

## **Why RBI will be forced to Revise its Inflation Forecast**

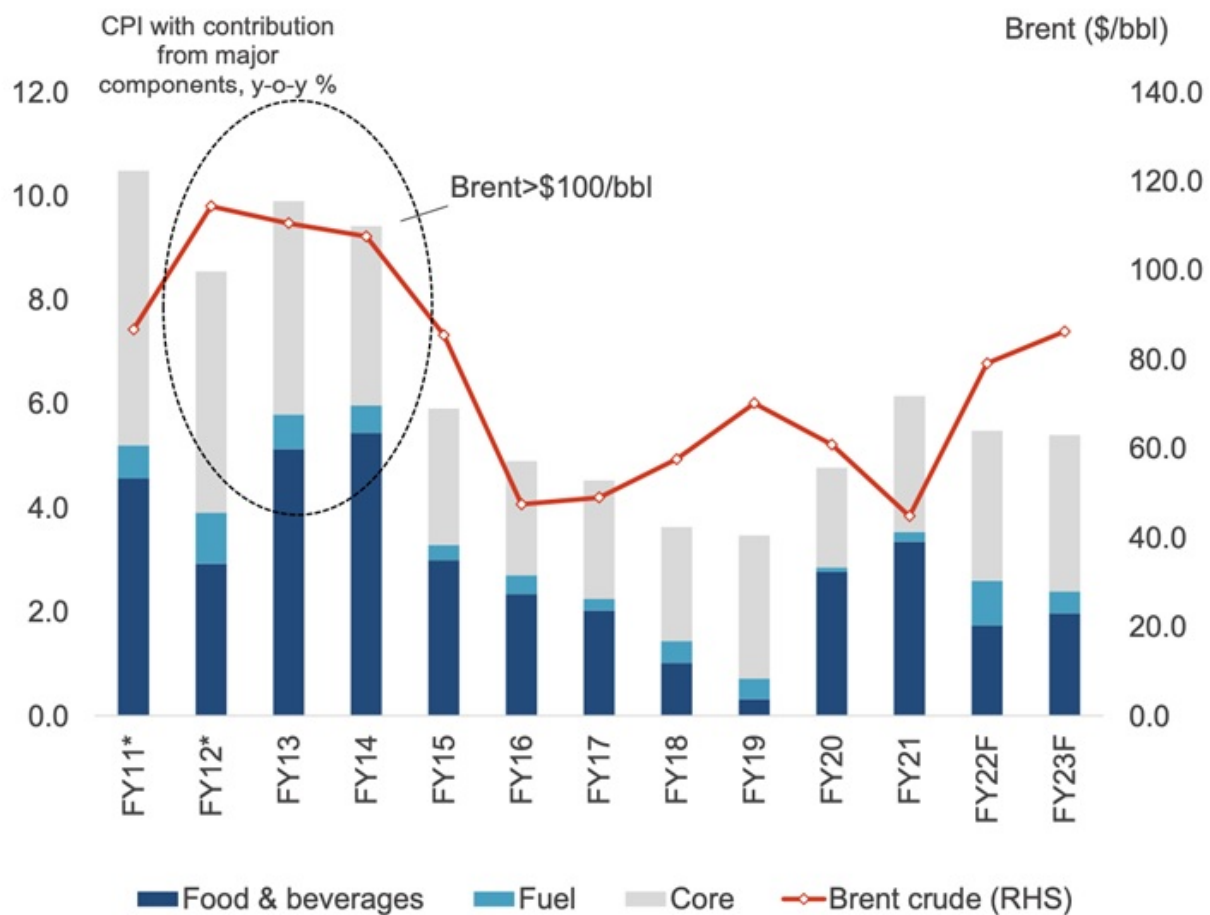
### **What is the issue?**

Retail inflation in February reached an eight-month high and breached the RBI's comfort zone even without the domestic oil prices reflecting the higher crude oil prices.

### **Why is this trend noteworthy?**

- At 6.1%, retail inflation in February breached the upper-bound of RBI's comfort zone (6%).
- This rise is despite the Indian economy being shielded from the sharp increase in crude oil prices across the world in the wake of the Ukraine crisis.
- In RBI's policy statement in February, the RBI's Monetary Policy Committee (MPC) stated that CPI inflation for 2022-23 was projected at 4.5 %.
- RBI continued to expect that inflation is likely to moderate in the first half of 2022-23 and move closer to the target rate thereafter, providing room to remain accommodative.

## Crude oil prices and CPI inflation



\*Data for CPI Industrial Workers

Note: Data on CPI components refer to their contribution to inflation; F refers to CRISIL's forecasts

Source: NSO, CEIC, CRISIL



## What are the main reasons for expecting the RBI to revise its inflation forecast upwards?

- **Higher crude oil prices-** Analysts expect that petrol prices need to rise by as much as around 24% cumulatively over the next few months (by Rs 25/litre) and LPG prices by around 33% (by Rs 300/cylinder) to bring them on par with market prices.
- **Higher natural gas prices-** natural gas prices, which are closely linked with crude oil prices, are set to spike.
- It is expected that domestic gas prices will double to 6-6.5 dollar / Metric Million British Thermal Unit, from April 2022.
- **Higher food prices-** While higher fuel prices will have a huge bearing on overall inflation directly, these prices would also lead to costlier food items.
- The higher prices of natural gas will imply costlier fertilisers, which, in turn, will feed into higher food inflation.
- Similarly, higher edible oil prices will raise overall food prices.
- The fuel and food prices account for almost 53% of weightage in the CPI inflation.
- **Higher commodity prices-** Russia isn't just a big supplier in the global oil and gas market but also in many other commodities thus impacting the price of many commodities.
- **Costlier consumer goods-** Consumer goods companies are set to pass on higher input costs

to consumers which are likely to affect the retail prices of home appliances, vehicles, personal care products and non-durables.

- **Costlier services**-The services sector has possibly been the worst affected during the Covid pandemic.
- As Covid caseload comes down, the services sector is expected to resume activity and this is likely to lead to higher prices of services such as education.

## What holds positive for India?

- India is by no means the worst affected.
- The economies that India is typically categorised with such as South Africa or Brazil are worst hit.
- Even in the developed world countries such as the UK and the USA, which are not used to such high inflation rates, the picture is comparatively worse than in India.
- Even if fuel prices were to climb back to the levels last seen in 2012 and 2013, India's domestic inflation may not reach the same levels as in the past.
- Of the three components of overall inflation (food, fuel and core) at present, both food and core inflation levels are still considerably lower than a decade ago.
- If India were to receive another year of normal monsoon rainfall, it will keep food inflation in check.

## Reference

1. <https://indianexpress.com/article/explained/explained-rbi-inflation-forecast-revise-oil-food-prices-7828879/>