# CPI Inflation: FY12-FY21

**May 12, 2021** I **Economics**

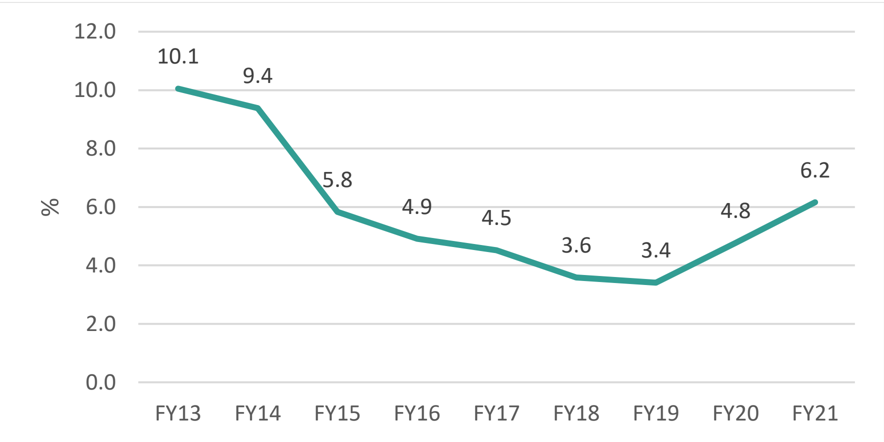
**Headline inflation** based on **Consumer price index (CPI)** has grown at a CAGR of 5.8% during the last ten years (i.e., FY12 to FY21). This can be viewed in the context of the Monetary Policy Committee's approach to flexible inflation targeting from 2016 onwards with the aim of maintaining inflation at 4% with a band of 2% on both sides.

Inflationary pressures have rebounded with retail inflation rising to 6.2% during FY21, exceeding the 6% limit. This has been manifested in both food inflation and core inflation. Higher food prices were due to supply shortfalls as in case of pulses as well as global trends in case of edible oils. Further, periodic disruptions caused by monsoon-related issues for vegetables caused inflation to increase sharply. Core inflation became fairly sticky as prices of various manufactured products and services increased post the unlock process.

**Global trends**

Pandemic and resultant lockdowns/restrictions imposed globally in order to restrict the spread of infections resulted in slowing down of economic activities. Global commodity and crude oil prices moved downward owing to bleak demand prospects. Central Banks turned accommodative to extend support to the economies hard-hit by the disruptions as inflation remained benign. On the domestic front, imposition of a nation-wide lockdown in March 2020 resulted in firming up of prices on the back of rising cost-push inflation and supply side disruptions. Declining global crude oil prices were partly offset by an increase in taxes which ensured that the benefit of lower prices did not fully reach the consumer. However, the global economy has been witnessing a rebound in activities and businesses although at a slow and uneven pace owing to considerable differences in the progress of vaccination drives, new virus mutations and renewed restrictive measures which continue to threaten demand in some countries. The recent uptick in domestic inflation is due to a notable jump in food inflation, pick-up in domestic demand, improvement in pricing power of firms and elevated input costs. More importantly the global recovery has also led to a bull run in commodities ranging from metals to Agro products.

