

# Inflation cools, but here's why RBI may still not cut rates in February | India Today Insight

*Double-digit inflation persists for products such as meat, eggs and pulses*

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Ghazipur vegetable market, East Delhi, Oct. 2020 (Chandradeep Kumar)



Just when fears regarding inflation were growing and threatening to change the course of the accommodative policy stance of the Reserve Bank of India (RBI) comes news of lower inflation numbers for December 2020. Retail inflation fell to a 15-month low of 4.6 per cent in December, against what many estimated would be around 6 per cent. Lower inflation raises hopes of interest rate cuts (though not in the upcoming RBI monetary policy meeting in February), which will support growth and burn consumers' pockets less.

On the flip side, lower price of food products may not be happy news for agri goods producers—farmers who have been traditionally straddled by lower income from their produce compared to their input costs. Inflation has, by and large, remained within the RBI's target of 4 per cent (+/- 2 per cent) until the national lockdown last March turned things on its head. Inflation reached a 77-month high of 7.61 per cent in October 2020, but eased to 6.9 per cent in November.

The RBI maintained a status quo on interest rates in December, wary of benign rates stoking inflation. Even with inflation easing further to within its target, it is unlikely that the central bank would cut interest rates in its next monetary policy to be announced in February as prices of certain food products are still reigning high. Moreover, despite the moderation in inflation, the average inflation during the April-December 2020 period continues to be high at 6.6 per cent, well above the RBI's target.

According to a research note from Care Ratings, the easing of retail inflation during the month has been primarily due to a high base effect (7.4 per cent in December 2019) and notable decline in some components on the food basket, especially vegetables. Core inflation moderated at a gradual pace to a six-month low of 5.65 per cent in December 2020 compared with 5.84 per cent in the previous month.

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In the past few months, the biggest component in the rise in headline consumer price index (CPI) inflation has been the 'food' category. It recently recorded two consecutive months of double-digit inflation (10.7 per cent in September and 11.1 per cent in October). What contributed to high food inflation has been vegetables (onion and potatoes mostly) and protein items, such as pulses, eggs, meat and fish. While initially, the lockdown led to supply disruptions, more recently, heavy rains in certain parts of the country impacted supplies even as demand started to firm up in the 'unlocked' economy. This supply-demand mismatch has kept food prices firm.

The RBI has also been cautioning about the inflationary trends. The RBI's State of the Economy report in December said the Indian economy is recovering faster than expected and may post minor positive growth in the third quarter, but efforts need to be redoubled to fight inflation so that it doesn't hurt the incipient growth impulses. It said that the Indian economy was pulling out of Covid-19's "deep abyss" and is "reflating" at a pace beats most predictions. 'Reflating' is the act of expanding economic output either through fiscal (government policies) or monetary (undertaken by the RBI) means.



In December, however, inflation in the food and beverages segment fell to a 16-month low of 3.9 per cent compared with 8.8 per cent in November 2020. A high base effect, coupled with fresh supply of kharif harvest crops and vegetables in the market, has eased the inflationary pressure in this segment, said the Care Ratings report. It also cautioned that despite the easing, double-digit inflation continues to remain for protein items like meat (15.2 per cent), eggs (16.1 per cent) and pulses (16 per cent), coupled with oils (20.1 per cent), spices (10.3 per cent) and non-alcoholic beverages (11.9 per cent). There has been a notable increase in the import prices of edible oils, which has pushed up inflation in the oil sub-segment.

Inflation for fuel components rose to four-month high of 3 per cent in December, compared with 1.9 per cent in November 2020 and 0.7 per cent in December 2019. A low base and rise in prices of LPG cylinders (non-subsidised), kerosene and airline turbine fuel owing to rise in global crude oil prices has led to the uptick in this segment. On

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January 19, petrol prices in Delhi touched a record high, with the fuel selling at Rs 85.20 a litre. In Mumbai, petrol prices reached a record high of Rs 91.56 a litre on January 18. Diesel prices too were at an all-time high of Rs 81.87 a litre.

Care Ratings expects retail inflation to be benign during the next couple of months as food prices moderate further. However, the firming up of global commodity prices will put more pressure across segments.

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