

### HIGHLIGHTS

- *The year-on-year (YoY) CPI inflation surprised on the downside, declining to a 13-month low print of 3.3% in October 2018 from 3.7% in September 2018, led by food and beverages, clothing and footwear, housing, and fuel and light.*
- *The inflation for food and beverages recorded a disinflation of 0.1% in October 2018, after a gap of fifteen months, partly reflecting the base effect, as well as the year-on-year (YoY) disinflation for vegetables and pulses and products, and sugar and confectionary.*
- *In contrast, the core CPI inflation (excluding food and beverages, fuel and light, as well as petrol and diesel for vehicles) hardened to a three-month high 6.1% in October 2018 from 5.7% in September 2018, led primarily by miscellaneous items and pan, tobacco and intoxicants.*

### OVERVIEW

- The CPI inflation corrected to a 13-month low 3.3% in October 2018 (+3.6% in October 2017) from 3.7% in September 2018 (+3.3% in September 2017; refer Exhibit 1 and 2), and undershot our forecast (+4.0%) and consensus expectations (+3.6%). This sequential moderation was led by food and beverages, clothing and footwear, housing, and fuel and light, even as the YoY inflation rose for miscellaneous items and pan, tobacco and intoxicants. Moreover, the CPI inflation remained below the Monetary Policy Committee's (MPC's) medium term target of 4.0%, for the third month in a row.
- After a gap of 15 months, the food and beverages sub-index recorded a YoY disinflation of 0.1% in October 2018 (+2.3% in October 2017), in contrast to the inflation of 1.0% in September 2018 (+1.8% in September 2017; refer Exhibit 3), partly on account of the base effect. The YoY inflation eased in October 2018 relative to September 2018 for vegetables (to -8.1% from -4.2%), pulses and products (to -10.3% from -8.7%), sugar and confectionary (to -7.6% from -6.4%), egg (to +2.2% from +3.8%), milk and products (to +0.9% from +2.4%), fruits (to +0.4% from +1.7%), oils and fats (to +2.2% from +3.1%), prepared meals and snacks (to +3.8% from +4.4%), cereals and products (to +2.6% from +2.9%), and spices (to +2.8% from +2.9%). However, the YoY inflation rose in October 2018 relative to September 2018 for non-alcoholic beverages (to +2.3% from +2.1%) and meat and fish (to +3.0% from +2.4%). In month-on-month (MoM) terms, the food and beverages sub-index declined by 0.4% in October 2018, in contrast to the rise of 0.8% that had been recorded in October 2017 (refer Exhibit 4), driven by the trend in vegetables (-0.3%, +3.8%).
- The inflation related to fuel and light dipped mildly to 8.5% in October 2018 (+6.4% in October 2017) from 8.6% in September 2018 (+5.6% in September 2017). However, this sub-index increased by a considerable 0.8% in MoM terms in October 2018, higher than the rise of 0.9% recorded in October 2017.
- In contrast, the core-CPI inflation hardened to a three-month high 6.1% in October 2018 from 5.7% in September 2018 (refer Exhibit 5), led by miscellaneous items and pan, tobacco and intoxicants. On an MoM basis, this sub-index rose by 0.8% in October 2018, higher than the uptick of 0.5% recorded in October 2017. Accordingly, the wedge between headline and core-CPI inflation widened considerably to 275 bps in October 2018 from 202 bps in September 2018.

#### Contact:

Aditi Nayar

+91 124 4545 385

[aditin@icraindia.com](mailto:aditin@icraindia.com)

Medha Sinha

+91 124 4545 399

[medha.sinha@icraindia.com](mailto:medha.sinha@icraindia.com)