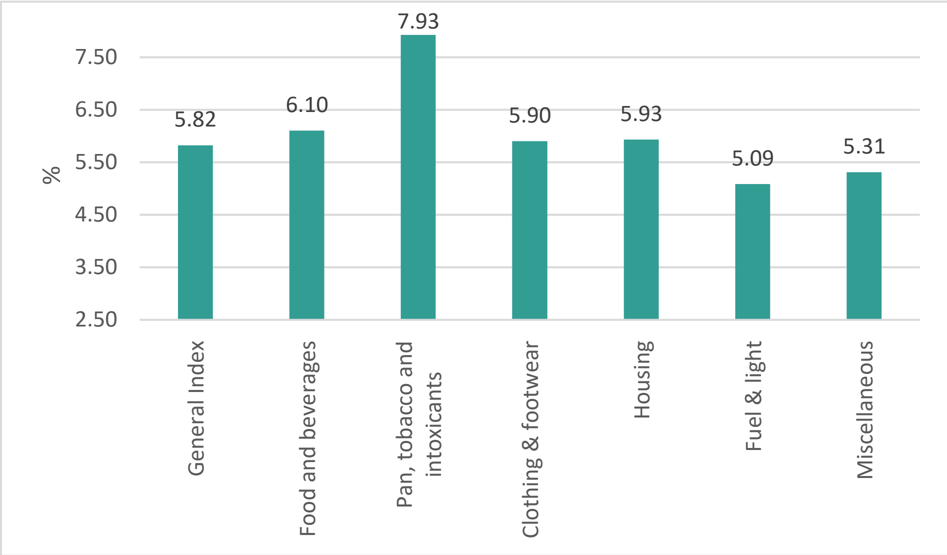
**Exhibit 1: Retail Inflation**




Source: CMIE

Exhibit 1 is interesting as it shows a virtual U-shaped curve starting FY13 which came down to a low of 3.4% in FY19 after which there has been an ascent. The falling trend has made it easier for the MPC to pursue a policy of soft interest rates as there were few pressures to increase the repo rate due to higher inflation. As the MPC became operational in the second part of FY17 with the inflation curve moving downwards decisively till FY16 the target of 4% looked reasonable. The rising trend is important because even in the past it has been noticed that commodity bull phases do run their cyclical path and as the world recovers from the pandemic there would be a tendency for prices to increase. Therefore, the future direction of this curve will also be driven by the global commodity cycle being sustained.

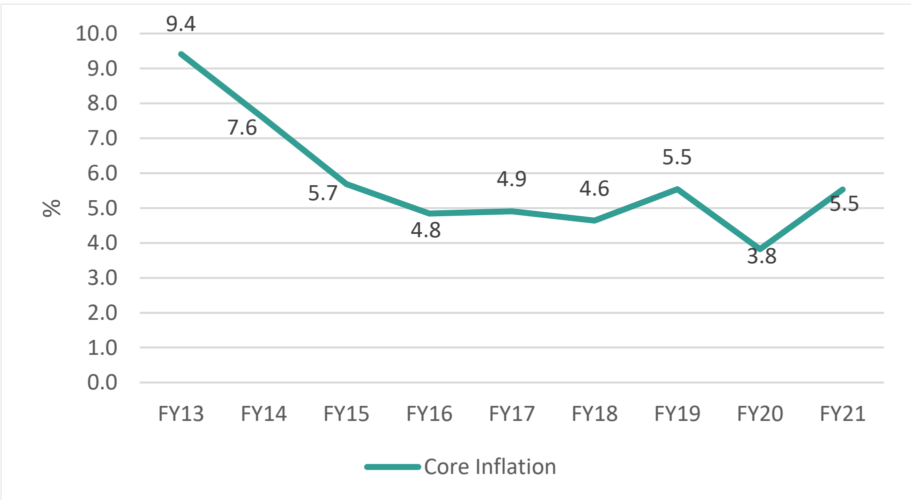
**Exhibit 2: Component wise CAGR of retail inflation**




Source: CMIE

- Inflation in food and beverages (which constitutes the maximum weight of 45.86 in the overall CPI basket) has grown at a CAGR of 6.1% and has been a crucial component in driving up India's retail inflation. Inflation had been coming down for this category till FY17 but remained above the 4% mark. It was only in the subsequent two years that inflation came down to 2.2% and 0.7% which helped in bringing headline inflation to a level of less than 4%. This was helped by good production levels for most product groups.
- However, retail inflation has witnessed an uptick on the back of higher food inflation in FY20 & FY21 because of;
  - Higher vegetable prices owing to monsoon led disruptions especially for onions and tomatoes.
  - Sharp rise in prices of pulses which can be attributed to production shortfalls especially for tur and moong.
  - Double digit inflation in eggs, fish and meat was also witnessed.
  - Uptick in prices of oils and fats due to high demand for edible oils, and greater reliance on imports (around 60% of consumption is met from imports) where prices were rising.
- The miscellaneous component (comprising household goods & services, health, transport & communication, recreation & amusement, education and personal care & effects) comprising 28.32% weight in the CPI basket has grown at a CAGR of 5.3% during the last ten years. This has lowered the average inflation rate with the other components barring fuel having inflation of above 5.5% each.
- Housing inflation (comprising house rent, repairs, water and other charges) has recorded a CAGR growth of 5.9% during FY12-FY21. Like other components, housing inflation too has moderated since FY14 and has remained within the range of 4.5% to 6.5%. As this component is reckoned on the HRA of central government employees, it gets linked to revisions recommended by the Pay Commission and may not truly be reflective of housing costs.

