputs such as HSD, fodder, fertilizers, pesticides and agricultural and forestry machinery have also picked up.
- **Given that retail inflation is largely driven by cost pressures, a moderation in input costs inflation would be critical for tempering the CPI inflation.**

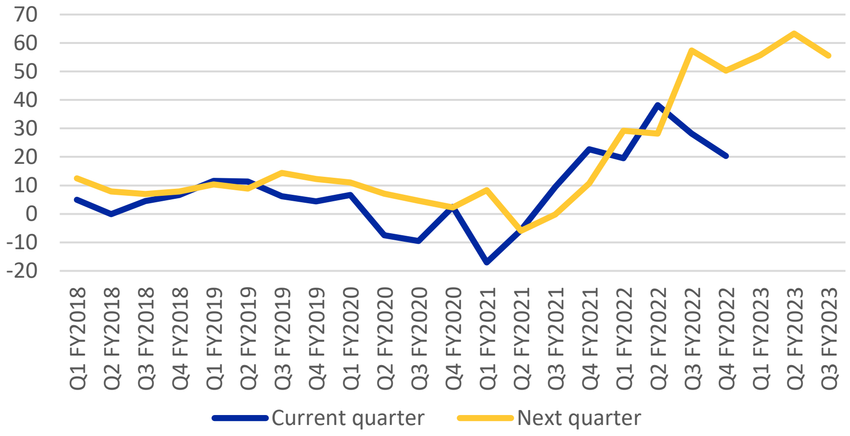
Manufacturing companies expect elevated input cost pressures, rise in selling prices over the next two quarters

EXHIBIT: Assessment and Expectations for Raw Material costs by manufacturing companies (Net responses, %)



Note: NR (Net Response) = Proportion of optimistic responses minus proportion of pessimistic responses; A decrease is RM costs is considered an optimistic response; Source: RBI, ICRA Research

EXHIBIT: Assessment and Expectations for Selling Prices by manufacturing companies (Net responses, %)



Note: NR (Net Response) = Proportion of optimistic responses minus proportion of pessimistic responses; Source: RBI, ICRA Research

- As per the 97th round of the IOS conducted by the RBI, manufacturers perceived continued price pressures with some softening in the pace of increase in input cost and selling prices in Q4 FY2022.
- **However, they expect that pressure from purchase of raw materials are likely to intensify in Q1 FY2023. The respondents expressed higher optimism for growth in selling prices indicating more pricing power combined with input cost pressures vis-à-vis the previous survey round.**
- **Respondents expect input cost pressures to continue and selling price to remain high in Q2 FY2023 and Q3 FY2023.**

Service sector enterprises expect cost burden to remain elevated over the next two quarters, express guarded optimism on selling prices

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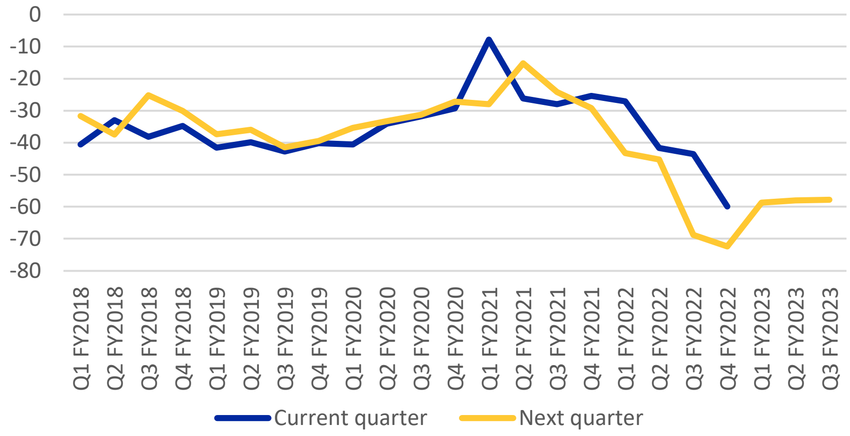
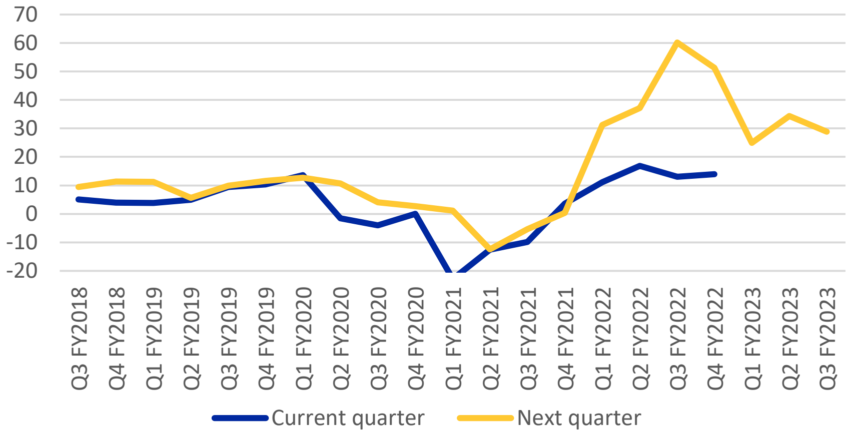
EXHIBIT: Assessment and Expectations for Raw Material costs by service sector enterprises (Net responses, %)



Note: NR (Net Response) = Proportion of optimistic responses minus proportion of pessimistic responses; A decrease is RM costs is considered an optimistic response; Source: RBI, ICRA Research

EXHIBIT: Assessment and Expectations for Selling Prices by service sector enterprises (Net responses, %)



Note: NR (Net Response) = Proportion of optimistic responses minus proportion of pessimistic responses; Source: RBI, ICRA Research

- Service sector enterprises were less positive on the prevailing overall business situation as well as their turnover and employment conditions during Q4 FY2022 compared to the previous quarter. Respondents assessed higher pressure stemming from cost of inputs and marginal improvement in selling price during the quarter.
- **For Q1 FY2023, respondents highlighted that they expect cost burden to remain at an elevated level, although some moderation is expected as compared to the previous quarter. Firms expressed guarded optimism for both selling price and profit margin in Q1 FY2023.**
- **Services firms expect elevated input cost burden in Q2 FY2023 and Q3 FY2023; a significant portion of which is expected to be transmitted to selling prices.**

Household inflation expectations have remained elevated in the post-pandemic period

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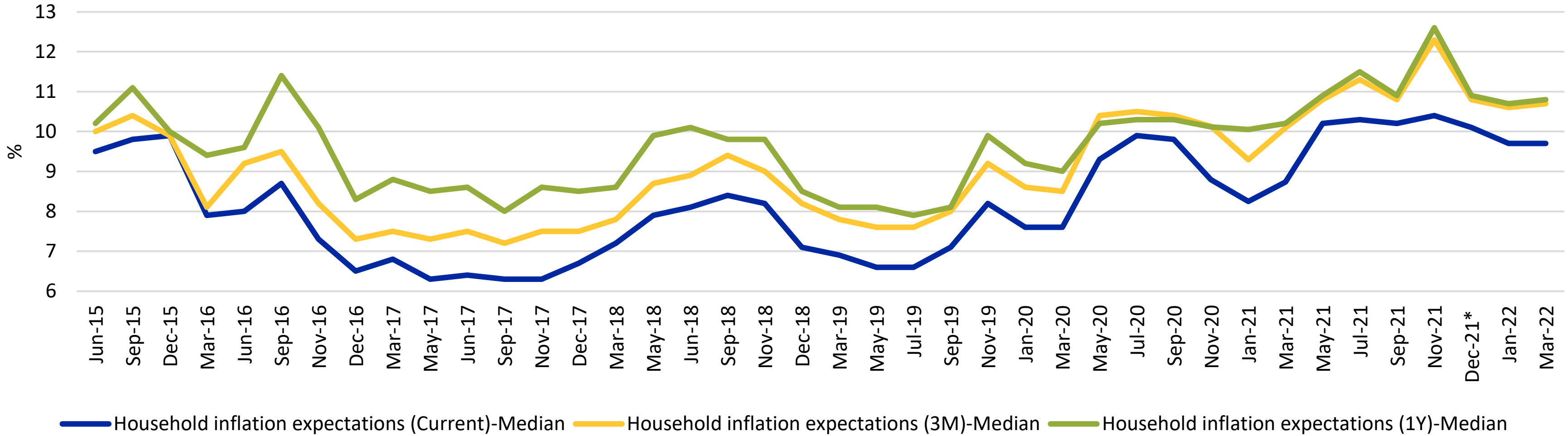
EXHIBIT: RBI's Household Inflation Expectation Survey



