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India and the US: A tale of two inflations

Inflation remains above comfortable levels both in India and the US, which means that the RBI and the Fed are likely to continue raising interest rates.

DEVINA MEHRA | FEBRUARY 22, 2023 / 07:47 AM IST

The recent inflation print is unlikely to be the harbinger of good news for market watchers (Representative image: Reuters)

Interest rates have been the tail that has been wagging the asset prices dog for the last few quarters. The interest rate stance of central banks, in turn, is determined by inflation numbers. I have rarely seen inflation numbers being watched so closely in my three decades of tracking markets.

This week, inflation numbers came out for both India and the US for the month of January.

Detailed analysis follows below, but the short point is that inflation continues to remain higher than where central bankers would like it to be — both the headline number and the core value, net of food and fuel.

The recent inflation print is unlikely to be the harbinger of good news for market watchers.

India CPI

India's headline Consumer Price Index-based (CPI) inflation grew 6.52 percent year-on-year (YoY), a three-month high, versus the 5.92 percent that was expected in January. Thus, there has been no moderation in the numbers.

As has been pointed out earlier, last month's somewhat-lower figure was solely due to the drop in food prices, specifically vegetables.

In the latest numbers, both the CPI-based inflation (excluding food and fuel) and the core inflation (including food and fuel) remain well above 6 percent. This is well beyond not just RBI’s target inflation rate of 4 percent, but also beyond its tolerance band of plus/minus 2 percent (4+2 = 6 percent).

This points towards interest rates remaining higher and for longer. The inflation numbers do not provide any leeway for the RBI to stop tightening anytime soon.

India CPI details

Of the month-on-month (MoM) increase in January 2023 over December 2022, 0.21 percent was contributed by food inflation alone, with cereals (2.6 percent MoM) and vegetables (-3.7 percent MoM) witnessing wild swings.

Clothing and footwear inflation remained high with the MoM number at 5.4 percent and the YoY number clocking 8.8 percent growth over January 2022.

Housing inflation jumped 0.8 percent MoM in January, while the YoY inflation was 4.6 percent. If this is not a one-off, then housing inflation will need to be watched closely.

In miscellaneous items, household goods & services, and health & personal care remain stubbornly high, both on a YoY and MoM basis.

When we consider CPI ex-food it stands at 5.74 percent MoM or 6.71 percent YoY, while CPI ex-food, fuel and light stands at 6.60 percent MoM, or 6.11 percent YoY.

Thus, given that both these measures which exclude volatile items remain above or close to 6 percent, the odds of the RBI delivering another rate hike at the next meeting are high. Higher (rates) for longer will be the case for the RBI (and the Fed), unless we see evidence of core inflation receding.

In government securities, the two-year yield is at a high of 7.2 percent which was hit in Oct 2022, even as the 10-year security trades sideways at 7.34 percent, much below its high of 7.62 percent hit in June 2022. Bond prices fall as yields (or interest rates) go up.

Group Code	Sub-group Code	Description	Weights (%)	MoM	YoY
1		***Food and beverages***	***45.9%***	***0.45%***	***6.19%***
	1.1.01	Cereals and products	9.7%	2.60%	16.12%
	1.1.02	Meat and fish	3.6%	0.81%	6.04%
	1.1.03	Egg	0.4%	2.26%	8.78%
	1.1.04	Milk and products	6.6%	0.58%	8.79%
	1.1.05	Oils and fats	3.6%	-0.64%	1.41%
	1.1.06	Fruits	2.9%	0.13%	2.93%
	1.1.07	Vegetables	6.0%	-3.75%	-11.70%
	1.1.08	Pulses and products	2.4%	0.06%	4.27%
	1.1.09	Sugar and Confectionery	1.4%	-0.57%	0.92%
	1.1.10	Spices	2.5%	1.56%	21.09%
	1.2.11	Non-alcoholic beverages	1.3%	0.23%	4.32%
	1.1.12	Prepared meals, snacks, sweets etc.	5.6%	0.42%	7.78%
2		***Pan, tobacco and intoxicants***	***2.4%***	***0.41%***	***3.07%***
	3.1.01	Clothing	5.6%	0.49%	8.83%
	3.1.02	Footwear	1.0%	0.34%	10.52%
3		***Clothing and footwear***	***6.5%***	***0.44%***	***9.08%***
4		***Housing***	***10.1%***	***0.82%***	***4.62%***
5		***Fuel and light***	***6.8%***	***0.00%***	***10.84%***
	6.1.01	Household goods and services	3.8%	0.41%	7.26%
	6.1.02	Health	5.9%	0.66%	6.36%
	6.1.03	Transport and communication	8.6%	0.12%	4.54%
	6.1.04	Recreation and amusement	1.7%	0.36%	5.15%
	6.1.05	Education	4.5%	0.11%	5.83%
	6.1.06	Personal care and effects	3.9%	1.59%	9.57%
6		***Miscellaneous***	***28.3%***	***0.47%***	***6.21%***
General Index (All Groups)			**100.0%**	**0.46%**	**6.52%**

Source: Ministry of Statistics and Programme Implementation (MOSPI)

US CPI Update

US headline and core inflation came bang in line with estimates on an MoM basis, however, the YoY numbers were higher by a small margin, probably due to the revision of index component weights.