- The inflation for miscellaneous items (with a weight of 28.3% in the CPI) hardened substantially to 6.7% in October 2018 from 5.6% in September 2018. The YoY CPI inflation for healthcare (to +7.9% from +6.0%), household goods and services (to +6.1% from +4.8%), transport and communication (to +7.7% from +6.5%, reflecting the rise in prices of fuels such as petrol and diesel), and personal care and effects (to +5.2% from +4.1%) rose in October 2018 relative to the previous month. In contrast, the CPI inflation eased for education (to +6.2% from +6.4%), and recreation and amusement activities (to +4.9% from +5.2%) in October 2018 relative to September 2018. On an MoM basis, the sub-index for miscellaneous items rose by 1.2% in October 2018, sharply higher than the uptick of 0.2% in October 2017.
- The inflation for pan, tobacco and intoxicants (with a weight of 2.4% in the CPI) rose to 6.1% in October 2018 from 5.6% in September 2018. Moreover, this sub-index increased by a substantial 1.1% in MoM terms in October 2018, higher than the 0.5% rise recorded in October 2017.
- However, the inflation for clothing and footwear (with a weight of 6.5% in the CPI) eased to a series-low 3.6% in October 2018 from 4.6% in September 2018. In MoM terms, the sub-index for clothing and footwear declined by 0.5% in October 2018, in sharp contrast to the uptick of 0.6% recorded in October 2017.
- Reflecting the favourable base effect, housing inflation (with a weight of 10.1% in the CPI Index) softened further to a 13-month low 6.6% in October 2018 from 7.1% in September 2018. In MoM terms, the sub-index rose by 0.7% in October 2018, considerably lower than 1.2% increase recorded in October 2017, which had reflected the staggered impact of the revision in house rent allowance for Central Government employees.
- The urban CPI inflation moderated to 4.0% in October 2018 from 4.3% in September 2018, led by food and beverages (to -0.2% from +0.7%), housing (to +6.6% from +7.1%), pan, tobacco and intoxicants (to +6.0% from +6.3%), and clothing and footwear (to +5.3% from +5.4%). However, the inflation hardened in October 2018 relative to the previous month for miscellaneous items (to +6.4% from +5.9%).
- Similarly, the rural CPI inflation softened to 2.8% in October 2018 from 3.3% in September 2018, led by clothing and footwear (to +2.5% from +4.2%), food and beverages (to -0.1% from +1.2%), and fuel and light (to +8.3% from +8.4%), even as the print for pan, tobacco and intoxicants (to +6.2% from +5.3%) and miscellaneous items (to +7.0% from +5.4%) rose during these two months. The urban CPI inflation exceeded the rural CPI inflation for the fourth month in a row in October 2018 (refer Exhibit 6).
- The buildup in the CPI inflation up to October 2018 stood at 3.0%, lower than the buildup of 4.0% recorded up to October 2017.
- The final headline CPI inflation for September 2018 was revised downward to 3.7% from the initial 3.8%, led by food and beverages (to +1.0% from +1.1%).

## OUTLOOK

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The high frequency data reveals a broad-based rise in food prices in early November 2018, barring milk, tomatoes and sugar, which may be related to the festive season. Moreover, the weak start to the post-monsoon rainfall season may impact the timing and pace of rabi sowing, although overall reservoir storage being in line with year-ago levels offers some relief. If market prices move closer to the revised minimum support prices (MSPs) for various crops, food inflation may record an uptick in the near term, while remaining mild.

The rise in the core inflation to an uncomfortably high 6.1% in October 2018, was led by services such as health, as well as the impact of commodity prices on the inflation for transport and communication, household goods and services, and personal care and effects. The recent pullback in crude oil prices and the INR have eased concerns related to the trajectory for core inflation.

Despite the change in the monetary policy stance to calibrated tightening, the MPC appears likely to maintain a status quo on the repo rate in the December 2018 policy review, following the correction in the October 2018 headline CPI inflation print, as well as the pullback in crude oil prices and the INR.

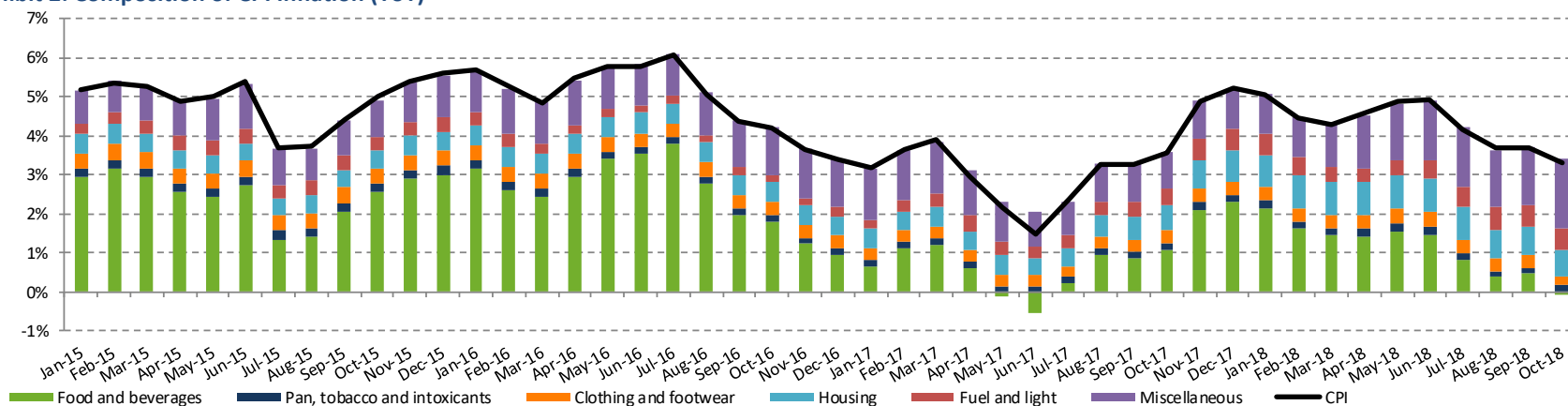
Exhibit 1: Trend in CPI Inflation (YoY)