- Households' median inflation perceptions for the current period remained unchanged at 9.7% in the March 2022 round, while the expectations for both three months and one year ahead rose by 10 bps each to 10.7% and 10.8%, respectively, as compared to January 2022 round.
- For a majority of population and age groups, uncertainty in inflation expectations increased for both three months and one-year horizons, as compared to the previous survey round.
- **Household inflation expectations are likely to climb further in the May 2022 round following the recent surge in food prices.**

**Extension survey conducted in early Dec 2021, wherein responses were received from 1,274 of the 5,910 households who had participated in the regular survey*
Source: RBI; ICRA Research

No signs of high wage growth implying that India is not witnessing demand-led inflation as yet; moreover, sustained high inflation could contain demand

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EXHIBIT: Growth in nominal rural wages and MGNREGA wages

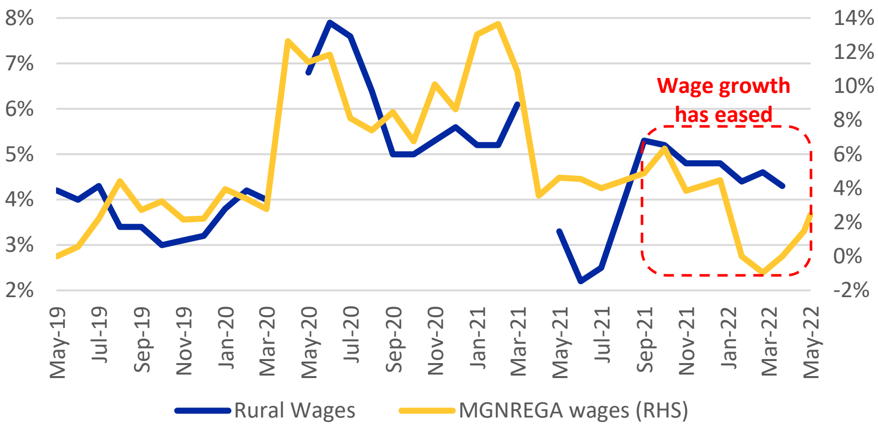


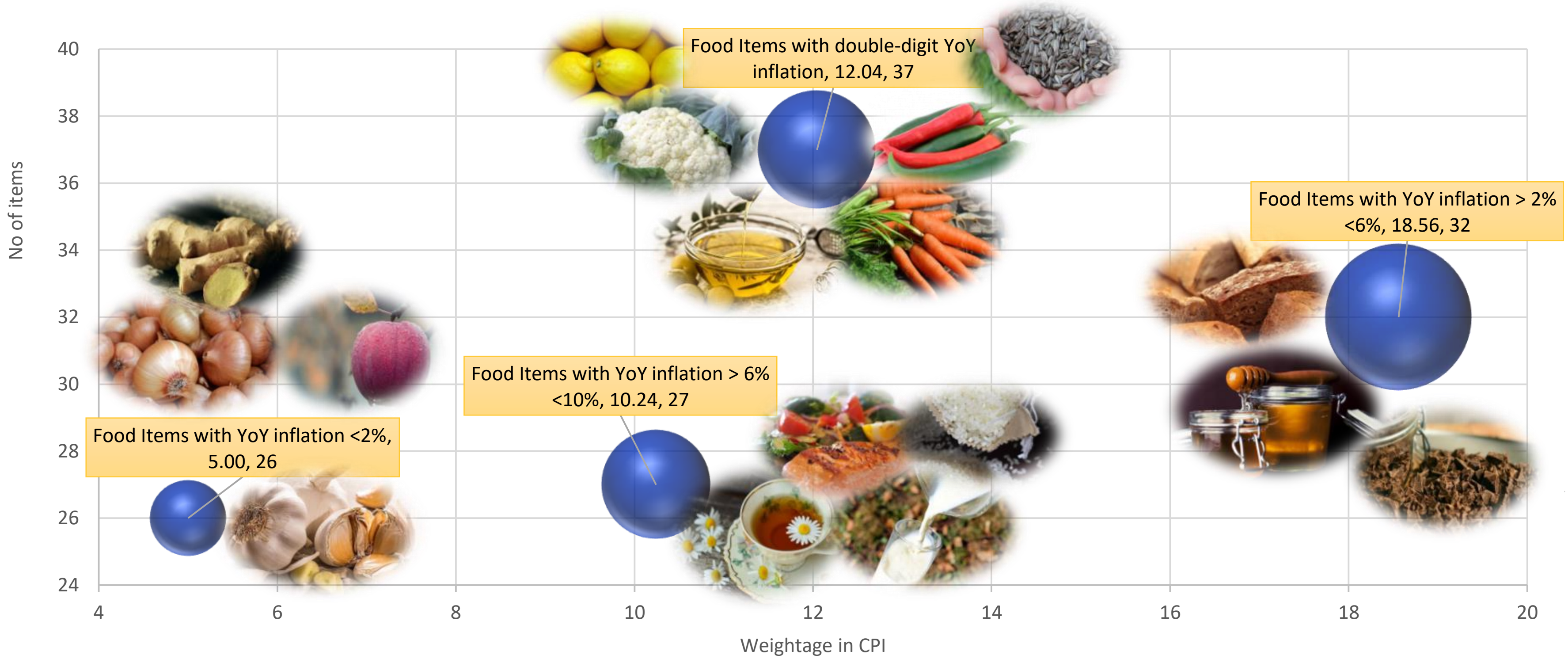
EXHIBIT: Growth in salaries and wages of the listed corporate sector

**YoY growth in rural wages for Apr 2021 has not been included due to unavailability of data on for Apr 2020; Note: Average wage rates are taken for rural labourers in agricultural and non-agricultural sectors; MGNREGA: Mahatma Gandhi National rural employment guarantee act; Source: CMIE; NSO; ICRA Research*

- While the growth in nominal rural wages and MGNREGA wages had spiked following the onset of the pandemic and had remained elevated through FY2021, it moderated in FY2022.
- The wage bill of the listed corporate sector increased by double-digits through FY2022. However, this has been driven by a low base (with a sharp fall in growth in H1 FY2021), rehiring across several service segments (following reopening) and a healthy growth in select segments (such as IT services) and should thus not be interpreted as arising out of high wage growth at the broader level.
- Overall, wage growth is not high (and is negative real terms in 2022 so far owing to high inflation levels) implying that India is not witnessing a broader demand-led inflation. Moreover, demand is likely to be adversely impacted by high inflation.

