LEADER SPEAK

"Inflation as measured by WPI is even higher than CPI, which poses the risk that CPI inflation could rise further if the jump in wholesale prices and input prices is passed on further to the consumers."

RAJANI SINHA
Chief Economist
CareEdge Group

"The high inflation in India is mainly because of global supply bottlenecks, making the government's task of controlling inflation challenging. And unfortunately, high inflation is coupled with very nascent economic growth revival, making it a tightrope walk for the Central Bank. Nevertheless, the government has the ammunition of reducing the fuel duties."

Unrelenting inflation is a major concern today for most economies of the world. After battling a pandemic-induced recession and broken supply chains for over two years, they are now up against an old enemy: rising prices. And the war between Russia and Ukraine—major exporters of energy, rare earth metals (which find application in high-tech gadgets, arms, aircraft frames, electric vehicles and satellites) and food grains—has only made things worse for them. Relentless, or more appropriately 'high' inflation, is not only giving major headache to the policymakers, but is also seen posing new challenges to the central banks around the globe. Runaway prices in India too are now a cause of concern, stoking fears a stagflation may be around the corner. But are such fears warranted? Also, what needs to be done to tame the inflation monster? Amit Singh Sisodiya, Deputy Editor, *The Global ANALYST*, invited Rajani Sinha, an alumnus of Delhi School of Economics and one of India's leading economists, to share her views on the current inflationary situation in the country, implications of a prolonged war in Europe on the domestic economy, and what measures are needed to rein in rising prices. Edited excerpts:

- **How do you view the current inflationary environment in India?**

  The current inflationary environment in the country is definitely worrisome. The continued upward pressure on inflation shows that it is not transitory as was being anticipated earlier. The inflationary pressure is being seen across most categories, with especially high inflation for food and fuel. In fact, inflation as measured by WPI is even higher than CPI, which poses the risk that CPI inflation could rise further if the jump in wholesale prices and input prices is passed on further to the consumers.

  Core CPI inflation that excludes the volatile component of food and fuel has averaged around RBI's upper band of 6% in the last fiscal year and in fact shot up to 6.3% in March 2022. There is a risk that high food and fuel inflation would push up inflationary expectations, which in turn would feed into actual inflation through wage price spiral.

  High inflation at this critical juncture poses the risk of destabilizing the nascent economic recovery. Manufacturing sector is feeling the pressure on margins due to the sharp rise in input prices. At the same time, consumer sentiments that are already subdued would also get adversely impacted by high inflation.

> **"Due to the global supply bottlenecks, there is upward pressure on the entire basket of commodities including food, fuel and metals. The pent-up demand in domestic market further poses risk for inflation. In such a scenario, we expect average CPI inflation in the range of 5.7-6% in FY23."**

- **Apart from the Ukraine-Russia armed conflict and the pandemic-induced supply disruptions, which are the other factors that you feel have led to a spike in food and fuel prices?**

  The spike in food and fuel prices are entirely due to supply-side factors. The global economy had been struggling with supply disruptions caused by the pandemic, and the Ukraine-Russia armed conflict further aggravated the supply bottlenecks. To make matters worse, the weather condition in India has also not been favorable to some crops. For instance, in some states, the wheat crop production has been adversely impacted by severe heat waves. This will put further pressure on wheat prices that had already been going up due to supply disruptions caused by the Russia-Ukraine war. The pent-up demand in the economy also has the potential of pushing some components of inflation further up.

- **Do you think a normal monsoon could help soften prices of agricultural produce from their current highs?**

  A normal monsoon would definitely provide some relief from skyrocketing food prices, however, high global agriculture commodity prices would continue to exert upward pressure on food inflation as far as India is concerned. For instance, edible oil and wheat prices have risen sharply globally due to the war situation and that is getting reflected in sharp rise in prices of these items in Indian basket as well. So apart from monsoon, the global food scenario will also have a role to play in India's food inflation.

- **Do you see oil prices stabilizing anytime soon as war is losing its intensity and cheap oil (courtesy Russia) continues to find its way to Asia, notably India and China, which have managed to buy the black gold at deep discounts that has helped them avoid buying much from traditional suppliers like the Middle East, all of which has probably helped contain any undue spike in crude?**

  It is difficult to comment on oil prices as there is a lot of uncer-

tainty around the war. While Russia has been offering crude at discount, many of the countries remain cautious of buying from Russia. India has increased its imports from Russia and there are expectations that China could also increase its imports going forward. Given the uncertain global dynamics and supply constraints, it is very difficult to predict the global crude oil prices. However, broadly Brent crude oil is expected to remain above $100 in 2022.

■ **What measures do you think could serve the economy well in its war on inflation?**

The high inflation in India is mainly because of global supply bottlenecks, making the government's task of controlling inflation challenging. And unfortunately, high inflation is coupled with very nascent economic growth revival, making it a tightrope walk for the Central Bank. However, with inflationary pressure aggravating the RBI has bitten the bullet and hiked the policy repo rate by 40 bps in an unscheduled meeting. The Central Bank has also hiked the CRR by 50 bps to reduce the liquidity in the system to make the rate hike more effective. While inflation is mainly because of supply-side factors, it is critical to anchor the inflationary expectations to avoid further upward pressure on actual inflation. The government has the ammunition of further reducing the fuel duties. While this will have a bearing on the exchequer, the government might still consider this option as inflationary pressure persists.

■ **Do you think RBI has taken enough steps to rein in the runway prices?**

The 40 bps repo rate hike announced by the Central Bank took market by surprise as it was an out of turn rate hike. RBI has clearly indicated its worry on second round effect of the high food and fuel inflation on other categories and the urgent need to anchor inflationary expectations. We feel there are chances of further rate hikes of around 60 bps in the next few months. RBI will be closely watching the inflation data for its further action on the policy front.

■ **What are your expectations on the fiscal policy front?**

There is some comfort on the fiscal policy front due to robust tax revenue collection so far. The gross tax revenue collection for FY22 has exceeded the revised estimate of the Union Budget. However, the subsidy bill of the government could overshoot the target due to extension of the Government's PMGKY as well as the war situation. Nonetheless, if the revenue collection remains robust in FY23, it will provide comfort on the fiscal front.

■ **What is your overall outlook on inflation for the rest of 2022?**

Inflation has proven to be much stickier than was being anticipated earlier. Due to the global supply bottlenecks, there is an upward pressure on the entire basket of commodities including food, fuel and metals. The pent-up demand in domestic market further poses risk for inflation. In such a scenario, we expect average CPI inflation closer to 6% in FY23

■ **Are there any other issues of concern that you would like to talk about?**

There are challenges on the external sector front too. With high commodity prices, India's trade deficit has been widening. The country is also witnessing FPI outflows as US Fed starts the rate hike cycle. India's forex reserves have been on a decline in the last few months and this is putting some pressure on the Indian currency. Depreciation of rupee will likely result in imported inflation. So, that's another risk on the inflation front. ■

CareEdge
Ratings • Advisory • Research • Risk Solutions

> **"The 40 bps repo rate hike announced by the Central Bank took market by surprise as it was an out of turn rate hike. RBI has clearly indicated its worry on second round effect of the high food and fuel inflation on other categories and the urgent need to anchor inflationary expectations. We feel there are chances of further rate hikes of around 60 bps in the next few months."**

Rajani Sinha
Chief Economist, CareEdge Group

Reference # 20M-2022-05-08-06