	Weight	YoY Inflation				MoM	Buildup*
		Aug-18	Sep-18	Sep-18	Oct-18	Oct-18	Oct-18
		Final	Provisional	Final	Provisional	Provisional	Provisional
<b>CPI (combined)</b>	<b>100.00</b>	<b>3.7%</b>	<b>3.8%</b>	<b>3.7%</b>	<b>3.3%</b>	<b>0.3%</b>	<b>3.0%</b>
<b>Food and beverages</b>	<b>45.86</b>	<b>0.8%</b>	<b>1.1%</b>	<b>1.0%</b>	<b>-0.1%</b>	<b>-0.4%</b>	<b>2.0%</b>
Cereals and products	9.67	3.0%	3.1%	2.9%	2.6%	0.1%	1.9%
Meat and fish	3.61	3.2%	2.3%	2.4%	3.0%	0.5%	2.0%
Egg	0.43	6.8%	3.8%	3.8%	2.2%	-0.7%	-3.0%
Milk and products	6.61	2.6%	2.6%	2.4%	0.9%	-0.7%	0.5%
Oils and fats	3.56	3.5%	3.2%	3.1%	2.2%	-0.4%	0.7%
Fruits	2.89	3.5%	1.1%	1.7%	0.4%	-2.3%	-2.9%
Vegetables	6.04	-7.1%	-4.2%	-4.2%	-8.1%	-0.3%	11.1%
Pulses and products	2.38	-7.8%	-8.6%	-8.7%	-10.3%	-2.2%	-4.7%
Sugar and confectionary	1.36	-5.4%	-6.4%	-6.4%	-7.6%	-1.1%	-3.1%
Spices	2.50	2.8%	2.9%	2.9%	2.8%	0.4%	1.7%
<b>Pan, tobacco and intoxicants</b>	<b>2.38</b>	<b>5.4%</b>	<b>5.6%</b>	<b>5.6%</b>	<b>6.1%</b>	<b>1.1%</b>	<b>2.9%</b>
<b>Clothing and footwear</b>	<b>6.53</b>	<b>4.9%</b>	<b>4.6%</b>	<b>4.6%</b>	<b>3.6%</b>	<b>-0.5%</b>	<b>1.9%</b>
<b>Housing</b>	<b>10.07</b>	<b>7.6%</b>	<b>7.1%</b>	<b>7.1%</b>	<b>6.6%</b>	<b>0.7%</b>	<b>3.0%</b>
<b>Fuel and light</b>	<b>6.84</b>	<b>8.6%</b>	<b>8.5%</b>	<b>8.6%</b>	<b>8.5%</b>	<b>0.8%</b>	<b>5.1%</b>
<b>Miscellaneous</b>	<b>28.32</b>	<b>5.6%</b>	<b>5.6%</b>	<b>5.6%</b>	<b>6.7%</b>	<b>1.2%</b>	<b>4.6%</b>
Household goods and services	3.80	5.0%	4.9%	4.8%	6.1%	1.4%	4.5%
Health	5.89	5.8%	5.9%	6.0%	7.9%	2.4%	5.5%
Transport and communication	8.59	6.0%	6.4%	6.5%	7.7%	0.7%	4.9%
Recreation and amusement	1.68	4.9%	5.0%	5.2%	4.9%	0.1%	3.3%
Education	4.46	6.1%	6.4%	6.4%	6.2%	0.2%	4.8%
Personal care and effects	3.89	4.5%	4.1%	4.1%	5.2%	1.5%	3.6%
<b>CPI-Food</b>	<b>36.55</b>	<b>0.3%</b>	<b>0.5%</b>	<b>0.5%</b>	<b>-0.9%</b>	<b>-0.5%</b>	<b>2.0%</b>
<b>CPI-Core</b>	<b>44.97</b>	<b>5.9%</b>	<b>5.7%</b>	<b>5.7%</b>	<b>6.1%</b>	<b>0.8%</b>	<b>3.6%</b>
<b>CPI Rural</b>		<b>3.4%</b>	<b>3.3%</b>	<b>3.3%</b>	<b>2.8%</b>	<b>0.1%</b>	<b>2.5%</b>
<b>CPI Urban</b>		<b>4.0%</b>	<b>4.3%</b>	<b>4.3%</b>	<b>4.0%</b>	<b>0.5%</b>	<b>3.6%</b>

