

## WERE MAY INFLATION NUMBERS AN ABERRATION?

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CPI inflation moderated marginally to 6.26% in Jun'21 from 6.30% in May'21. Core also moderated to 6.16%. The headline inflation was much lower than market expectations and surprised pleasantly on the downside. Food items, especially protein items and oils and fats though are still exhibiting increase in prices in contrast with the global trend. The FAO Food Price Index averaged 124.6 points in Jun'21, down 2.5% from May'21. The decline in Jun'21 marked first drop in the index following 12 consecutive monthly increases and was brought about by decline in prices of vegetable oils, cereals and, dairy products.

Interestingly, the decline in Jun'21 inflation print reveals an across the board decline in sequential momentum. Items in core basket having disproportionately larger weights that had exhibited significant jump in prices in May are now back to trend path. Surprisingly most items in food and non-food have registered a de-growth in Jun'21. **This raises the broader question whether the May'21 inflation print was a data aberration given that most of the country was under the grip of a lockdown in May'21. Interestingly this is all the more possible as core inflation in May'21 has undergone a large downward revision.**

Coming to the other major component fuel, between May'21 and Jun'21, the international crude prices went up by \$6/bbl. The future outlook hinges on the production increases by OPEC+. The recently cancelled meeting of OPEC+ indicates that we are headed towards elevated levels in Brent and this will have cascading impact on fuel inflation in India. **Our calculations show that with every 10% increase in petrol pump prices (Mumbai) there is 50 bps increase in CPI .**

The Jun'21 inflation number perhaps reflect another interesting trend. As consumers are spending more on fuel, it is crowding out expenses on health. Our analysis of SBI card spends indicates that spend on non-discretionary health expenditure has been substantially reduced to accommodate increased expenditure on fuel. In fact such spending has more than crowded out the spending on other non-discretionary items, like grocery and utility services to such an extent that the demand for such products has significantly declined. The share of non discretionary spend on items like fuel has jumped to 75% in Jun'21 from 62% in Mar'21.

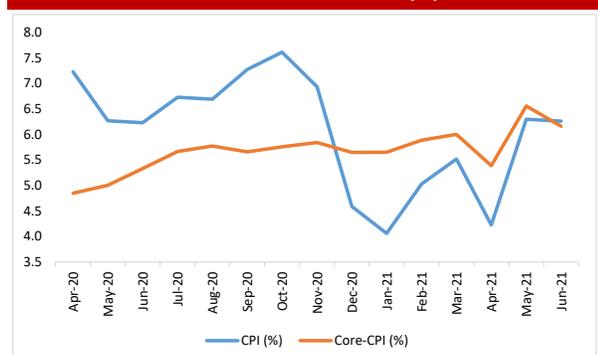
Even though inflation has shown marginal decline, the levels are still elevated and combined with a decline in financial savings, are adding to household challenges. According to preliminary estimates by RBI, the household financial savings rate in Q3 FY21 has come down to 8.2% of GDP from 21.0% and 10.4% in the previous two quarters. Interestingly, the savings rate in US has gone to 34% of GDP in Apr'21 from 8.0% in Dec'19. Our estimate indicates that during the second wave period (Jun'21 over Mar'21) the number of districts with deposits outflows might be double than the first wave.

Various leading indicators, including port cargo traffic, freight traffic, railway freight earning, manufacturing PMI, steel consumption have worsened sequentially in Jun'21 compared to their levels in May'21. Also, the second wave of the pandemic is exhibiting a fat tail with daily new cases in India still above 40,000. The 7D moving average of daily vaccine doses has come down to 33.7 lakh from a maximum of 60.2 lakh as on 27 Jun'21. We need to increase vaccination speed to defeat the pandemic. If India speeds up the vaccination rate to 70 lakh per day, then the entire adult population can be covered by the end of FY22.

### CPI INFLATION

- ◆ CPI inflation moderated marginally to 6.26% in Jun'21 from 6.30% in May'21. Inflation though having moderated, is still at elevated levels and above the tolerance level of RBI (6%). The moderation in inflation in Jun'21 has been driven by pan, tobacco and intoxicants, which eased to 4% in Jun'21 from 10% in May'21. However, food items, especially protein items and oils and fats are still exhibiting increase in prices (like egg, milk, pulses etc.).
- ◆ Core also moderated to 6.16% in Jun'21 from 6.40% in May as pan, tobacco & intoxicants showed decline of almost 600 bps m-o-m. Housing component also showed a marginal decline of 11 bps m-o-m.

