

Indian inflation still falling

Inflation in May fell further and is now only just above the mid-point of the Reserve Bank of India's 2-6% target range. We don't think inflation will fall much further, but this still means real policy rates are high, and that the RBI can start to think about reversing some of its tightening as early as 4Q23



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4.25 CPI inflation
YoY%

As expected

Further falls in inflation

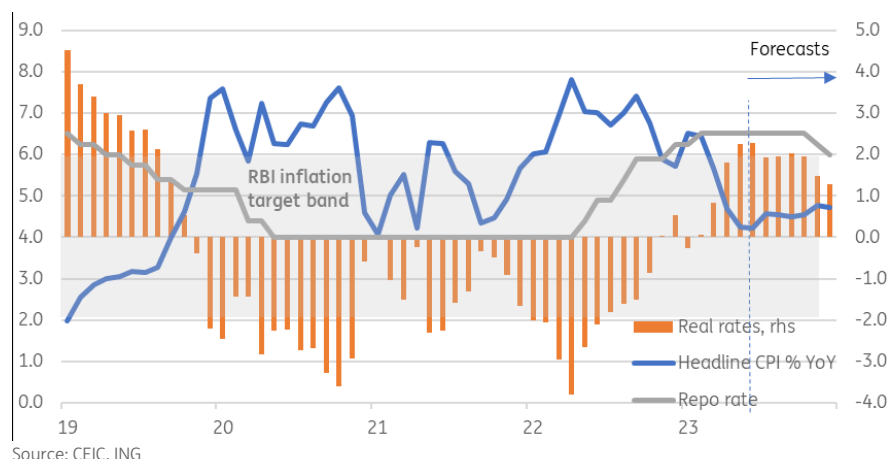
At 4.25%YoY, India's May inflation figures were close to expectations (consensus 4.31%, INGf 4.27%) but are nonetheless a welcome sight for policymakers and households alike.

Inflation has fallen a long way from its 7.8%YoY peak in 2022. But although we may get a further

month of falls in June, this may be as low as inflation gets for a while - unless we see some more moderation in the monthly run-rate. The CPI index has risen by 0.5% MoM in the last two months and if this persists, it will take inflation back up towards 5%YoY by the year-end. It will require a slowdown in the pace of CPI increase to between 0.3-0.4% MoM keep inflation close to the middle of the RBI target range.

This, and the fact that core inflation (ex-food and beverages, fuel and light) has only fallen to 5.0%YoY means that is still too early to say the inflation fight has been won.

Inflation, policy rates and real rates



Real policy rates high

But even if further proof may be needed before declaring "job-done" on inflation, at 6.5%, the gap between the policy repo rate and current inflation is high, and that means that the RBI's tightening should be having the desired dampening effect on the economy and inflation.

It is too soon to be looking for the RBI to cut the repo rate. But rate cuts before the year-end are still possible. Rate cuts this year would be more likely if we were to see concrete signs that monthly inflation had eased, core rates continued to fall, or that the economy was showing some more obvious signs of a slowdown. So the next few months of data will be important.

We are currently pencilling in 50bp of easing by the RBI by the end of 4Q23. This is earlier than the consensus of forecasters. Though we may see the RBI adopting a neutral stance on policy at its next meeting on 10 August as a first step towards actual easing.

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