SBI RESEARCH

ECOWRAP

CPI INFLATION EASES ALONG EXPECTED LINES BUT THE ROAD AHEAD COULD BE BUMPY DUE TO MONSOON MAYHEM: FOLLOW THE FED SEEMS ENTERING ITS TWILIGHT YEARS AS MORE CENTRAL BANKS LOOK INWARDS TO DECIDE ON RATE TRAJECTORIES ALIGNED WITH DOMESTIC FACTORS

Issue No. 11, FY25
Date: 12 Aug 2024

India's CPI inflation eased to almost 5-years low to 3.54% in Jul'24 as against 5.08% in June, smoothened in part by a base effect. This is also the first time in last five years that CPI inflation is lower than the RBI's target of 4%. The sharp deceleration in vegetable prices (from a high of 29.3% in June to merely 6.8% in July) is the major contributor to this multi-year low retail inflation. The weighted contribution of vegetables also decelerated from 1.77% in June to 0.55% in July. Apart from vegetables, fruits and fuel & light also exhibited moderation in July. Contrary to the sharp moderation in overall CPI ,there is slight increase in the core CPI inflation. The core CPI increased from 3.12% in Jun'24 to 3.30% in July, primarily due to increase in mobile tariff. Transport and communication inflation increased by 2.48% in July from 0.97% in June. The gap between core CPI and overall CPI has turned lowest since Apr'23.

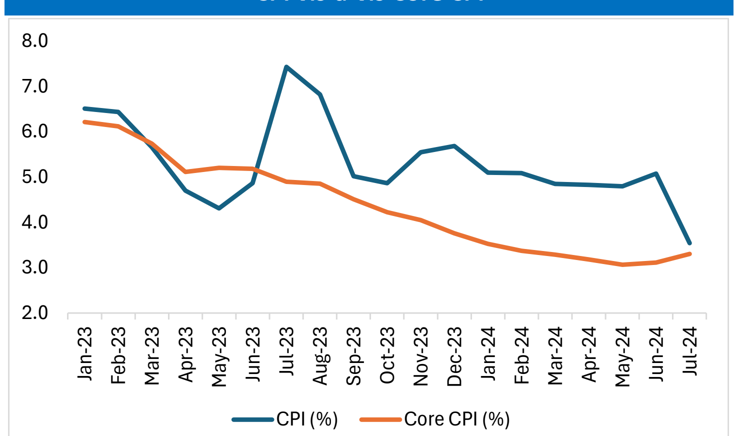
Also, the moderation in food inflation (yoy) has been due to higher base effect. The distribution of monsoon is still uneven with the major foodgrain producing states having deficient rainfall. However, with La Nina getting precedence, excess rainfalls in August and September could result in crop loss and thus have a debilitating impact on food prices. We believe that inflation may remain elevated and is likely to hover above the RBI's forecast of 4.5% in FY25. Domestic growth momentum is strong and GDP is expected to come above 7% in Q1 FY25, though geopolitical uncertainty is one of the risks to growth dynamics. Meanwhile, RBI is maintaining tight liquidity to control inflation. Given the current predicaments, the rate cut has been shifted to Dec 2024 / Feb 2025. The state wise evolution of CPI inflation shows most of the states witnessing a rate lesser than the national average.

The old world charm of Follow the Fed appears to be in its twilight zone as the rate actions of various Central Banks, both from the DM as also EM Cohorts show, in turn also raising a finger on the ubiquitous position of King Dollar as the central instrument of trade and currency realpolitik gets shrouded in uncertainty. With both ECB and BoE taking a lead in initiating (an uncertain and non-linear) pivot, the talks for the Fed to lessen the borrowing costs are gyrating, with CME FedWatch data now showing a sharp drop in traders expecting a 50 bps rate cut in upcoming Sep'24 meet. Our study shows the move of the central banks in the rate hike cycles are synchronised across countries but during the rate cut cycles they become unsynchronized as vindicated by data from central banks including China, Chile, Brazil and Mexico among the developing countries and UK, Canada and ECB among the developed world that have already progressed on the pivot. IIP rose by 4.2% in June from the upward revised figure of 6.2% in May as Mining grew by 10.3%, Manufacturing grew by 2.6% and Electricity grew by 8.6%.