CPI & Core-CPI Inflation (%)



Source: SBI Research

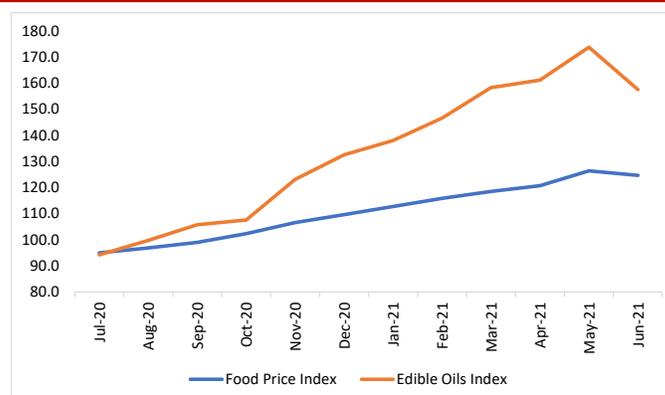
Top 40 Items MoM Change during Apr'21 to Jun'21 (%)							
Items	Weight	May-21	Jun-21	Items	Weight	May-21	Jun-21
<b>Food and Fuel Inflation (20 items)</b>	<b>52.7</b>	<b>1.8</b>	<b>1.1</b>	<b>Core Inflation (20 items)</b>	<b>47.3</b>	<b>1.3</b>	<b>0.2</b>
cauliflower	0.2	17.8	14.5	goods for recreation and hobbies	0.0	58.6	-33.5
radish	0.1	12.5	7.1	other conveyance expenses	0.0	13.9	-6.2
cabbage	0.2	12.3	11.0	hotel lodging charges	0.0	12.6	1.3
carrot	0.1	12.0	11.8	cloth for upholstery, curtains, tablecloth, etc. (metre)	0.0	10.3	-3.0
small millets & their products	0.0	11.6	0.0	CD, DVD, audio/video cassette, etc	0.0	8.9	-4.7
potato	1.0	11.2	5.4	bedstead	0.1	8.0	-5.5
orange, mausami (no.)	0.1	10.7	5.6	of which, clothing: second-hand	0.0	7.8	9.6
grapes	0.2	9.2	4.9	electric batteries	0.0	7.1	-0.1
apple	0.5	9.1	6.9	bathroom and sanitary equipment	0.0	6.2	-4.6
papaya	0.0	8.6	2.9	rickshaw (hand drawn & cycle fare)	0.0	5.7	-1.4
pickles (gm)	0.1	8.5	-0.7	suitcase, trunk, box, handbag and other travel goods	0.0	5.4	-0.3
mustard oil	1.3	7.6	4.8	sweeper	0.0	5.2	-2.3
gram products	0.0	5.3	1.1	clock, watch	0.0	5.1	12.6
black pepper (gm)	0.1	5.3	0.4	torch	0.0	4.7	1.7
turmeric (gm)	0.5	4.9	0.3	other cooking/ household appliances	0.0	4.7	-2.2
refined oil [sunflower, soyabean, saffola, etc.]	1.3	4.7	2.5	school bus, van, etc.	0.2	4.5	2.5
raisin, kishmish, monacca, etc.	0.1	4.7	0.4	toddy (litre)	0.1	4.2	1.0
banana (no.)	0.6	4.6	-2.7	clothing (first-hand): other	0.1	4.0	0.6
of which, dung cake	0.4	4.5	0.9	zarda, kimam, surti (gm)	0.0	3.8	-4.6
other dry fruits	0.0	4.5	-0.2	pan: leaf (no.)	0.1	3.8	-1.5
<b>Overall CPI</b>					<b>100.0</b>	<b>1.6</b>	<b>0.6</b>

