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.



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/

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