Food items with 12% weight in the CPI basket reported a double-digit YoY inflation in April 2022, partly impacted by the heatwave

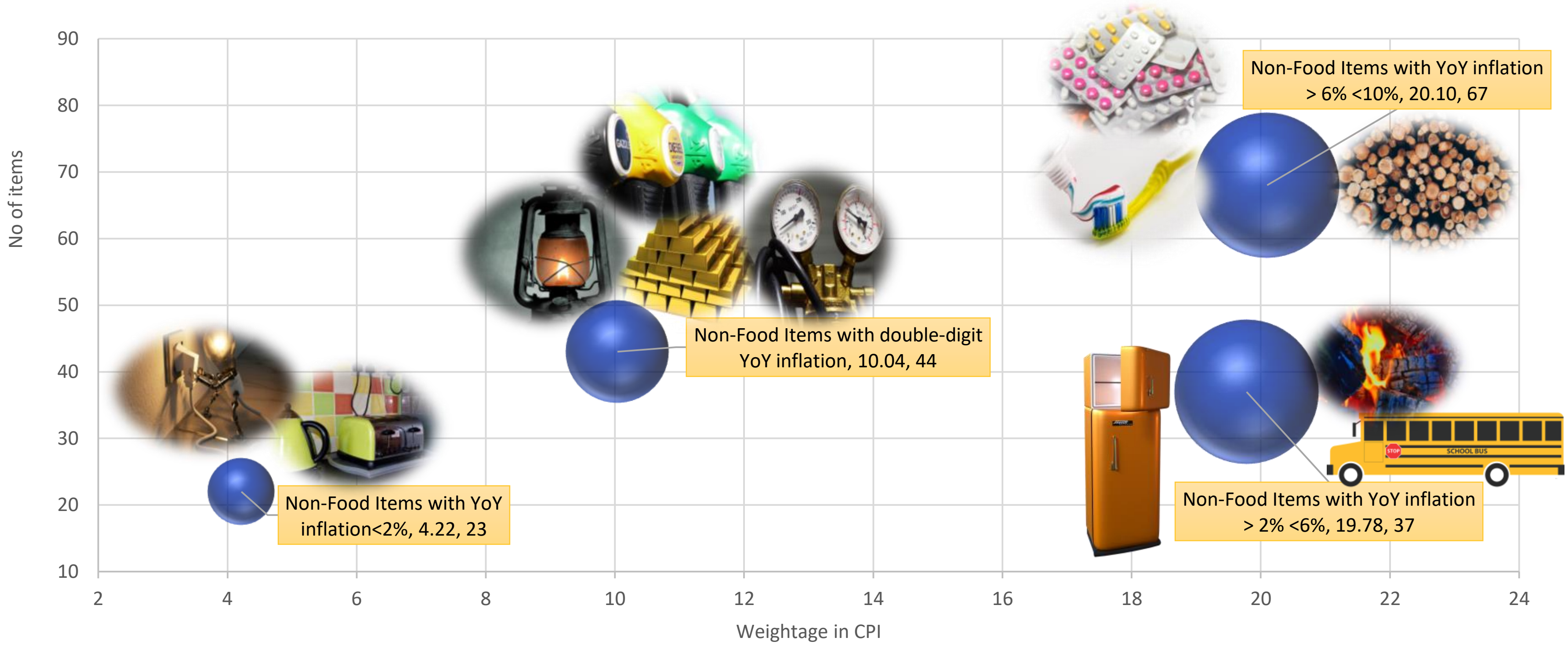
EXHIBIT: Scatter plot of items (weightage and number of items in CPI) having YoY inflation/disinflation under food and beverages sub-group in April 2022



Bubble size represents the weight in the CPI basket; Source: NSO; CEIC; ICRA Research

Non-food items with 30% weight in the CPI basket, such as gold, fuels, medicines and steel utensils witnessed a YoY inflation >6% in April 2022

EXHIBIT: Scatter plot of items (weightage and number of items in CPI) having YoY inflation/disinflation under non-food sub-group in April 2022



Source: NSO; CEIC; ICRA Research

Extreme weather conditions impacting prices of perishables such as tomatoes

EXHIBIT: Annual Production of Vegetables, Roots and Tubers

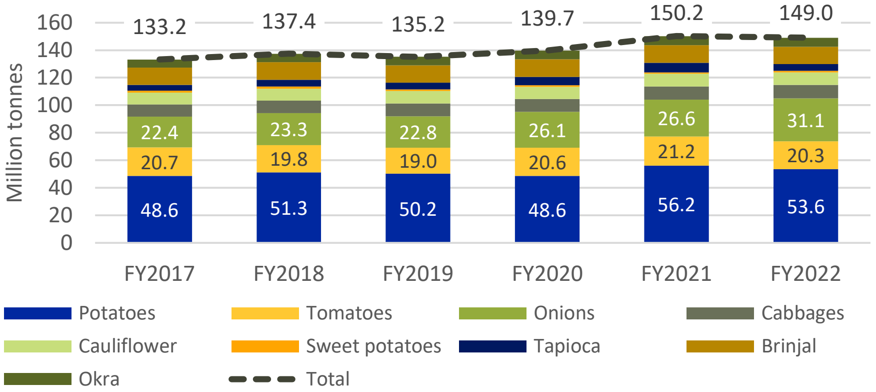
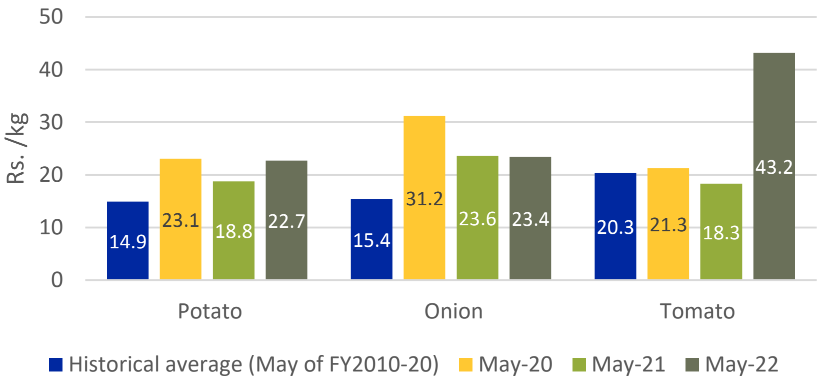


EXHIBIT: Average prices of potato, onion and tomato in May



Note: Data for 2020-21 is as per final estimates. Data for 2021-22 is as per first advance estimates; Source: National Horticulture Board; FAO; DCA; ICRA Research

Weightage in CPI/WPI: 6.0%/1.9%

Vegetables

Output

- As per the first advance estimates (AE) of production, aggregate output of vegetables, roots and tubers is estimated to ease by 0.8% to 149 million tonnes in FY2022 from all-time high of 150.2 million tonnes in final estimates for FY2021. This was on account of lower output expected for potatoes (-2.6 mn tons), tomatoes (-0.9 mn tons) and tapioca (-2.2 mn tons), even as onion production (+4.5 mn tons) is estimated to record a healthy increase in FY2022, relative to FY2021.

Price

- The average prices of tomatoes in May 2022 are twice as high as the prices seen in the historical period, following dwindling supplies from certain parts of the country due to extreme weather conditions such as heatwave in Northwest India and heavy rains in Southern India.
- While average prices of onions in May 2022 were similar to year-ago levels, those of potatoes saw a modest uptick. Nevertheless, prices of both in May 2022 exceeded the respective historical trends.