CPI INFLATION MODERATED SHARPLY TO 3.54%

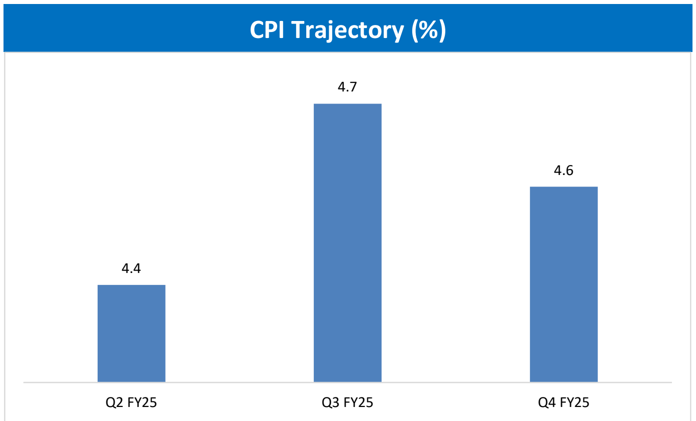
- CPI inflation eased to almost 5-years low to 3.54% in Jul'24 as against 5.08% in June. This is also the first time in last five years that CPI inflation is lower than the RBI's target of 4%. The sharp deceleration in vegetable prices (from 29.3% in June to merely 6.8% in July) is the major contributor to this multi-year low retail inflation. The weighted contribution of vegetables also decelerated from 1.77% in June to 0.55% in July.
- Contrary to the sharp moderation in overall CPI there is slight increase in the core CPI inflation. The core CPI increased from 3.12% in Jun'24 to 3.30% in July is primarily due to increase in mobile tariff. Transport and communication inflation increased by 2.48% in July from 0.97% in June.

CPI vis-à-vis Core CPI



Source: SBI Research

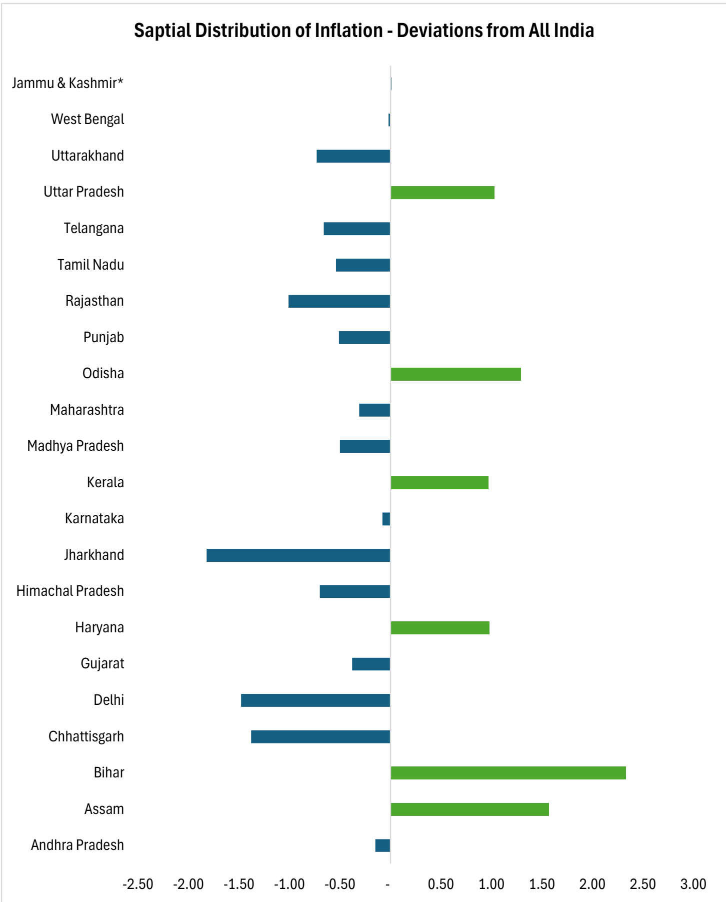
- Food inflation moderated to 5.06% yoy in Jul'24 mainly because of higher base. The distribution of monsoon is still uneven with the major foodgrain producing states having deficient rainfall. However, with La Nina getting precedence, excess rainfalls in August and September could result in crop loss and thus have a debilitating impact on food prices. We believe that inflation will remain elevated and is likely to come above the RBI's forecast of 4.5% in FY25. Domestic growth momentum is strong and GDP is expected to come above 7% in Q1 FY25, though geopolitical uncertainty is one of the risks to growth dynamics. Meanwhile, RBI is maintaining tight liquidity to control inflation. Given the current predicaments, the rate cut has been shifted to Dec 2024 / Feb 2025.