**Exhibit 3: Core Inflation**

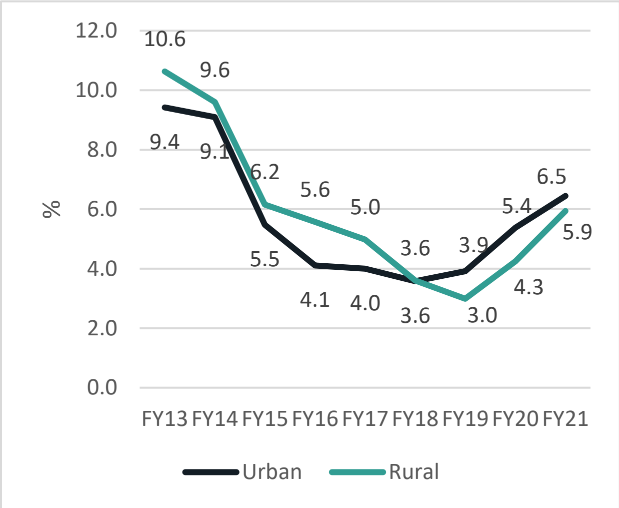



Source: CMIE

Core inflation which excludes components such as food and fuel has remained elevated and has exhibited a mixed trend- coming down till FY16 before rising again and then coming down sharply in FY20. Core inflation has edged up to 5.5% in FY21 after having moderated to 3.8% during the previous year on account of firming up of cost pressures and uptick in domestic demand following relaxation of coronavirus led restrictions. Core inflation has tended to remain above 4% in 8 of the 9 years and above 5% in 5 of the 8 years. This component is of special interest to the MPC as it deals with non-food products that are not driven by supply-demand mismatches.