Recent ban on wheat exports likely to keep domestic prices in check

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EXHIBIT: Final and Advance Estimates for India's Wheat Production

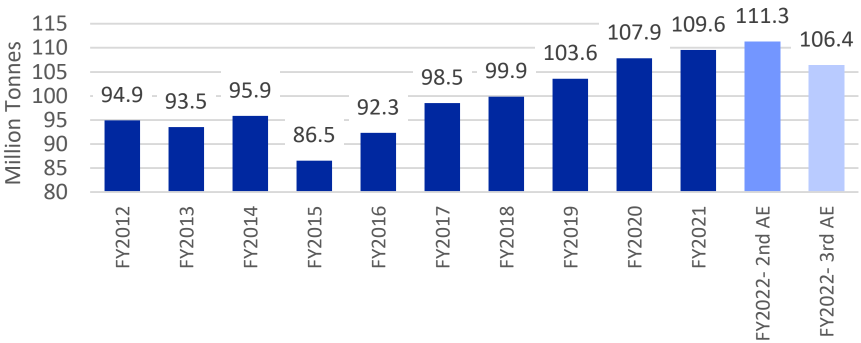
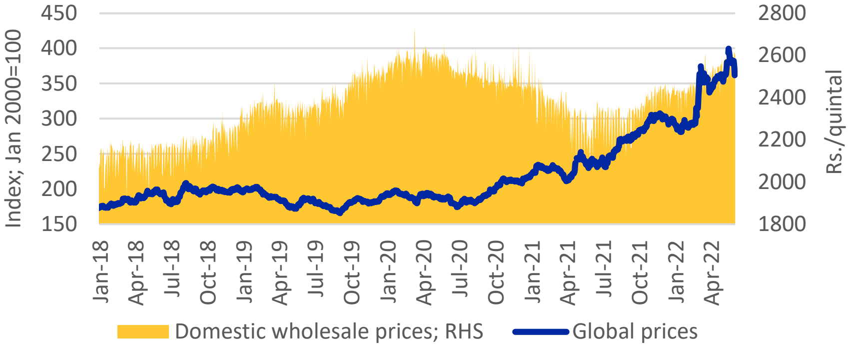


EXHIBIT: Global and Domestic Wheat prices



Source: Ministry of Agriculture and Farmers' Welfare; International Grains Council; Department of Consumer Affairs; ICRA Research

Weightage in CPI/WPI: 2.7%/1.2%

Wheat

Output

- Wheat output is estimated at a four-year low of 106.4 million tonnes (MT), a YoY decline of 2.9% in FY2022 as per the recently released 3rd AE of crop production.
- Relative to the 2nd AE for FY2022, output has been revised downwards by a sizeable 4.4% or 4.9 MT in the 3rd AE, given the impact of heatwave across certain parts of the country on yields and output.

Prices

- Following India's export ban (India accounts for ~5% of world wheat exports) on May 13, 2022, global wheat prices have soared to multi-year highs in the month.
- However, the ban has aided in preventing domestic wheat prices from rising considerably. **Going forward, the ban on wheat exports may limit any sharp price movements in the domestic market.**

Farmers in some states are selling wheat directly to traders given higher market prices vs. MSP, indicating lower procurement by GoI

EXHIBIT: Market Price vs. MSP for Wheat crop in RMS FY2023

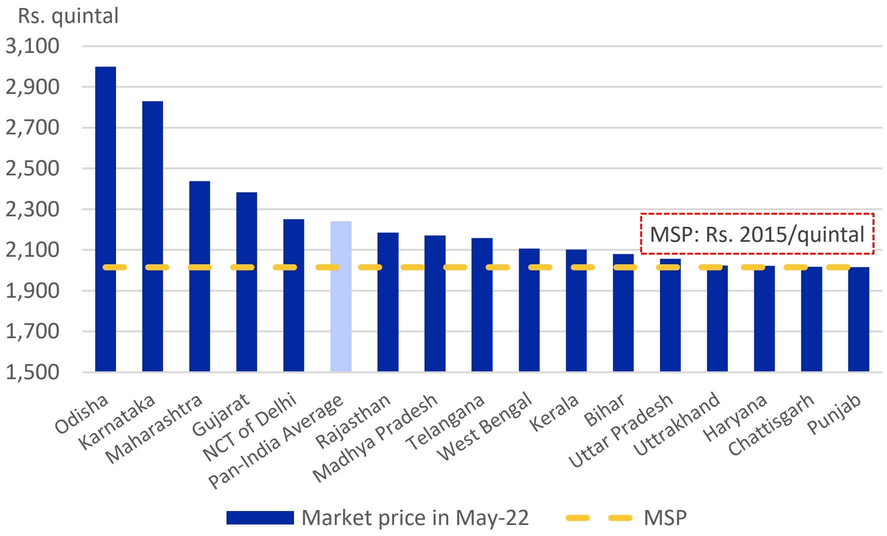
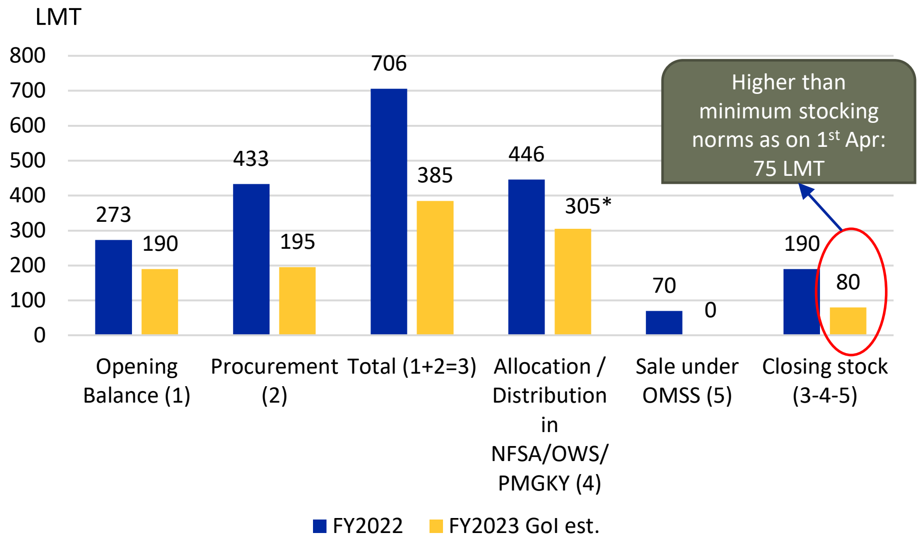


EXHIBIT: Wheat (in Central Pool) Balance Sheet



In states such as Odisha, Maharashtra, Gujarat, MP and Rajasthan, market prices of wheat are higher than the MSP of Rs. 2015/quintal for the ongoing rabi marketing season FY2023, prompting farmers to sell directly to traders and exporters instead of getting the crop procured by the GoI.

In view of this and other factors like lesser production in few states, the GoI has estimated wheat procurement at 195 LMT in FY2023, considerably lower than last year; nevertheless, closing stock is projected at 80 LMT, higher than the FCI's minimum stocking norms of 75 LMT, after taking into consideration the stock required for NFSA, OWS and six months of PMGKY

*55 LMT additional Rice has been allocated in place of wheat in PMGKY; sale under OMSS will depend on final procurement figures; NFSA: National Food Security Act; PMGKY: Pradhan Mantri Garib Kalyan (Ann) Yojana; OWS: other welfare schemes; FCI: Food Corporation of India; Source: Ministry of Agriculture and Farmers' Welfare; Department of Consumer Affairs; ICRA Research

India's export limits on sugar would maintain adequate domestic availability, allowing some price stability in domestic market

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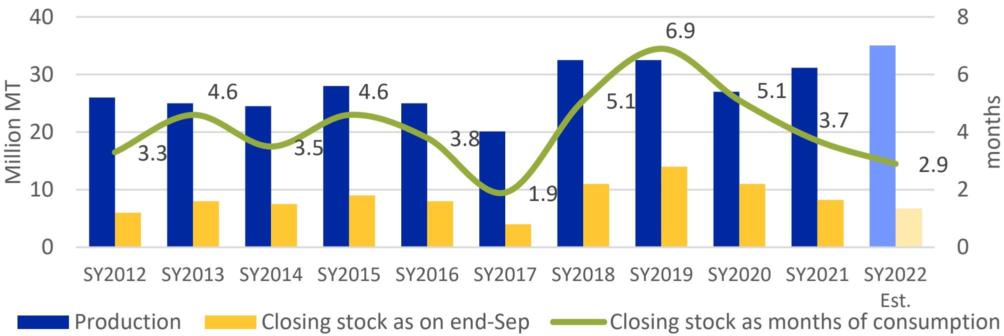
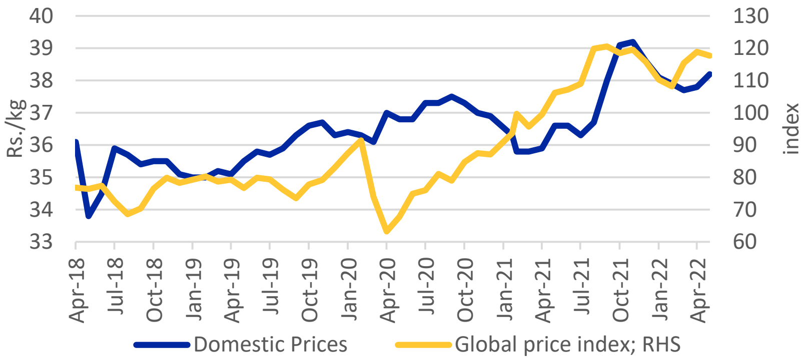
EXHIBIT: Yearly trends in domestic sugar production and closing stock



