Despite inflation relief, interest rate cuts are still a while away

Inflationary pressures seem to be abating, with the CPI easing in May to a 25-month low of 4.25% year-on-year. This is inching closer to RBI's medium-term target of 4%. At this rate, the headline CPI inflation could match RBI's projection of 4.6% for Q1FY24. >P4

Rate cuts are still a while away

Rupali Sarkar
feedback@livemint.com

Inflationary pressures finally seem to be abating with the Consumer Price Index (CPI) easing sharply in May to a 25-month low of 4.25% year on year (y-o-y). This is inching closer to the Reserve Bank of India's (RBI) medium-term target of 4%. If pricing pressures continue to ease in June, the headline CPI inflation could comfortably match, or even be lower than the RBI's projection of 4.6% for the first quarter (Q1FY24).

Well, there are reasons that the trend may sustain at least through H1FY24. First, the food and beverages inflation has fallen sharply to 3.3% in May. Agreed, there was a favourable base effect at play. Even so, stripping that, the month-on-month increase of 0.6% in May is the lowest for the month in the last three years. Moreover, within the food basket, heavyweight cereals and fruit inflation eased and vegetables remained in deflation.

The fuel inflation story looks convincing too with a drop to a 26-month low of 4.6% y-o-y. Global crude oil prices have remained capped lately, largely unaffected by the recent announcement of an output cut by Saudi Arabia, the top OPEC producer.

Beyond the volatile food and fuel components, core inflation—reflecting the underlying pricing pressures in the economy is on a downtrend as well. The Bloomberg measure of core inflation (excluding food and fuel & light) fell from above 6% through most of FY23 to 5.1% in May. There has been a broad-based drop across most sub-segments except 'personal care and effects,' which is likely impacted by higher gold and silver prices.

There are other supporting factors that should keep inflation tamed ahead. First, geopolitical tension and volatility in global financial markets seem to have abated in the recent weeks. Second, global crude oil prices may remain capped in the near term amid slowing global growth and higher Russian oil supplies. Lower commodity prices, weakening household spending and increased anchoring of households' inflation expectations, as pointed out by the RBI bi-monthly survey may likely aid a dis-inflation in the core basket.

Yes, uncertainty surrounding El Niño and its impact on monsoon and kharif sowing is a key risk. However, a significant favourable base effect, particularly till September may likely support an easing inflation in H1FY24. With inflation in India much closer to RBI's medium-term target, a rate pause is almost certain. But those rooting for a rate cut may be disappointed.

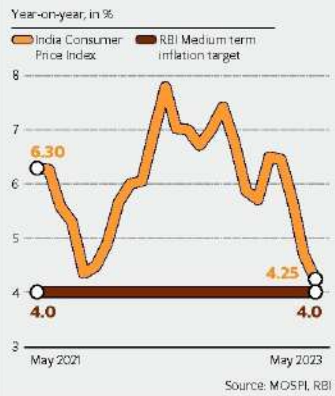
As the RBI said in the June monetary policy review, the upside risks to inflation are likely to be more pronounced during H2FY24. This is also reflecting in its higher CPI forecast for Q3. Besides, the benefit of a favourable base effect would also fade in H2FY24. Some risks may also stem from imported inflation concerns on account of decoupling of monetary policies.

With inflation running stubbornly higher than the respective central banks' targets in developed economies like US and the Eurozone, major central banks may still be tightening rates while RBI maintains an extended pause.

Interest rate differentials arising out of this may weigh on the Indian rupee, triggering imported inflation concerns. Thus, with the RBI committed to achieving the inflation target of 4%, and the upside risks appearing more pronounced in H2FY24, the possibility of a rate cut in FY24 looks slim despite the recent inflation dip unless growth takes a beating. "We believe, RBI would avoid any premature policy decisions in this uncertain environment and put its credibility at stake, we have not pencilled in rate cuts in CY23," wrote Hitesh Suvarna of JM Financial Institutional Securities Ltd in a report on 12 June.

Trending lower

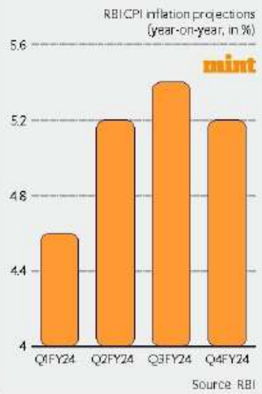
CPI inflation eased sharply in May to 4.25%, closer to the RBI's medium term target of 4%.



Source: MOSPI, RBI

Keeping an eye

RBI projects CPI inflation to inch higher in Q3FY24.



Source: RBI

SATISH KUMAR/MINT

LOOMING CLOUDS

THE uncertainty surrounding El Niño and its impact on the monsoon and Kharif sowing is a key risk

BUT a favourable base effect, mainly till Sept, may support an easing inflation trajectory