\*Buildup with reference to March 2018

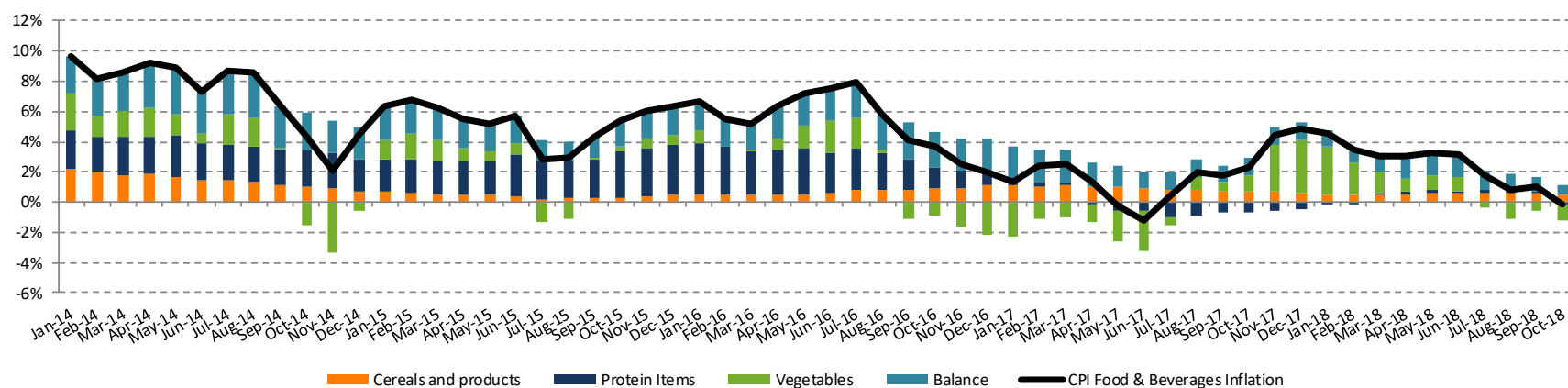
Source: Central Statistics Office (CSO); ICRA research