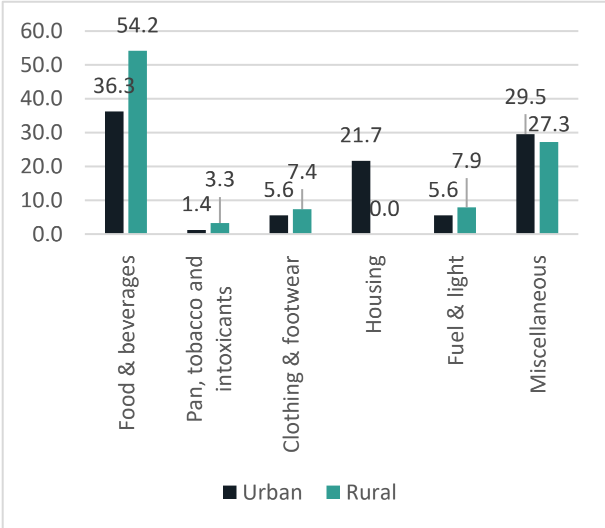
**Trends in rural-urban inflation**

**Exhibit 4: Headline Inflation- Rural Vs Urban (y-o-y growth)**




Source: CMIE

**Exhibit 5: Group-wise weights- Rural Vs Urban**

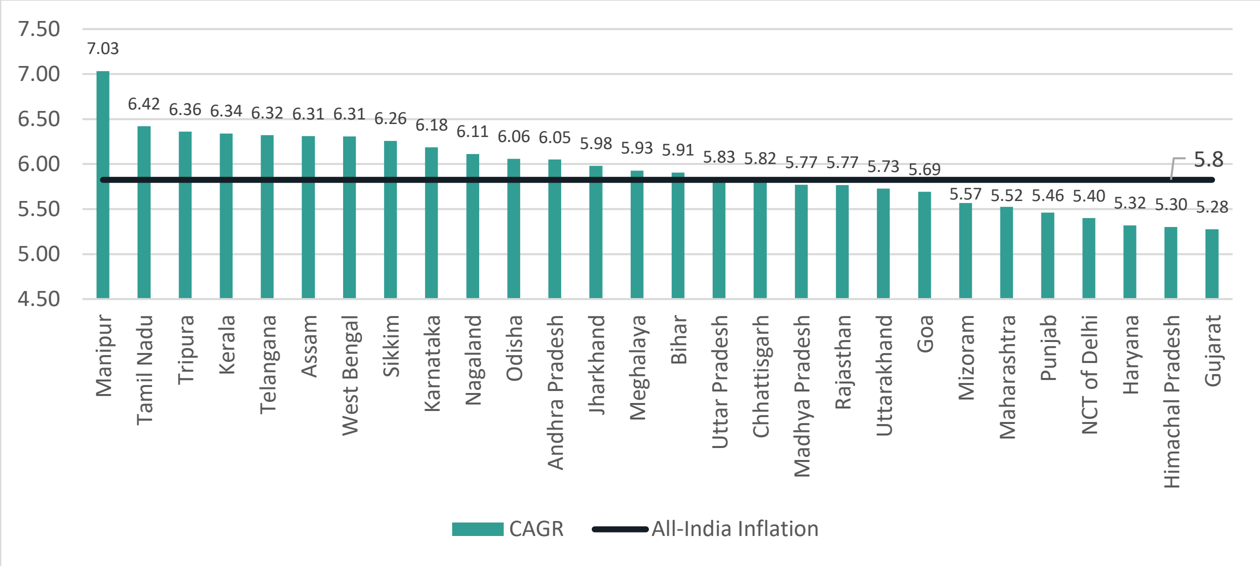



Source: CMIE

- The trends in CPI for rural and urban segments show that inflation in the former has been higher than the latter during FY13 to FY17. This trend has reversed since FY19 with urban inflation picking up.
- Inflation has been declining in both rural as well as urban segments since FY13 on account of a notable moderation in prices of food and beverages. Rural inflation has been more responsive to the moderation in food inflation mainly due to a higher weight (54.2%) assigned to this component. (Exhibit 5 shows the differential weights assigned to components in computation of urban and rural CPI inflation)
- Though both rural and urban inflation have moved together since FY13, the differential in rural-urban inflation widened by 1.5 percentage points in FY16.
- In FY20, higher urban inflation was on the back of an uptick in prices of food and clothing. Though rural food inflation edged up in FY21 narrowing the rural-urban price differential, a notable jump in the urban fuel and light prices has kept urban inflation levels elevated.

## Trends in inflation across states

**Exhibit 6: State-wise Retail Inflation (CAGR %)**




Source: CMIE & MOSPI

- Retail inflation in India has grown at a CAGR of 5.8% over the period FY12 to FY21.
- During FY12 to FY21, the inflation growth (measured in terms of CAGR) in 17 states has been higher than the all-India level. Manipur has recorded the highest growth in inflation of 7% while it has been the lowest in Gujarat (5.3%).
- Higher levels of Inflation have been observed in the north-eastern states of Assam, Manipur, Meghalaya, Nagaland, Tripura and Sikkim.
- Since the RBI formally adopted flexible inflation targeting in 2016 fewer states have retail inflation exceeding the upper tolerance limit of 6%. Six states namely, Andhra Pradesh, Bihar, Chhattisgarh, Gujarat, Sikkim and Meghalaya have consistently maintained inflation levels below 4% barring FY21 when the all-India inflation level breached the 6% limit.
- Variation in rates of inflation has been the maximum in case of Meghalaya and Tripura while it has been the least in Jharkhand during FY13 to FY21.
- Food inflation in Delhi, Chhattisgarh and Madhya Pradesh has persistently been below the national average while it has been higher in Manipur, Odisha and Sikkim.

## Key Observations

- Headline inflation has moderated since 2014, however inflationary pressures have rebounded since FY20 and FY21.
- Retail inflation has been driven by prices of food and beverages followed by the miscellaneous components.
- Core inflation in India has remained sticky and elevated over the past.
- Urban inflation has been higher than rural inflation since FY19.
- North-eastern states have been reporting higher levels of inflation.

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