As the graph shows, currently, services inflation (shelter inflation) is a big component of inflation. This has remained persistently high even as goods inflation has moderated.

Core services, ex-shelter inflation, seem to be of primary importance given that goods inflation has already receded quite a bit. The trend here seems to be lower on a three-month basis, but is still quite high at close to 4 percent, which is consistent with wage data as wages have risen 5 percent on a three-month basis. A slowdown in jobs data should help bring down this sticky bit of inflation. However, based on the latest jobs data that doesn’t seem to be the case yet.

Looking at other components, while shelter inflation remained high at 0.7 percent MoM and 7.9 percent YoY, this component comes with a significant lag and market-based housing price/rent indices have already started trending down, which should begin reflecting in the CPI from this summer.

Apparel inflation surged the most since Sept 2021 (0.8 percent MoM), but it could easily be a one-off as the trend remains lower. Meanwhile, used cars & trucks inflation surprised with a -1.9 percent MoM value, given that the Manheim Used Vehicle Value Index released earlier rose 2.5 percent MoM in January.

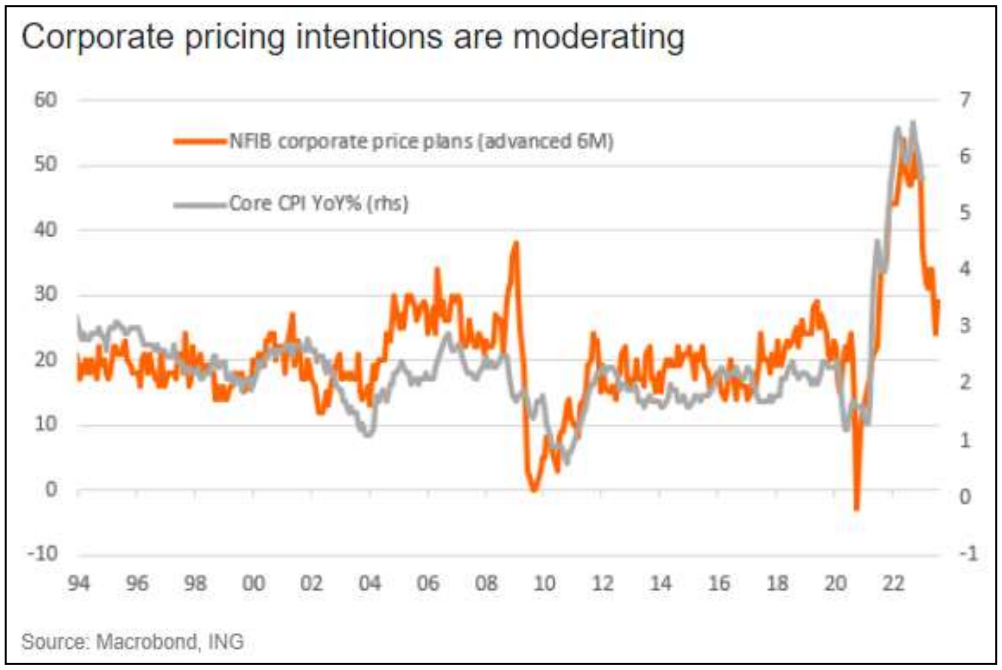
Thus, inflation remains on a downward trajectory. However, we would need to see a considerable slowdown in the labour market to get core services (ex-shelter inflation) to more sustainable levels to justify a lower peak Fed funds rate than is currently priced in.

As against the current Fed interest rate of 4.5 to 4.75 percent, the market is pricing in a peak rate of 5.27 percent.