**Exhibit 2: Composition of CPI Inflation (YoY)**



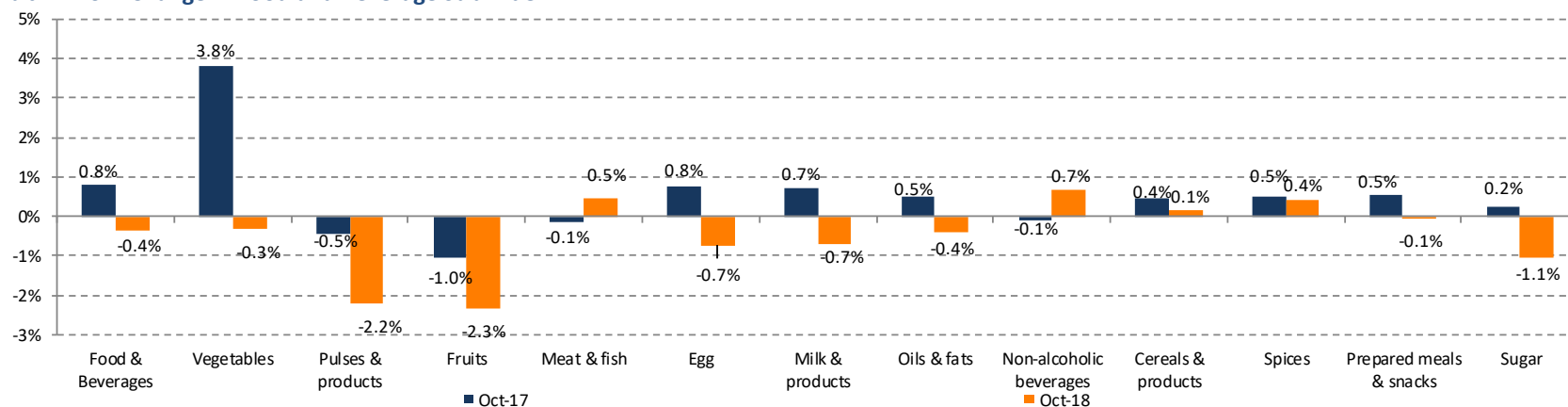
Source: CSO; ICRA research

**Exhibit 3: Composition of Food and Beverages Inflation (YoY)**



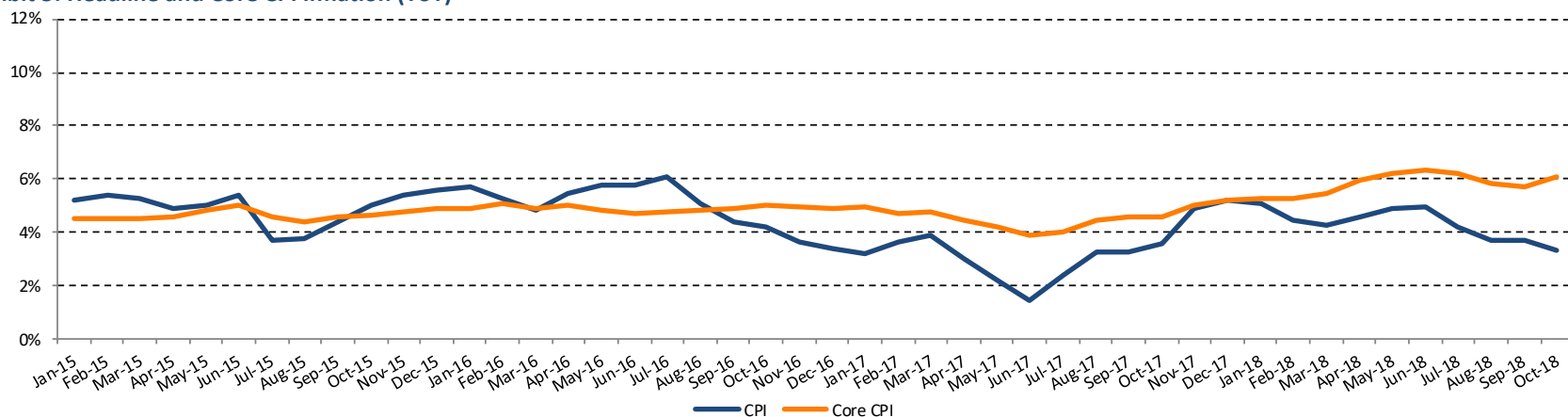
Source: CSO; ICRA research

**Exhibit 4: MoM Change in Food and Beverage Sub-Index**



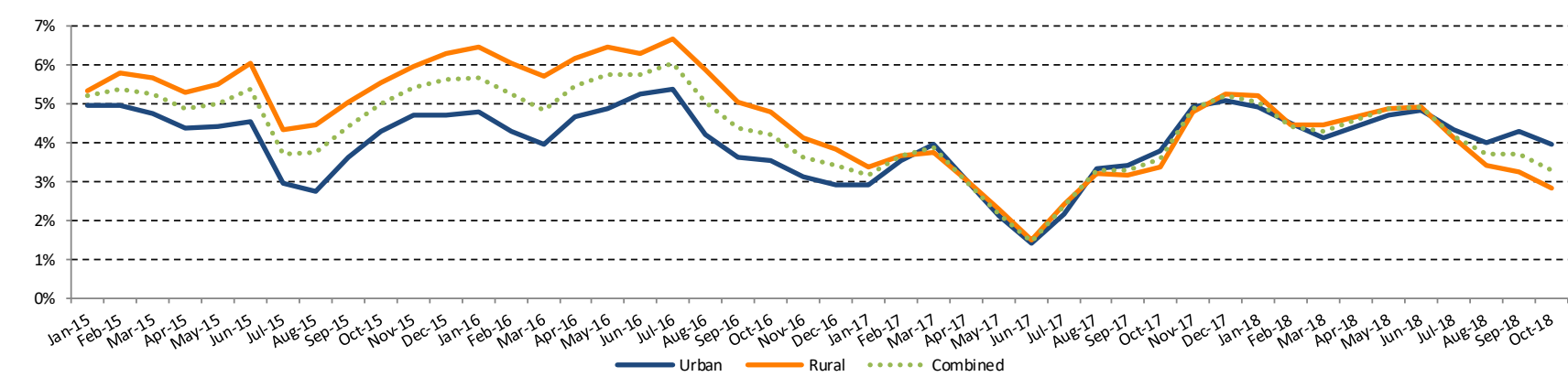
Source: CSO; ICRA research

**Exhibit 5: Headline and Core CPI Inflation (YoY)**



Source: CSO; ICRA research

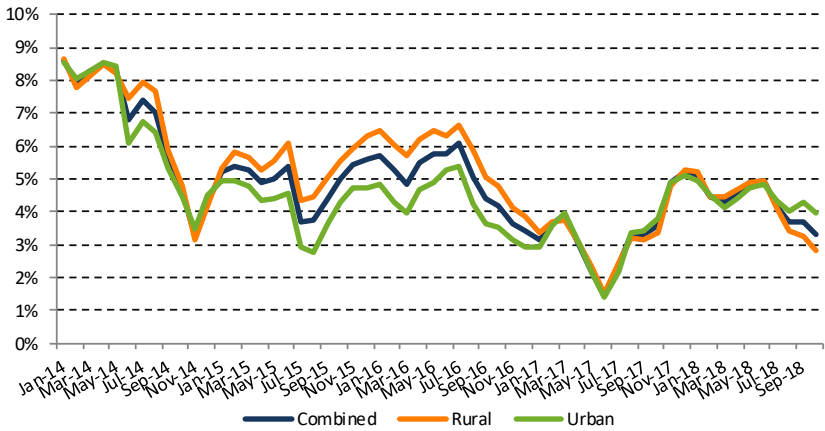
Exhibit 6: Rural and Urban CPI Inflation (YoY)



