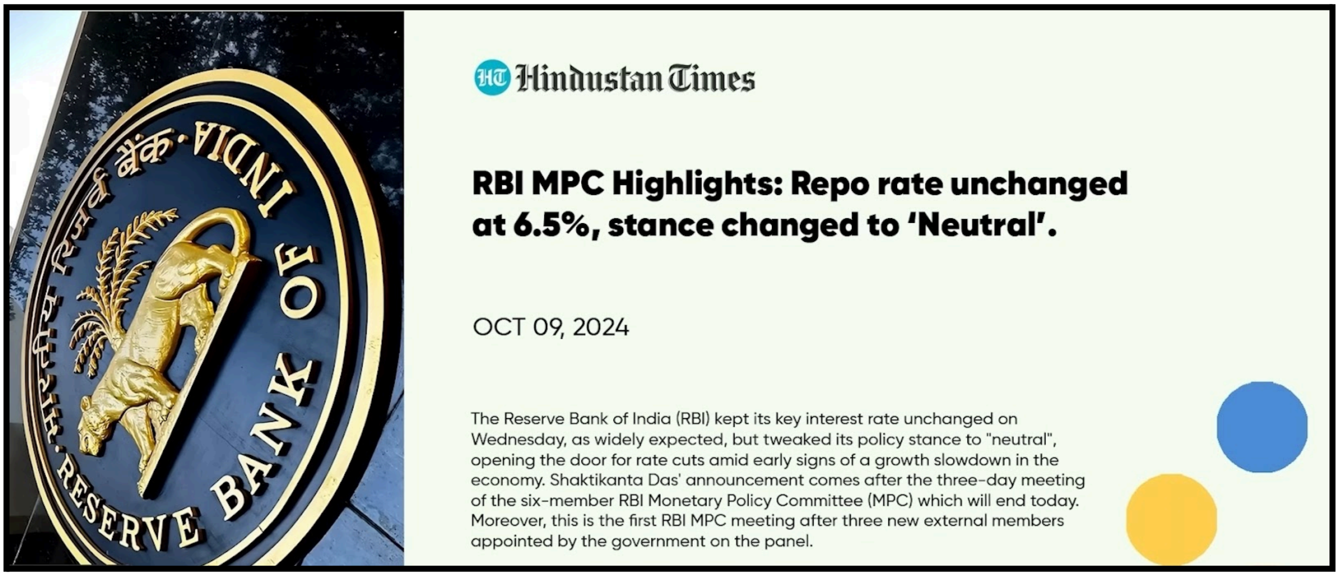
Research Report: Indian Inflation Rate CPI October 2024

By Chaitanya Sabharwal, as an intern for PredictRAM.



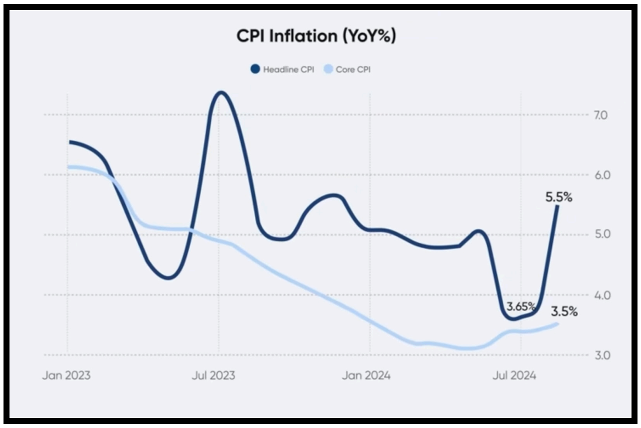
Cover image for the research paper - Source: Hindustan Times 9th October 2024.