Source: SBI Research

### GLOBAL FOOD & OIL PRICES: MARGINAL DECLINE EXHIBITED IN JUNE

- ◆ The FAO Food Price Index averaged 124.6 points in Jun'21, down 2.5% from May'21 still 33.9% higher than its level in the same period last year. The decline in Jun'21 marked first drop in the index following 12 consecutive monthly increases. The drop in Jun'21 reflected declines in the prices of vegetable oils, cereals and, though more moderately, dairy products, which more than offset generally higher meat and sugar quotations. The FAO Edible Oil Price Index fell by 9.8% in the month, marking a four-month low. The sizeable m-o-m drop mainly reflects lower international prices of palm, soy and sunflower oils.
- ◆ However, in India, oil and fat inflation have risen to 34.8% in Jun'21 from 30.9% in May'21 thus showing that the government basic import duty cut on crude palm oil to 10% from 15% and refined palm oils to 37.5% from 45% is not having much impact.

### FAO Monthly Real Food Price & Edible Oils Index



Source: FAO; SBI Research

### SOARING SHIPPING AND TRANSPORT COSTS

- ◆ With the onset of Covid-19 pandemic in Mar'20, ocean freight rates as measured by the Baltic Dry Index (a measure of shipping costs) have increased almost 5-6 times. Even in 2021 the Baltic Dry Index increased by 2-3 times while higher gasoline prices and truck driver shortages in some regions are pushing up the cost of road transport services. Higher transport costs will eventually increase consumer food inflation.

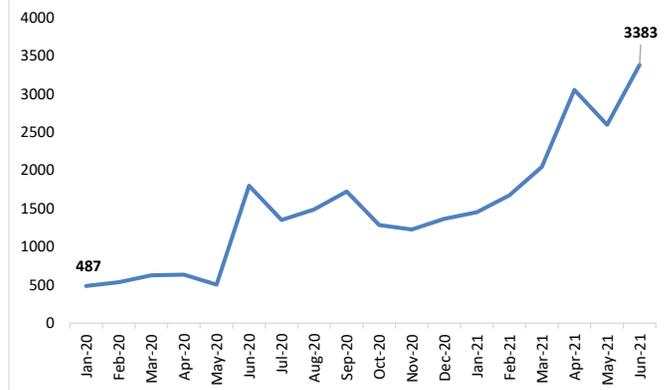
### CRUDE OIL PRICES & IMPLICATION OF CANCELLATION OF OPEC+ MEETING

- ◆ Crude oil prices have gone from a low of \$20/bbl by end Apr'20 to above \$75 in Jul'21. In this regard the cancellation of recent OPEC+ meeting will have severe implications on crude oil prices, with potential demand supply mismatch exacerbating. There are 3 major implications of cancellation of OPEC+ deal:
  - Base case scenario:** Brent has a very strong probability to reach \$80/bbl in light of increased demand & no increase in supply in August.
  - An outlandish scenario:** The cancellation of meeting lead to a free for all oil production starting August which will lead to OPEC+ disbanding leading to a self defeating fall in prices like last year between Saudi Arabia & Russia.
  - The most probable scenario** of Saudi Arabia & UAE reach an agreement on UAE's core demand that all output increases linked to old baseline end in Apr'22 & OPEC+ increase output per month by 0.4 mbpd. This scenario is most probable but even that won't be able to match the H2 demand in CY2021 which is expected to be higher than H1 demand by 5 mbpd. Hence In all likelihood, we are headed towards elevated levels in Brent. The only way we might see any significant correction in Brent is if OPEC+ breaks.

### CRUDE OIL PRICES ADVERSELY IMPACTING INFLATION IN INDIA

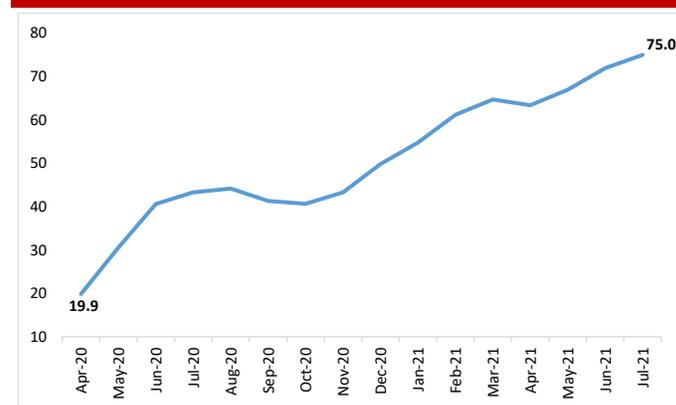
- ◆ For India, the rising crude oil prices, have led to challenges for the Government as it tries to balance the need for extra revenue from high excise duties with rising fuel inflation and its impact on overall inflation.
- ◆ Our calculations show that with every 10% increase in petrol pump prices (Mumbai) there is 50 bps increase in CPI.