Source: Indian Sugar Mills Association, ICRA Research; SY: Sugar Year (from Oct 01 to Sept 30)

EXHIBIT: Domestic (wholesale) and International Sugar Prices



Source: DCA; Food Agricultural Organization; Sugar Price Index; ICRA Research

Weightage in CPI/WPI: 1.2%/1.2%

Sugar

Output, exports and closing stock

- According to ISMA's recent estimates, sugar production is estimated at ~35 million MT for SY2022, a healthy YoY growth of 12.3% even after considering diversion of 3.4 million MT towards ethanol.
- The GoI's recent decision to cap the level of sugar exports at 10 million MT for SY2022 effective from June 1, 2022 is unlikely to impact mills significantly as the industry-expected export levels are less than 10 million MT for SY2022 (~9-9.5 million MT). With this, closing stock will moderate from previous season.

Prices

- Since Apr 2022, domestic wholesale sugar prices are on an uptrend, with higher seasonal demand in summers, besides closure of crushing activities. However, the GoI's said move would ensure adequate sugar supply before the onset of crushing season, especially to meet domestic demand during the festive season. This would also allow some stability in prices in the domestic market.

Rise in poultry feed cost fueling pressures in food inflation trajectory

EXHIBIT: Domestic WPI index for meat* and Global Meat Price index^

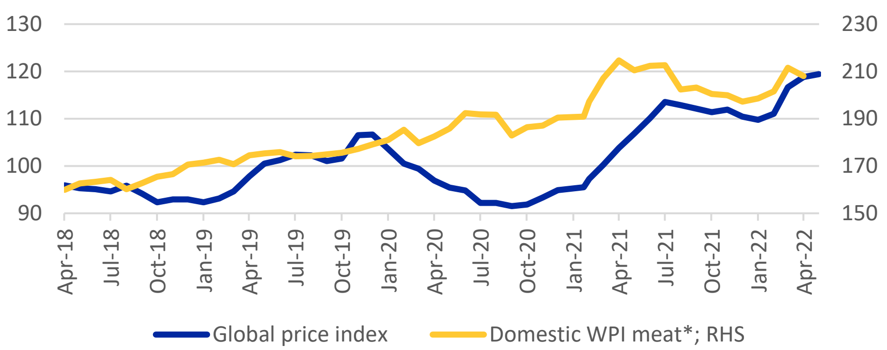
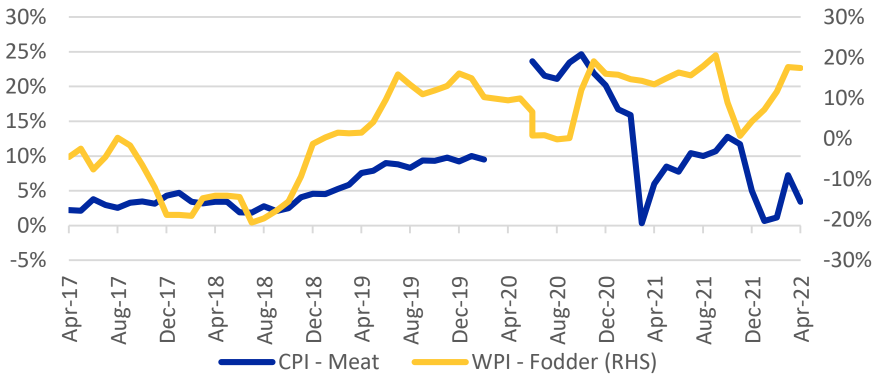


EXHIBIT: CPI inflation for meat and WPI inflation in fodder



*Includes mutton, beef and buffalo meat, poultry chicken and pork; Source: Food Agricultural Organization-Meat Price Index; EAindustry; ICRA Research; ^the value of the Meat Price Index for the most recent months is derived from a mixture of projected and observed prices; ~comprises 60% grains and 35% soybean, groundnut, sunflower meals and 5% vitamin premix and calcium

Weightage in CPI/WPI: 2.3%/1.3%

Meat

Price Movement

- The FAO Meat Price Index reach all-time highs of 122.0 in May 2022, up 0.5% from April 2022, driven by a steep rise in world poultry meat prices, outweighing the declines in pig and ovine meat values. In May 2022, poultry meat prices rose, reflecting the continued supply chain disruptions in Ukraine and recent cases of avian influenza amid a surge in demand in Europe and the Middle East.
- Domestic prices, while tracking the global trend in past few months, saw a mild dip in the constructed meat WPI index (weight: +1.3% in WPI) in April 2022.
- Inflation in fodder remains elevated in double digits in CY2022. While CPI inflation in meat has remained low in CY2022 so far on account of a favourable base, rising fodder prices pose upside risks.

Duty-free imports of edible oils a positive for domestic inflation; nevertheless, high import reliance may limit impact to some extent

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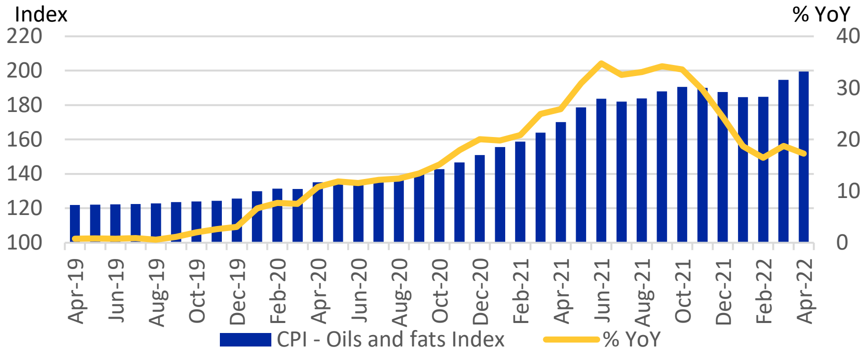
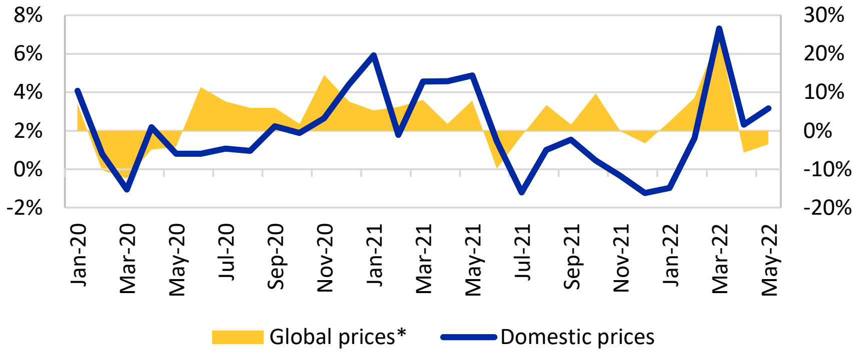
EXHIBIT: CPI for oils and fats



Source: MOSPI; CEIC; ICRA Research

EXHIBIT: MoM trends in domestic and global prices of edible oils



*Global prices are based on the FAO Vegetable Oil Index (Weight of 13.5% in the FAO Food Price Index), consisting of soybean, sunflower, rapeseed, groundnut, cotton seed, copra, palm kernel, palm, linseed and castor; Source: FAO; Department of Consumer Affairs (DCA); ICRA Research

Weightage in CPI/WPI: 3.6%/3.7%

Edible oils

Output

- Following the upward trend in the past six years, the output of oilseeds is estimated to rise to 38.5 Mn tonnes in FY2022 from 35.9 Mn tonnes in FY2021 (YoY: +7.1%), as per the 3rd AE for FY2022 released by the Ministry. Additionally, imports of edible oils have risen by 6.5% in FY2022, in contrast to the trend observed in the past two pandemic-affected years (-3.0% in FY2020; -10.3% in FY2021).