Source: CSO; ICRA research

ANNEXURE

Exhibit 7: CPI Inflation (YoY)



Source: CSO; ICRA research

Exhibit 8: Food and Beverages Inflation (YoY)

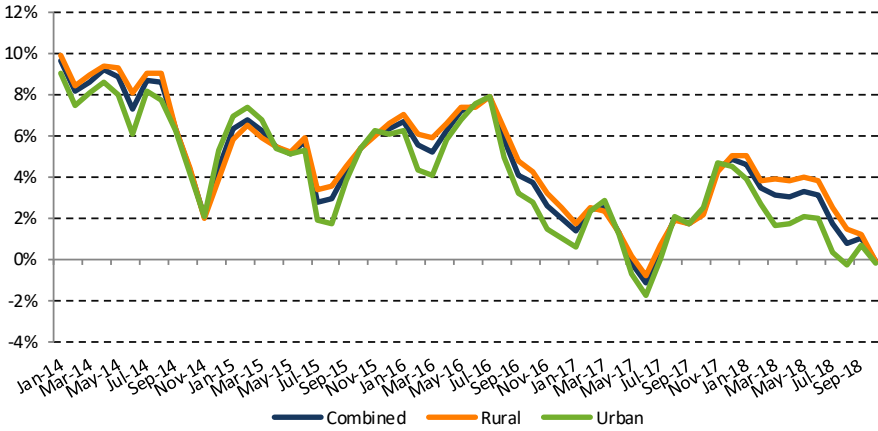
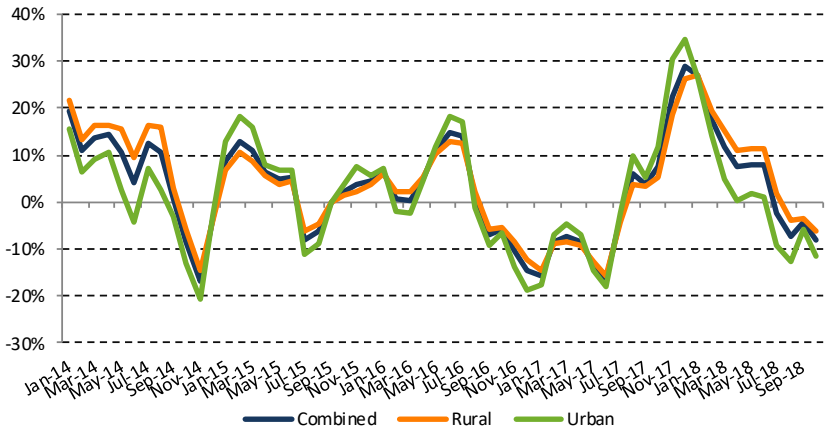
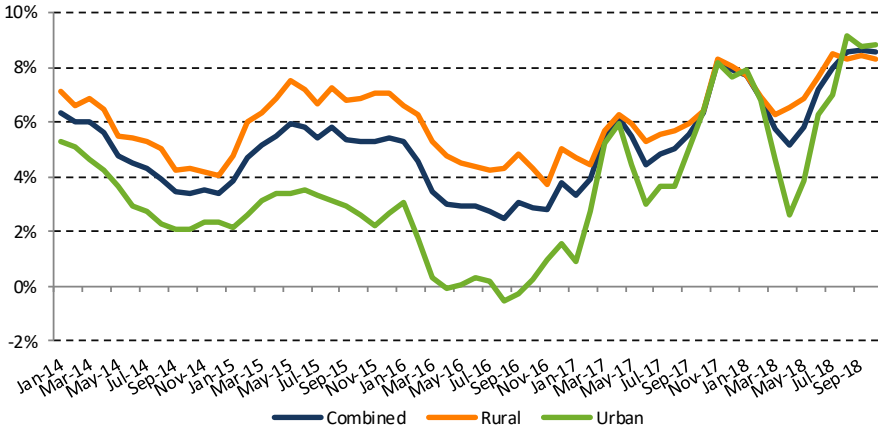


Exhibit 9: Vegetables Inflation (YoY)