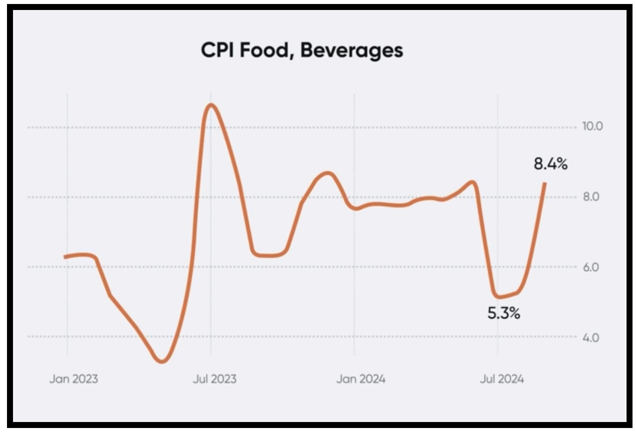
Introduction

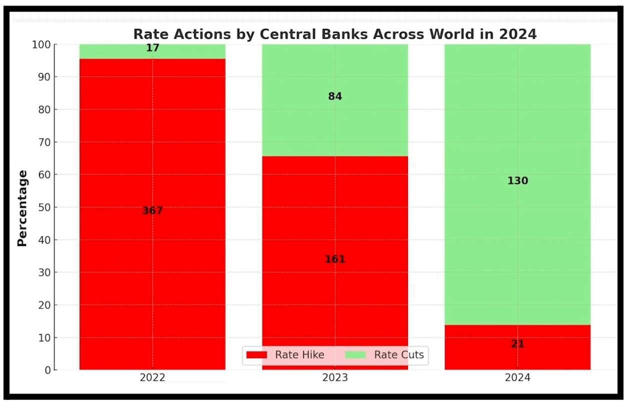
This report examines recent trends in Indian inflation and interest rates, analysing factors contributing to these trends and their impact on various sectors of the Indian economy. It also explores the Reserve Bank of India's (RBI) monetary policy stance, considering the influence of US Fed interest rate cuts amidst a volatile geopolitical environment.

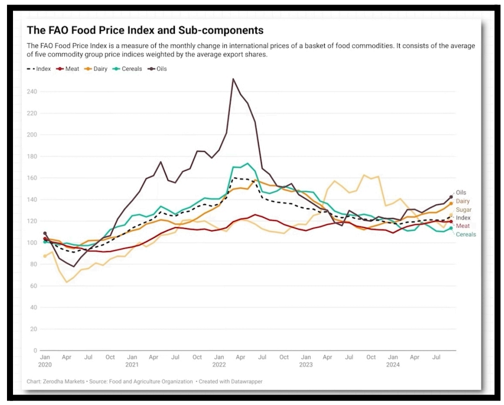
Recent Trends in Inflation and Interest Rates

India's CPI inflation surged from 3.65% in August to 5.5% in September 2024. This increase is primarily attributed to a sharp rise in food inflation, surging from 5.23% to 8.4% during the same period. Heavy rains and supply chain disruptions, particularly affecting fresh vegetable prices, are cited as the primary causes. However, core inflation, excluding food prices, has remained relatively stable. While the weakening rupee, particularly against the Chinese Yuan, raises concerns about potential increases in core inflation.









The RBI has maintained the repo rate at 6.5% as of October 10, 2024. This decision contrasts with the global trend of rate cuts, including two consecutive cuts by the US Federal Reserve, lowering their benchmark rate to 4.50% - 4.75% as of November 7, 2024.

Factors Contributing to Recent Inflation and Interest Rate Trends

Global factors contributing to India's inflation include rising global commodity prices, particularly crude oil, uneven monsoon rains impacting crop yields, and the influence of global metal prices on domestic inflation. The weakening rupee against the Chinese Yuan, India's largest trading partner, is also a concern as it makes imports more expensive, potentially fueling inflation.

The RBI's decision to hold interest rates amidst global rate cuts is driven by a cautious approach to balancing inflation control with economic growth. The RBI has adopted a neutral policy stance, signalling its willingness to adapt to evolving economic data. The central bank projects strong economic growth of 7.2% for the fiscal year 2024-2025, fueled by robust private consumption, government spending, and decent agricultural performance. However, concerns remain regarding potential short-term inflation spikes due to factors such as an adverse base effect, rising food prices, and global commodity price fluctuations.

Ripple Effect of the recent Interest Rates Trends on a few Sectors of the Indian Economy

1. **Banking and Financial Sector:**
    a. The recent interest rate trends have somewhat pressurised the NIMs (Net Interest Margin) of the banks and NBFCs. While the higher interest rates have also been passed on to the customers, this usually translates into lower loan disbursements, but surprisingly credit growth has been consistently outpacing the deposit growth. Many experts believe it is of a temporary nature.
    b. RBI's concerns regarding higher CDRs (Credit to Deposit Ratios) and liquidity risks have come down a little hard on the banks. The banks are advised to keep the CDRs healthy. This, even as it sounds alarming, is not a dangerous situation right now but things can spiral out of control in no time given the recent geopolitical situation. In late Q2FY25, the deposit growth is starting to pick up and the credit growth is being intentionally slowed down.
    c. In addition to these, RBI has cracked down hard on the microfinance industry too because of compliance issues and over-exposure to unsecured lending.
    d. Stocks like HDFC Bank, Kotak Bank, Bajaj Finance saw regulatory actions and the entire banking sector saw a relatively deep underperformance in the past 3 - 4 years with ICICI Bank, Federal Bank and SBI being the exceptions.