Price Movement

- Led by elevated global prices, the domestic prices of edible oils have risen by 3.1% MoM in May 2022, pushing the YTD increase to ~17% in CY2022 so far.
- **The recent measures taken by the GoI (duty-free imports of 2 mn tonnes each of crude soyabean and sunflower oil for two years) and Indonesia's decision to lift the ban on palm oil exports is expected to cool the prices of such items in the near-term. Nevertheless, persistent geopolitical developments and India's high import reliance may prevent an appreciable correction in edible oil prices.**

Dip in cotton production in FY2022, high international prices pushed up domestic cotton prices

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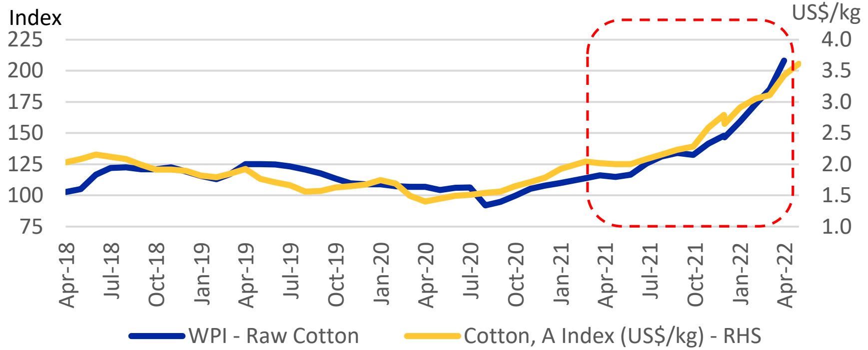
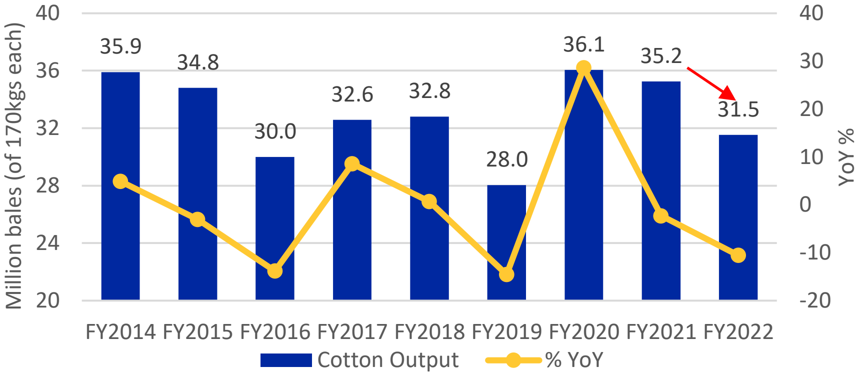
EXHIBIT: WPI for raw cotton (Index: FY2012=100) and Global cotton price (Cotton, 'A' index - US$/kg)



Source: NSO, CEIC, ICRA Research

EXHIBIT: Cotton output (Million bales) and growth (YoY %)



Source: Ministry of Agriculture and Farmer's Welfare; ICRA Research

Weightage in CPI/WPI: 5.6%/3.3%

Cotton/Clothing

Raw cotton prices

- As per the WPI data, the average monthly wholesale prices of raw cotton have surged by ~42% between Dec 2021 and Apr 2022. Prices were 81.2% higher on a YoY basis in Apr 2022. International prices of cotton have also increased quite sharply; the cotton 'A' Index price has risen to an 11-year high of US$3.61/kg in May 2022, nearly 80% higher than year ago levels.

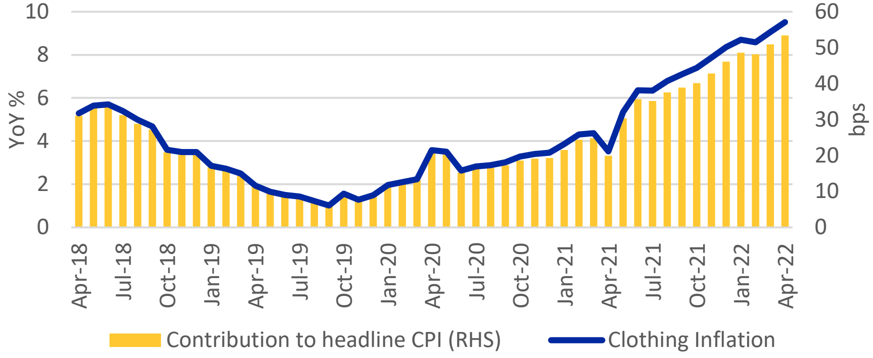
Output

- Lower domestic cotton production, partly owing to the impact on yields on account of the unseasonal rainfall in Nov-Dec 2021, also contributed to the increase in cotton prices. As per the 3rd AE of crop production released on 16th May 2022, cotton output declined by 10.5% to 31.5 million bales in FY2022 from 35.2 million bales in FY2021.
- Given that the marketing season for cotton extends from October to September and more than 90% of crop arrivals take place by May-end, prices are unlikely to correct significantly in the near term unless global prices decline sharply.

Clothing inflation continues to trend higher amidst input cost pressures; expect it to remain elevated through FY2023

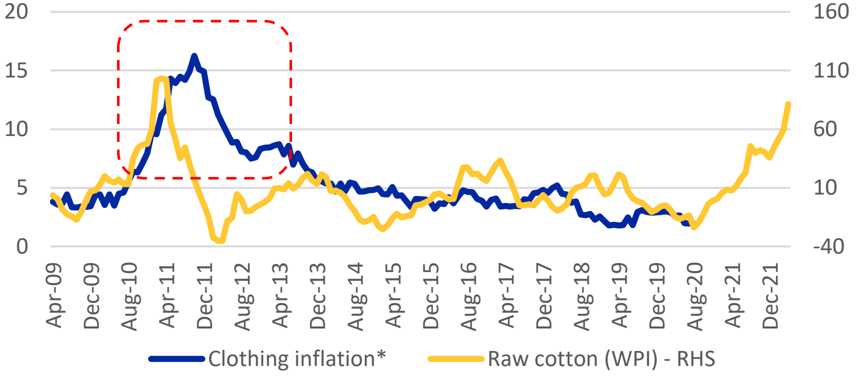
ICRA

EXHIBIT: CPI inflation in the clothing segment (YoY %) and contribution of clothing to headline CPI inflation (bps)



Source: World Bank, Office of the Economic Advisor, Ministry of Commerce and Industry; ICRA Research

EXHIBIT: Raw cotton prices and clothing inflation (YoY %)



*computed from clothing items in CPI-IW (Base=2001); Source: Labour Bureau, Office of the Economic Advisor, Ministry of Commerce and Industry, GoI; CEIC; ICRA Research

Weightage in CPI/WPI: 5.6%/3.3%

Cotton/Clothing

Clothing inflation

- The spike in raw cotton prices has led to the sharp increase in CPI inflation in the clothing segment. The YoY inflation in the clothing segment (weight of 5.58% in the CPI) surged to a 103-month high of 9.5% in April 2022.
- Consequently, the contribution of clothing to the headline CPI inflation has doubled to ~50bps in Mar-Apr 2022 from ~20-25bps in Mar-Apr 2021.