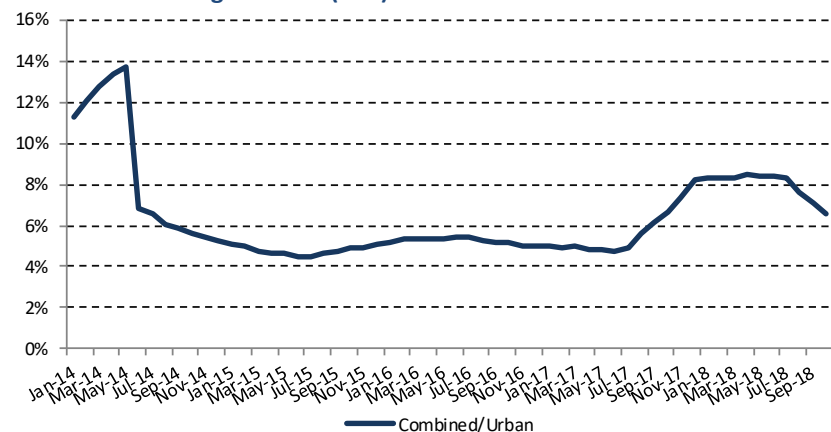


Source: CSO; ICRA research

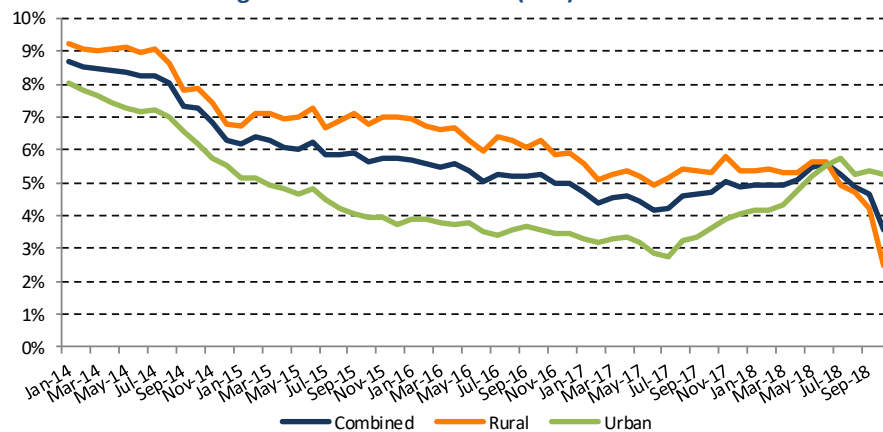
Exhibit 10: Fuel and Light Inflation (YoY)