### Baltic Dry Index



Source: SBI Research

### Crude Oil Price (Indian Basket) (\$/bbl)



Source: SBI Research

### HOUSEHOLD DISTRESS AND ITS IMPACT ON INFLATION

- ◆ During the initial lockdown period in 2020, deposits of the ASCBs increased due to less avenues to spend. However, subsequently, it declined marginally in the festive months. The trends of deposits during the first wave (March-December, 2020) of COVID-19 as revealed by ASCBs data from RBI for 711 districts across all States/UTs show deposit outflows from 112 districts of Rs 1.06 lakh crore. However, in the same 112 districts, a total of Rs 49,698 crore of inflow of deposits had happened during Mar'19-Dec'19.
- ◆ If we look the data, between Mar'21 and Mar'20, the deposit outflow only declined to Rs 38,295 crore from 61 districts in the country suggesting revival in economic activity in Q4FY21.

- ◆ Our estimate indicate that during the second wave period (Jun'21 over Mar'21) the number of districts with deposits outflows was almost double than the first wave. The overall data of ASCB deposits indicates that during in Q1FY22 (Till 18 Jun), deposits declined by 38%, compared to the growth seen during Q1FY21.
- ◆ This indicates the level of household distress in India. The fact is also validated from the decline in financial savings. According to preliminary estimates by RBI, the household financial savings rate in Q3 FY21 has come down to 8.2% of GDP from 21.0% and 10.4% in the previous two quarters. Interestingly, the savings rate in US has gone to 34% of GDP in Apr'21 from 8.0% in Dec'19. This indicates how delayed the recovery will be in India compared to US as we are pre-dominantly domestic consumption based.
- ◆ The recovery will be delayed as there is an indication of debt financed consumption in India. During 2020-21, incremental PFCE has declined by Rs 7.41 lakh crore, while household stress (debts) has also increased by Rs 7.53 lakh crore. With this, the household debt (% GDP) has sharply increased to 37.3% (Rs 73.6 lakh crore) in FY21 from 32.5% of GDP in FY20 (Rs 66.1 lakh crore).

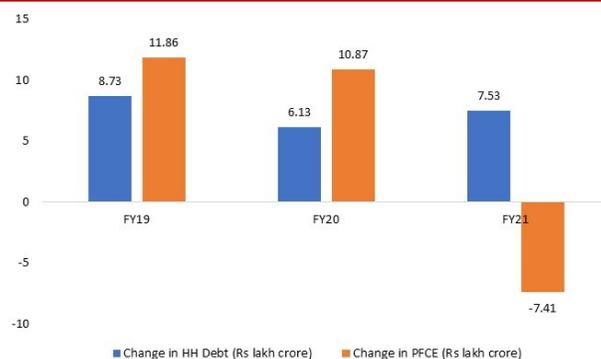
#### OUR CPI NUMBERS ARE LOWER THAN NSO: FUEL CROWDED OUT EXPENSES ON OTHERS

- ◆ We have re-estimated the CPI inflation since Jan'20 by using monthly credit card spends of SBI credit cards of a sufficiently large sample of customers on a recurring basis across all age groups gender-wise and spending that we bifurcated into non-discretionary and discretionary spends, by changing weights for all the months.
- ◆ The computed CPI inflation was higher than CSO estimate since Dec'20. However, in Jun'21 it has changed and is below the NSO CPI inflation by 28 bps. This has happened as spend on health expenditure has substantially reduced but expenditure on oil has more than crowded out the spending on other non-discretionary items, like grocery and utility services that was the trend in earlier months which is worrisome. In fact, the share of non discretionary spend has jumped to 75% in June'21 from 62% in Mar'21. In Apr-May'20, the non-discretionary share has reached 84%.
- ◆ This demands urgent cut in oil prices through tax rationalization, otherwise consumers' non discretionary spending will continue to get distorted and crowd out discretionary expenses. This will also impart an upward bias in inflation.