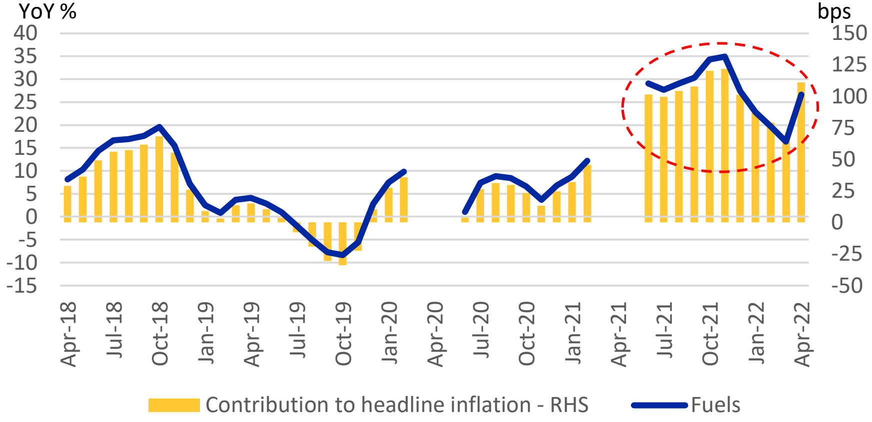
Outlook

- **Clothing inflation is likely to remain quite elevated for most part of FY2023 and correct gradually even if cotton prices correct sharply in the near term.** The last time cotton prices had witnessed a surge similar to the current episode was during 2010 and 2011; inflation in the clothing segment had printed in double digits for 14 consecutive months and had remained elevated for an extended period.

Elevated inflation in fuels is a key contributor to the headline print; excise duty cut on petrol and diesel to mitigate some upside risks to inflation in FY2023

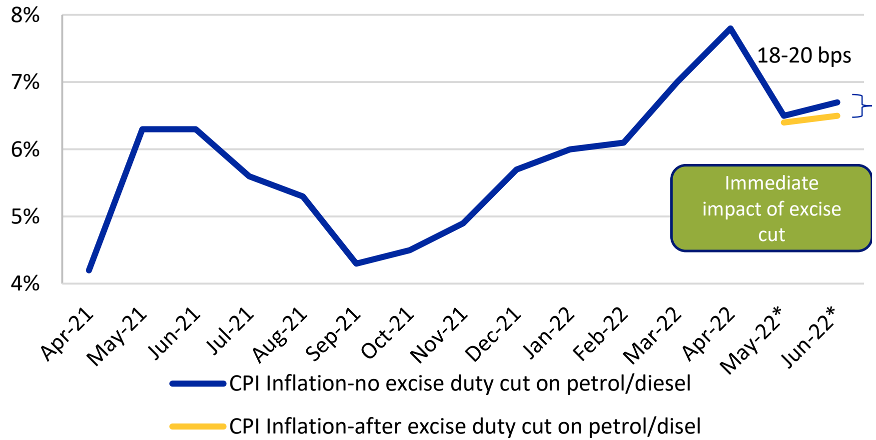
ICRA

EXHIBIT: Inflation in fuels (YoY %) and contribution of fuel to headline CPI inflation (bps)



**Since the detailed data for March-May 2020 is not available, we have not calculated the contribution of fuel and non-fuel to headline CPI inflation for March-May 2021; Source: NSO; CEIC; ICRA Research*

EXHIBIT: YoY Headline CPI Inflation

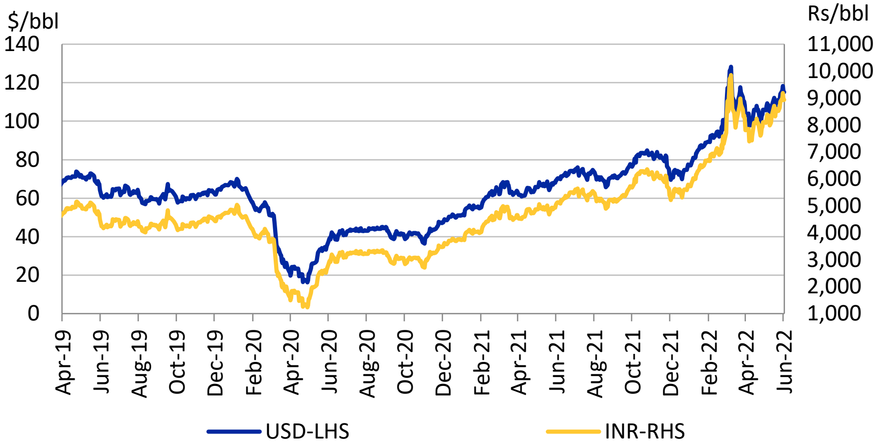


**ICRA's projection for May-June 2022, with and without announcement of excise cut; Source: NSO; ICRA Research*

- Fuel inflation (weight in CPI: 4.2%) has averaged at 27.1% between June 2021 and April 2022. Since June 2021, fuel inflation has contributed an average of 1.0 percentage point (18% on average) to the headline CPI inflation number.
- However, the domestic RSPs of petrol and diesel in metro cities declined in the range of Rs. 7-9/litre on May 22, 2022, following the excise duty cut announced by the GoI, which will help mitigate some of the upside risks to inflation in the remaining part of FY2023.
- **We are projecting the May 2022 CPI inflation print to cool to 6.9% from the 95-month high of 7.8% in April 2022, on account of a high base, and the first-round impact of the excise cut for 10 days in that month.**
- **The direct impact of the reduction in central excise duty on MS and HSD on the June 2022 CPI inflation print would be ~18-20 bps.**

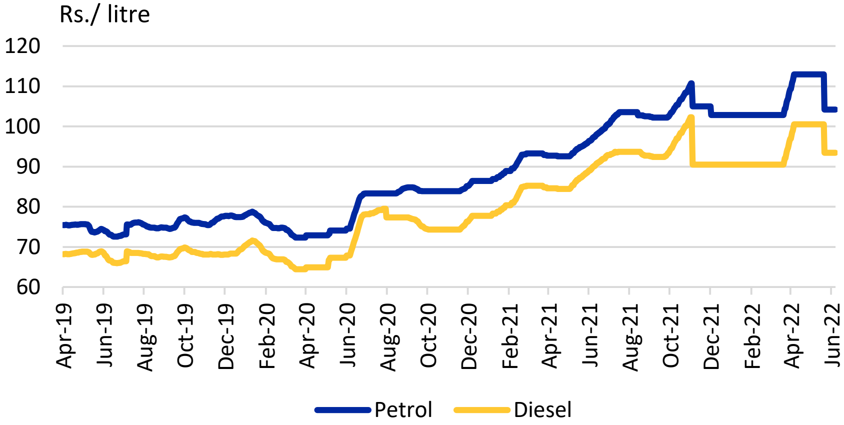
Crude oil price rose to three-month high at end-May 2022; now expected to range between ~US$100-120/bbl through FY2023

EXHIBIT: International Crude Oil Price (Indian Basket terms)



Source: PPAC; ICRA Research

EXHIBIT: Daily average RSPs of Petrol and Diesel in 4 metro cities



Source: PPAC; ICRA Research

- Despite the recent decision by OPEC+ nations to accelerate their monthly output target over the next two months (0.648 mbpd in Jul-Aug 2022; 50% higher than previous target), the price of the Indian crude oil basket rose to a three-month high of US$118.3/bbl at end-May 2022 on account of rising concerns regarding the supply increases amid fresh sanctions by EU countries on Russian oil and the improved demand outlook following the reopening of Chinese cities.
- **ICRA expects the price of the Indian basket of crude oil price to range between US$100-120/bbl through the remainder of FY2023 amidst lack of clarity on the volume and discount, at which Indian companies may be purchasing Russian crude.**
- **With rising crude oil prices, the transmission into domestic fuel prices going ahead is inevitable, adding upside risks to inflation trajectory and limiting gains from the excise duty cut.**