**Exhibit 11: Housing Inflation (YoY)**

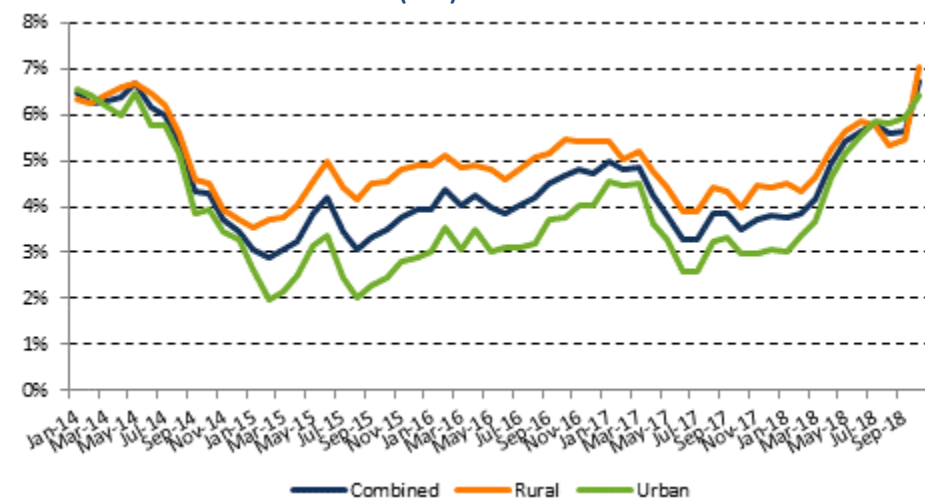


**Exhibit 12: Clothing and Footwear Inflation (YoY)**

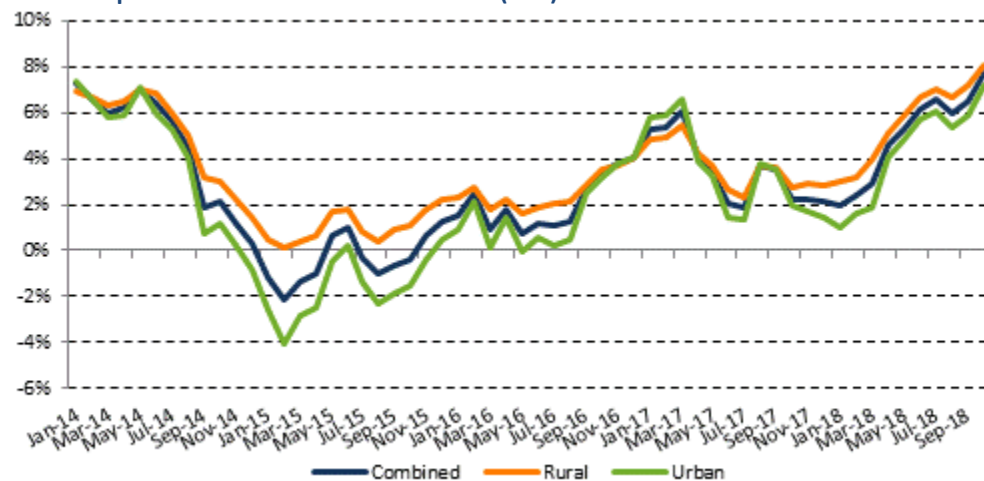


Source: CSO; ICRA research

**Exhibit 13: Miscellaneous Inflation (YoY)**



**Exhibit 14: Transport and Communication Inflation (YoY)**



Source: CSO; ICRA research





### Business Contacts

Mr. L. Shivakumar  
E-mail: [shivakumar@icraindia.com](mailto:shivakumar@icraindia.com)  
Tel: +91 22 6114 3406 / +91 98210 86490

Mr. Jayanta Chatterjee  
E-mail: [jayantac@icraindia.com](mailto:jayantac@icraindia.com)  
Tel: +91 80 4332 6401/ +91 98450 22459

### Media and Public Relations

Ms. Naznin Prodhani  
E-mail: [communications@icraindia.com](mailto:communications@icraindia.com)  
Tel: +91 124 4545 860

### Branches

#### Registered Office:

1105, Kailash Building, 11<sup>th</sup> Floor,  
26, Kasturba Gandhi Marg,  
New Delhi - 110 001  
Tel: + 91 11 2335 7940-45

#### Corporate Office:

Building No.8, 2<sup>nd</sup> Floor,  
Tower A, DLF Cyber City Phase II,  
Gurgaon- 122 002  
Tel: +91 124 4545300

#### Ahmedabad

907 & 908, Sakar – II,  
Ellisbridge, Opp. Town Hall,  
Ahmedabad - 380 006  
Tel: +91 79 4027 1500/01

#### Bengaluru 1

'The Millenia', Tower- B,  
Unit No. 1004, 10<sup>th</sup> Floor, 1 & 2 Murphy  
Road,  
Bengaluru - 560 008  
Tel: +91 80 4332 6400

#### Bengaluru 2

2<sup>nd</sup> Floor, Vayudooth Chamber,  
15-16, Trinity Circle, M.G. Road,  
Bengaluru - 560 001  
Tel: +91 80 4922 5500

**Chennai**

5<sup>th</sup> Floor, Karumuttu Centre,  
634, Anna Salai, Nandanam  
Chennai - 600 035  
Tel: +91 44 4596 4300

**Hyderabad 1**

No. 7-1-58, 301, 3<sup>rd</sup> Floor, 'CONCOURSE',  
Above SBI-HPS Branch,  
Ameerpet,  
Hyderabad - 500 016  
Tel: +91 40 4920 0200

**Hyderabad 2**

4A, 4<sup>th</sup> Floor, SHOBHAN,  
6-3-927, A&B Somajiguda,  
Raj Bhavan Road,  
Hyderabad – 500082  
Tel: +91 40 40676500

**Kolkata**

A-10 & 11, 3<sup>rd</sup> Floor, FMC Fortuna 234/3A,  
A.J.C. Bose Road,  
Kolkata -700 020  
Tel: +91 33 7150 1100/01

**Mumbai**

3<sup>rd</sup> Floor, Electric Mansion  
Appasaheb Marathe Marg, Prabhadevi,  
Mumbai - 400 025  
Tel: +91 22 6169 3300

**Pune**

5A, 5<sup>th</sup> Floor, Symphony, S. No. 210  
CTS 3202 Range Hills Road, Shivajinagar,  
Pune - 411 020  
Tel: +91 20 2556 1194

**Email:** [info@icraindia.com](mailto:info@icraindia.com)

**Helpdesk:** 124 3341580

**Website:** [www.icra.in/](http://www.icra.in/) [www.icraresearch.in](http://www.icraresearch.in)

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