2. **Auto Sector:**
    a. Automakers saw an increase in the raw material cost and the exhaustion of pent-up demand in H1FY25. In addition to this, the sustained higher interest cost on auto loans may have made it difficult for the consumers to spend on vehicle purchases. This resulted in a slowdown in the auto sector in India in Q2FY25.
    b. Most of the stocks from the auto sector have been underperformers in Q2FY25 with notable mentions like Tata Motors and Eicher Motors being beaten down and in deep consolidation respectively. Not so surprisingly Mahindra & Mahindra and TVS Motors have been the brightest stocks because of their enhanced product portfolio.

3. **IT Sector:**
    a. The IT sector is less directly affected by domestic interest rate changes, but a strong economy driven by lower rates can indirectly benefit IT services demand. A domestic interest rate cut allows the domestic clients of the IT industry to have more discretionary spends.
    b. Usually the Indian IT industry depends higher on the US Fed's interest rate changes as most of their clients and deals come from the United States and other western nations.

c. With the US Fed's interest rate cuts, the IT Industry has again become a darling of the street rallying on the expectation of sustained higher earnings.
d. Stocks like HCL Tech, Persistent Systems and Infosys have outperformed the broader markets in the past 6 months.

4. **FMCG Sector:**
    a. Rising food and commodity prices are putting pressure on household budgets.
    b. Rate cuts can boost consumer spending power, potentially increasing demand for FMCG products, especially discretionary items.
    c. Whereas in a high interest rate environment consumer discretionary products like fashionable items may face reduced demand.
    d. The consumer staples like wheat and rice largely stay unaffected.
    e. Stocks like Tata Consumer and Hindustan Unilever have also underperformed the broader markets. ITC is an exception in the Nifty FMCG pack.

5. **Infrastructure and Construction:**
    a. Lower borrowing costs can incentivize investment in infrastructure and construction projects. It also calls for a higher private investment in big infrastructure projects.
    b. Many companies and even governments issue bonds to fund big infrastructure projects. In a high interest rate environment, the cost of funds increase therefore reducing the number of new project commissioning.
    c. Stocks like Larsen & Toubro are expected to rally in the coming months on the expectations of an easing interest rate environment and execution of large infrastructure projects.

6. **Real Estate Sector:**
    a. The real estate sector is already booming in India. Going forward with lesser interest rates, more affordable home loans can drive demand for residential properties.

Factors Influencing Future RBI Interest Rate Decisions

Several factors will likely influence the RBI's future interest rate decisions:

1. **Inflation Trajectory:**
    a. The RBI will closely monitor inflation trends, particularly food inflation, aiming to ensure it remains within the 4% target.
2. **Economic Growth Prospects:**
    a. The RBI will consider the impact of interest rate changes on economic growth, seeking to maintain the positive momentum projected for the fiscal year 2024-2025.
3. **Global Economic and Financial Conditions:**

   a. Global commodity prices, US Fed policies, and the overall health of the global economy will be key considerations.
4. **Geopolitical Risks:**
   a. Uncertainties arising from geopolitical tensions can influence the RBI's decision-making, prompting a cautious approach to policy changes.

Conclusion

The US Fed rate cuts could impact India by influencing capital flows and exchange rate fluctuations. A weaker US dollar could make Indian exports more competitive, but also potentially contribute to imported inflation. The RBI will need to carefully balance the potential benefits of lower interest rates against the risks of rising inflation, especially in a volatile geopolitical environment.

Whether the RBI's decision to hold rates will lead to a slowdown in the Indian economy is uncertain. The RBI's growth projection of 7.2% suggests confidence in the economy's resilience. However, the impact of global economic conditions and the effectiveness of the RBI's balancing act between inflation control and growth support will determine the ultimate outcome. As a research analyst, I feel that the RBI's cautious approach, given the current geopolitical environment and potential inflationary pressures, is justified.

The India CPI Inflation data for November 2024 is expected to be at 5.81%, up from 5.55% in the year ago period.

The stock market is expected to be range bound and under consolidation for November 2024 if the market dynamics stay similar.

Lastly please take note of the highly important events coming up ahead:
1. 12th Nov 2024 - India CPI Inflation data.
2. 14th Nov 2024 - India WPI Inflation data.
3. 29th Nov 2024 - Real GDP Growth.
4. 6th Dec 2024 - RBI Policy (Repo Rate).