Inflation in services excl. house rent has seen an uptrend in last six months; services demand recovery to exert pressure on services inflation through FY2023

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EXHIBIT: YoY trends in services CPI inflation

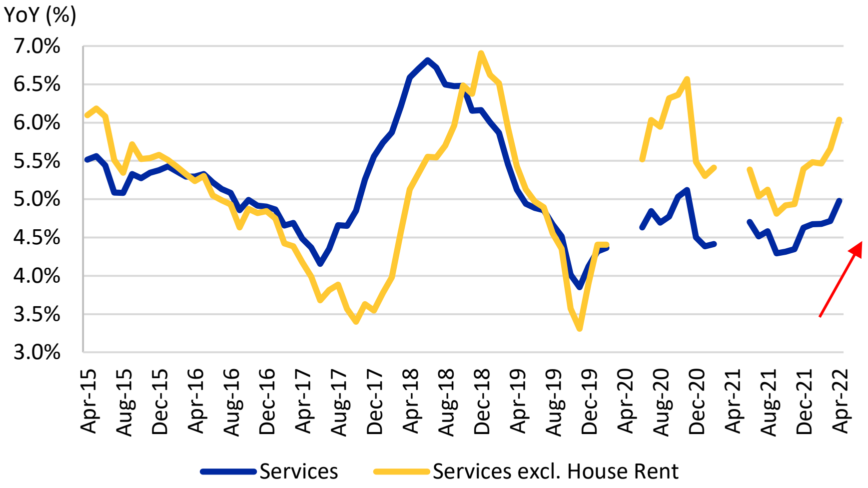


EXHIBIT: Heatmap of YoY inflation in some major sub-components of services CPI

YoY Growth (%)	House rent, garage rent	Tuition & other fees	Mobile charges	Bus/ Tram fare	Monthly charges for cable TV	Doctor's fee	Domestic servant/ cook	Airfare; economy class
Wt. (%)	9.5	2.9	1.8	1.4	0.8	0.8	0.6	0.1
Nov-21	3.5	2.0	3.5	5.4	5.7	5.8	7.9	33.5
Dec-21	3.5	2.3	8.5	4.6	5.3	5.9	8.1	24.4
Jan-22	3.5	2.9	9.6	4.6	5.3	5.2	9.4	22.5
Feb-22	3.5	3.4	9.8	4.3	4.8	5.3	8.9	27.9
Mar-22	3.3	3.1	10.4	4.5	4.7	5.5	8.4	26.8
Apr-22	3.4	4.1	9.6	5.5	5.0	6.1	9.1	20.1

Sequential dip | Sequential pickup | No sequential change

- While inflation in the services segment (weight in CPI: 23.4%) has inched up to 5.0% in April 2022 from 4.4% in Q3 FY2022 and 4.7% in Q4 FY2022, it has remained relatively benign compared to the goods segment. However, this is largely on account of house rent (weight in CPI: 9.5%), which has remained stable at ~3.3-3.5%; excl. house rent, services inflation has surged to 6.0% in April 2022 from 5.1% in Q3 FY2022 and 5.5% in Q4 FY2022.
- Services such as mobile and internet, domestic help, healthcare and travel (airfare, taxi and auto fare) have witnessed an uptick in inflation over the last 3-4 months. **With a recovery in demand for services expected in FY2023, inflation in the services (excl. house rent) segment is likely to remain elevated through the year.**

**YoY inflation for services CPI inflation has not been included for Mar-May 2021 due to unavailability of data for Mar-May ; Source: NSO; CEIC; ICRA Research*

CPI inflation projected at 6.5% in FY2023, the highest in past eight years

ICRA's projection for FY2023

CPI-Food

6.3%

Core-CPI

6.6%

Headline CPI

6.5%

While the recent measures taken by the GoI (ban and limitation on exports of wheat and sugar and scrappage of import duties on edible oils) may contain some of the upside risks to the food inflation trajectory, extreme weather conditions impacting supplies of perishables and monsoon activity remain key monitorables.

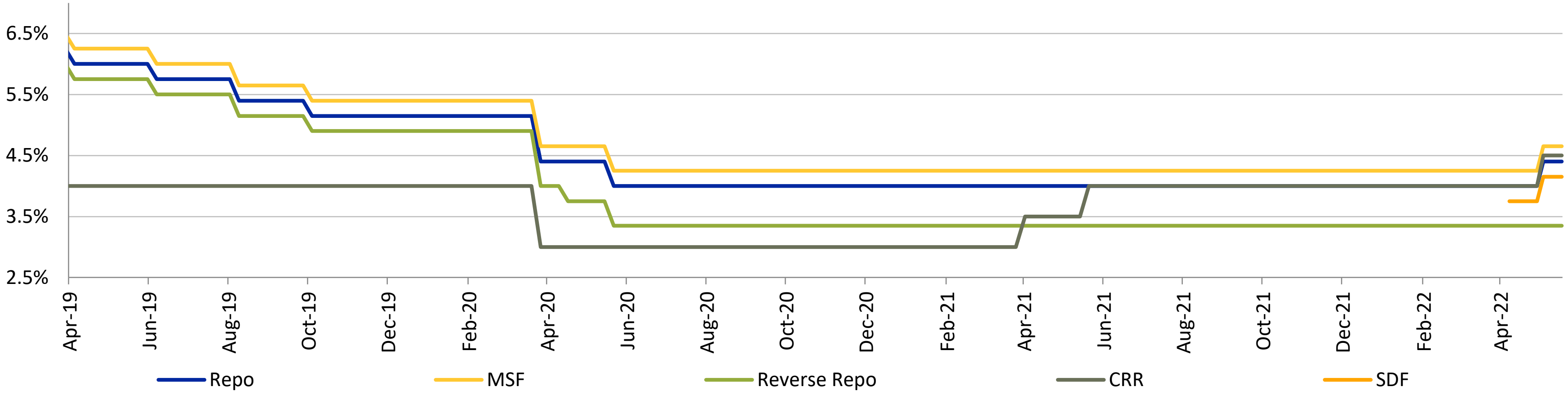
Core-CPI inflation would take a cue from the commodity price movement, the duration of geopolitical conflict, developments in China, sustenance of demand for services, as well as the ability of domestic producers to pass on the input cost pressures. The recent RBI surveys on manufacturing and services companies suggest a continued transmission of elevated input prices.

ICRA projects the headline CPI inflation at 6.5% in FY2023 (+5.5% in FY2022), reaching the highest level since FY2014, amid a broad-based rise in the inflation across the CPI basket. With the price of the Indian basket of crude oil now seen at US$100-120/bbl, we see an upside bias to our CPI projections, despite the cooling impact of the excise duty cuts.

ICRA expects a repo rate hike of 40 bps in June 2022 review followed by 35 bps each in Aug 2022 and Sep 2022 reviews

ICRA

EXHIBIT: Movement in Key Rates



Source: RBI, DBIE; ICRA Research

- The MPC hiked the policy repo rate and CRR by 40 bps and 50 bps, to 4.40% and 4.50%, respectively, while remaining accommodative. By advancing the rate decision by approximately one month, the MPC focused on preventing inflationary expectations from unanchoring in an increasingly uncertain environment.
- Although the May 2022 excise cut has distinctly lowered the probability of highly front-loaded rate hikes, the resumption of the uptrend in crude oil prices poses a concern.
- **While the MPC is likely to maintain its growth projection at 7.2%, we expect it to raise its inflation forecast for FY2023 to 6.5% with an upside bias from 5.7%.**
- **We foresee the MPC to hike the repo rate by a further 40 bps in the June 2022 review and 35 bps each in the Aug 2022 and Sep 2022 reviews. This is expected to be followed by an extended pause to assess the robustness of growth. We believe that overtightening is not warranted under the current circumstances as inflation is being fuelled by global supply side factors and it may needlessly sacrifice domestic growth and sentiment.**

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Thank You!