#### State-wise Distribution of Districts: Outflow of Deposits during Dec'20 over March'20

State or UTs	No of District	Deposit (Rs crore)	CFR in Second Wave
Arunachal Pra-	4	-161	0.6
Assam	5	-329	1.2
Bihar	7	-2806	0.8
Chhattisgarh	6	-2759	1.4
Gujarat	17	-18237	1.1
Jammu & Kashmir	1	-140	1.2
Jharkhand	5	-1694	1.8
Karnataka	15	-11760	1.0
Madhya Pradesh	4	-992	0.8
Maharashtra	9	-55761	1.4
Manipur	1	-27	2.0
Meghalaya	1	-17	2.0
Mizoram	1	-11	0.4
Nagaland	2	-231	3.0
Odisha	7	-478	0.2
Rajasthan	5	-3963	0.9
Telangana	4	-798	0.6
Uttar Pradesh	16	-6256	1.1
Uttarakhand	1	-12	2.1
West Bengal	1	-365	0.7
<b>Total</b>	<b>112</b>	<b>-1,06,798</b>	<b>1.2</b>

#### Consumption Decline and Household Debt increase



Source: SBI Research

#### NSO vis-à-vis SBI CPI Inflation (%)

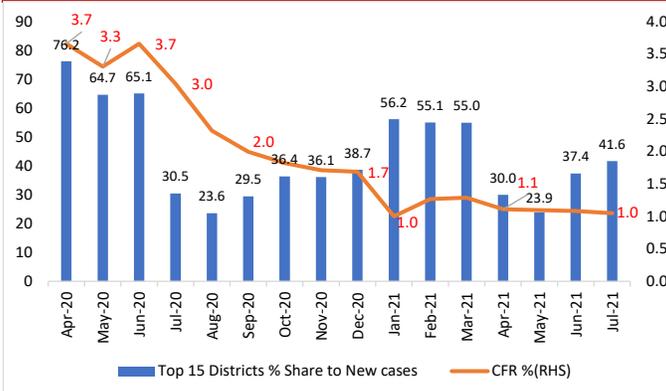


Source: SBI Research

**COVID UPDATE & VACCINATION**

- ◆ The second wave is not yet over. Daily new cases in India are still above 40,000 (except for Sundays when less number of cases are reported). The daily cases are still high in Kerala and Maharashtra. Even in the North Eastern States of Assam, Meghalaya, Mizoram, and Odisha and Tamil Nadu the daily cases are almost stagnant. District wise data shows that daily new cases in top 15 districts have risen to 41.6% as on 11 Jul’21, however their cumulative fatality rate continues to decline modestly to 1.05% currently. At the same time, the share of rural districts in daily new cases is moderating gradually, to 46.3% from 48.7% in Jun’21. Interestingly, the share of top 15 districts increased after the peak was reached in Sep’20 and it reached the maximum in Feb’21, implying that there was concentration of COVID-19 cases initially and gradually it spread to other areas.
- ◆ Meanwhile, India has given total of 37.73 crore vaccine doses, including 30.4 crore with one dose and 7.3 crore fully vaccinated (5.3% of entire population). The 7D moving average of daily vaccine doses has come down to 33.7 lakh (64% or 21.5 lakh first dose and 36% or 12.2 lakh second dose) from a maximum of 60.2 lakh as on 27 Jun’21. We need to increase vaccination speed to defeat the pandemic.
- ◆ If India speeds up the vaccination rate to 70 lakh per day, then the entire adult population can be covered by the end of FY22. On the other hand, around 33% of the adult population has at least got the 1st dose and we should prioritise the rest 30 crore working population to get their 1st dose before Dec’21.

**Share of Top 15 districts in New cases and CFR**



Source: SBI Research

**COVID-19 Vaccination Arithmetic**

Total 18+ Population	A	94.5
2nd Dose Received	B	7.3
1st Dose Received	C	30.4
Pending Both doses	D=A-C	64.1
Pending 2nd Doses	E=C-B	23.1
Total Required Doses	F=2D+E	151.2

Source: SBI Research

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