Time	Cur.	Imp.	Event	Actual	Forecast	Previous
Tuesday, February 14, 2023						
19:00	USD	★★★	Core CPI (MoM) (Jan)	**0.4%**	0.4%	0.4%
19:00	USD	★★☆	Core CPI (YoY) (Jan)	**5.6%**	5.5%	5.7%
19:00	USD	★★★	CPI (YoY) (Jan)	**6.4%**	6.2%	6.5%
19:00	USD	★★★	CPI (MoM) (Jan)	**0.5%**	0.5%	0.1%

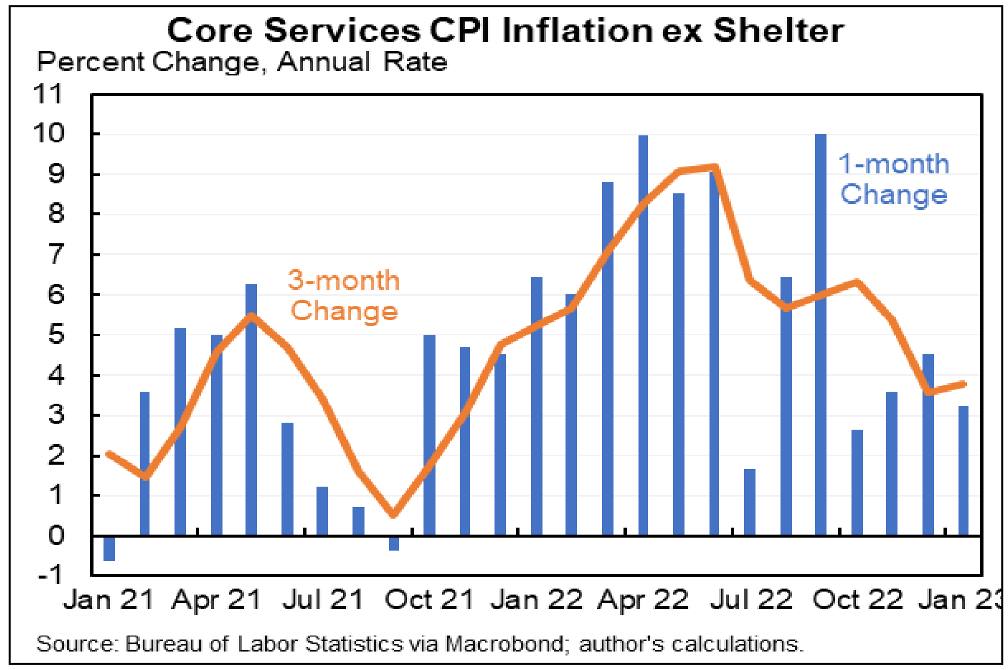
	Seasonally adjusted changes from preceding month							Un-adjusted 12-mos. ended
	Jul. 2022	Aug. 2022	Sep. 2022	Oct. 2022	Nov. 2022	Dec. 2022	Jan. 2023	Jan. 2023
All items	0.0	0.2	0.4	0.5	0.2	0.1	0.5	6.4
Food	1.1	0.8	0.8	0.7	0.6	0.4	0.5	10.1
Food at home	1.3	0.8	0.7	0.5	0.6	0.5	0.4	11.3
Food away from home(1)	0.7	0.9	0.9	0.9	0.5	0.4	0.6	8.2
Energy	-4.7	-3.9	-1.7	1.7	-1.4	-3.1	2.0	8.7
Energy commodities	-7.9	-8.0	-4.1	3.7	-2.1	-7.2	1.9	2.8
Gasoline (all types)	-8.1	-8.4	-4.2	3.4	-2.3	-7.0	2.4	1.5
Fuel oil(1)	-11.0	-5.9	-2.7	19.8	1.7	-16.6	-1.2	27.7
Energy services	0.0	1.8	1.2	-0.7	-0.6	1.9	2.1	15.6
Electricity	1.5	1.2	0.8	0.5	0.5	1.3	0.5	11.9
Utility (piped) gas service	-3.8	3.5	2.2	-3.7	-3.4	3.5	6.7	26.7
All items less food and energy	0.3	0.6	0.6	0.3	0.3	0.4	0.4	5.6
Commodities less food and energy commodities	0.1	0.4	0.0	-0.1	-0.2	-0.1	0.1	1.4
New vehicles	0.5	0.8	0.7	0.6	0.5	0.6	0.2	5.8
Used cars and trucks	-0.8	-0.2	-1.1	-1.7	-2.0	-2.0	-1.9	-11.6
Apparel	-0.1	0.3	0.0	-0.2	0.1	0.2	0.8	3.1
Medical care commodities(1)	0.6	0.2	-0.1	0.0	0.2	0.1	1.1	3.4
Services less energy services	0.4	0.6	0.8	0.5	0.5	0.6	0.5	7.2
Shelter	0.6	0.7	0.7	0.7	0.6	0.8	0.7	7.9
Transportation services	-0.4	1.0	1.9	0.6	0.3	0.6	0.9	14.6
Medical care services	0.4	0.7	0.8	-0.4	-0.5	0.3	-0.7	3.0