Source: SBI Research

SPATIAL DISTRIBUTION OF INFLATION

- The state wise evolution of CPI inflation shows most of the states witnessing a rate lesser than the national average. Of the 22 states, only six states recorded an inflation higher than the national average. Thus, on average there was broader deflation seen all geographies.
- However, from the rural urban differential side, (rural minus urban), most of the states witnessed sharp differentials inflation across population groups. Only four geographies witnessed negative differential with urban inflation higher than rural inflation.



ARE CENTRAL BANKS' RATE CYCLES SYNCHRONIZED?

- When the Fed changes the interest rate, all the countries get affected due to the change in capital flows. The central banks of emerging markets respond by changing their own interest rates. However, historical data shows that the Fed rate cut cycle during the global financial crisis led the emerging markets cut their rates, however the timing has been different. While some countries like Brazil had started cutting the rates prior to the Fed, others including India, Malaysia and South Africa had cut the rates after several months from the time when Fed initiated its rate cut cycle. However, when we look at the latest Fed hike cycle in 2022 to 2023 most of the countries started increasing rates almost at the same time (except Brazil). Thus the move of the central banks in the rate hike cycles are synchronised across countries but during the rate cut cycles they become unsynchronised. This is what is happening currently when many central banks including China, Chile, Brazil and Mexico among the developing countries and UK, Canada and ECB among the developed world have already cut the rates while the US is likely to cut its rate in Sep'24.

IIP GREW BY 4.2% IN JUNE 2024

- IIP rose by 4.2% in June from the upward revised figure of 6.2% in May. Mining grew by 10.3%, Manufacturing grew by 2.6% and Electricity grew by 8.6%. Meanwhile, for April-Jun 2024, industrial growth stood at 5.2% as against 4.7% in April-May 2023.

Response of Select EMEs during Fed Rate action

Country	Cut in bps	Start of the cycle	End of the cycle
Fed cut 06/2007 to 9/2009 (-525 bps)			
Brazil	1100	09/2005	07/2009
Hong Kong	625	09/2007	12/2008
India	425	10/2008	04/2009
Malaysia	150	11/2008	02/2009
South Africa	700	12/2008	07/2012
Philippines	250	07/2007	02/2008
Fed hike 3/2022 to 07/2023 (525 bps)			
	Hike in bps	Start of the cycle	End of the cycle
Brazil	1175	03/2021	07/2023
Hong Kong	500	03/2022	07/2023
India	250	05/2022	02/2023
Malaysia	100	05/2022	05/2023
South Africa	475	11/2021	05/2023
Philippines	425	05/2022	03/2023

Source: SBI Research, CEIC

Contact Details:

Dr. Soumya Kanti Ghosh

Group Chief Economic Adviser

State Bank of India, Corporate Centre

M C Road, Nariman Point, Mumbai - 400021

Email: soumya.ghosh@sbi.co.in,
gcea.erd@sbi.co.in

Phone:022-22742440

: kantisoumya