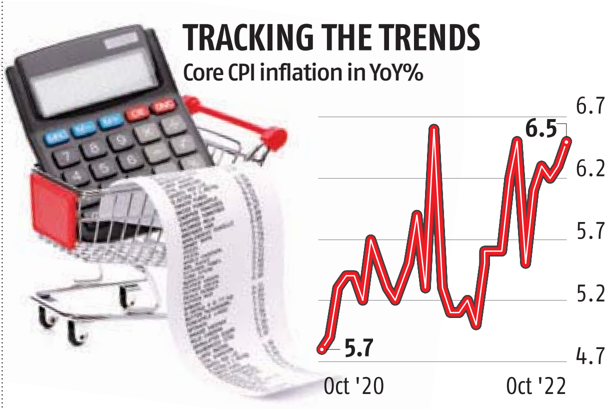
Core inflation makes it tough to check prices



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Core retail inflation rose from 6.3 per cent in September to 6.5 per cent in October even as the overall rate of price rise eased from 7.41 per cent to 6.77 per cent, indicating price pressures will sustain longer than expected.

The rate of core price rise has been over five per cent for over two years now and remained over six per cent for five months till October in the current financial year.

Core inflation refers to the rate of price rise in non-food and non-fuel items. Food and fuel prices are considered volatile and hence core inflation represents the non-volatile nature of inflation.

As such, it becomes difficult to bring down inflation if the core part of it remains elevated.

Madan Sabnavis, chief economist at the Bank of Baroda, said core inflation is largely driven by products that have a maximum retail price (MRP) and once they increase they rarely come down even when prices of inputs are correct.

"Hence, it tends to get embedded in the system. For example higher steel prices push up prices of automobiles. But once steel prices come down, rarely do auto prices recede," he said.

Vivek Kumar, economist at QuantEco Research, said there is strong evidence of transmission between non-core and core WPI inflation. Not only the correlation coefficient stands at a high level of 82 per cent in this case, the pass-through is seen to be near instantaneous with a lag of up to one month.

In contrast, the transmission between non-core and core CPI inflation is moderate, he said, adding the correlation coefficient stands at 40 per cent with peak impact happening with a lag of six months.

While non-core CPI inflation has moderated from its recent peak of 8.9 per cent in April to seven per cent in October, core inflation has remained sticky in the 6.1-6.5 per cent range.

"Since the transmission of intra price pressure within CPI usually takes about six months, we can expect the process to start unfolding sometime in the second half of 2022-23 in a gradual manner," Kumar said.

However, it would not be surprising if the transmission takes more than usual as the recent economic recovery post the third wave of Covid is spearheaded by services rather than manufacturing, he said.

ICRA chief economist Aditi Nayar said the rise in the core inflation has been driven by multiple factors, including input price pressures for clothing, rebound in demand for services as well as transmission of headline inflation into categories like housing rentals.

Clothing inflation inched down in October but remained elevated at 9.78 per cent in October from 9.90 per cent in September. Inflation in clothing remained over 10 per cent in both these months in rural India.

Among services, similarly inflation in recreation and amusement also fell but remained above six per cent at 6.05 per cent in October compared to 6.28 per cent in September. On the other hand, inflation in personal care and effects rose from 6.81 per cent in September to 7.03 per cent in October.

Sabnavis said the fear of headline inflation transmitting into core inflation is palpable in India.

The International Monetary Fund (IMF) in its Regional Economic Outlook for Asia and Pacific released last month said core inflation has risen in the region and its persistence—driven by inflation expectations and wages—must be closely monitored.

It also said the dollar has strengthened against most major currencies in the region as the Federal Reserve raises interest rates and signals further hikes to come. Most Asian emerging market currencies have lost between 5 percent and 10 percent of their value against the dollar this year, while the yen has depreciated by more than 20 percent.

These recent depreciations have started passing through to core inflation across the region, and this may keep inflation high for longer than previously expected, said the IMF.