Source: U.S. Bureau of Labor Statistics, investing.com



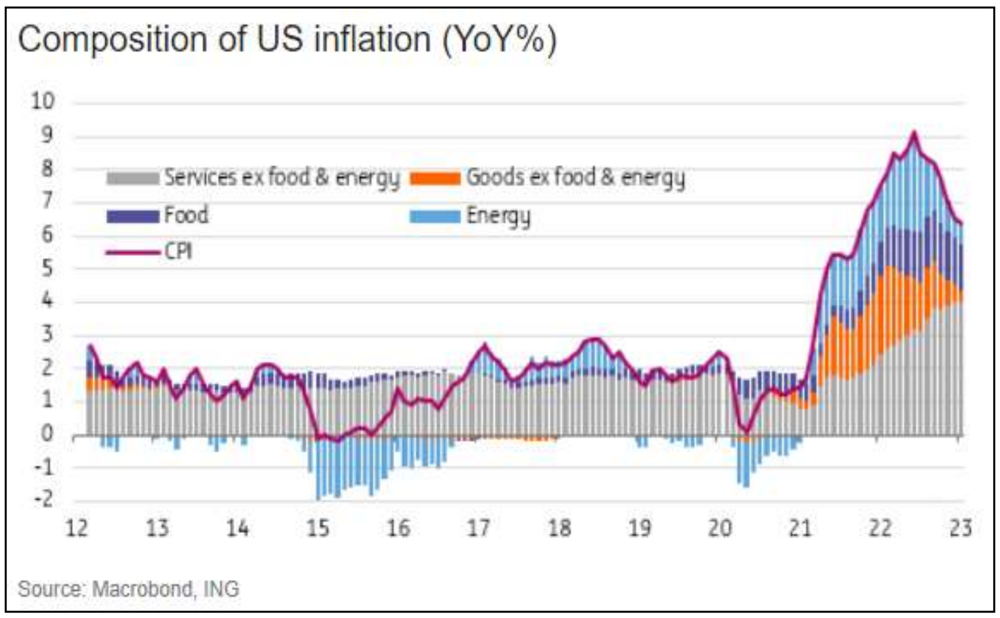
Corporate pricing intentions are moderating

Source: Macrobond, ING



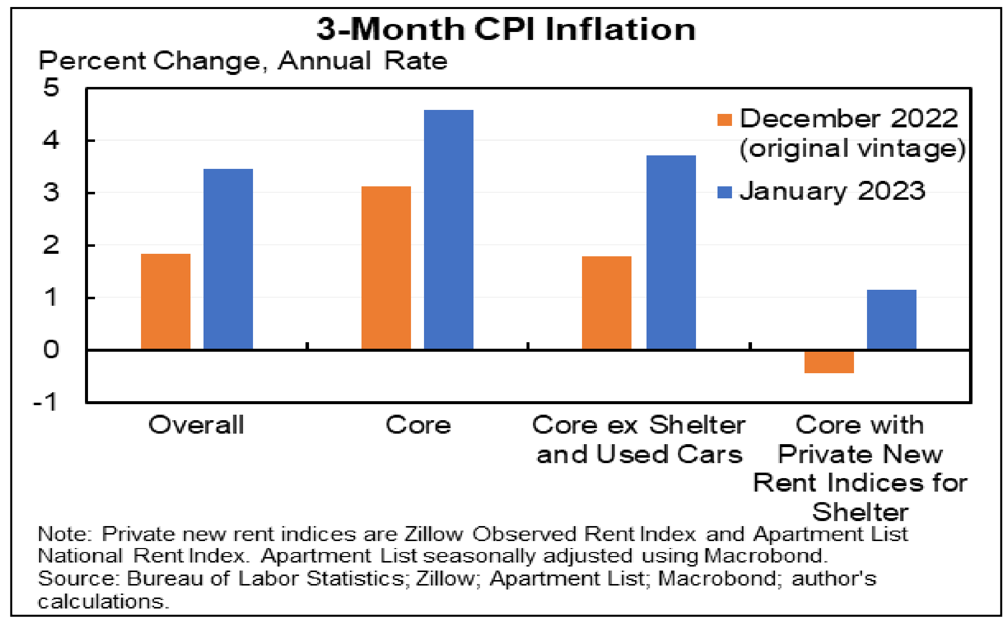
Core Services CPI Inflation ex Shelter

Source: Bureau of Labor Statistics via Macrobond; author's calculations.



Composition of US inflation (YoY%)

Source: Macrobond, ING



3-Month CPI Inflation

Note: Private new rent indices are Zillow Observed Rent Index and Apartment List National Rent Index. Apartment List seasonally adjusted using Macrobond.
Source: Bureau of Labor Statistics; Zillow; Apartment List; Macrobond; author's calculations.

In sum, inflation remains above comfortable levels both in India and the US, which means that the RBI and the Fed are likely to continue raising interest rates and are unlikely to reverse direction in a hurry even when peak rates are reached.

Therefore, there is unlikely to be much relief on this front for the markets.

(Harsh Shivlani of First Global also contributed to this article)

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