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CPI SOFTENING BUT DISCORDANT NOTES PERSIST

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I. Introduction:

US President Donald Trump's imposition of a 25 per cent tariff on steel and aluminium weighed on global markets. According to the US President's proclamation, on January 19, 2018, the US Secretary of Commerce (Secretary) conveyed a report into the effect of imports of aluminium on the national security of the United States (US) [under section 232 of the Trade Expansion Act of 1962, as amended (19 U.S.C. 1862) (section 232)], which highlights that aluminium is being imported into the US in such quantities and under such circumstances as to threaten to impair the national security of the United States.

Earlier, the market was relatively cool after Trump postponed the proposed tariff on Canada and Mexico for one month. But the recent announcement of a flat 25 per cent tariff implementation on steel and aluminium products have spooked the market. Globally, Dow Futures was down by 0.20 per cent, whereas NASDAQ was down by 0.36 per cent.

II. Market Movements in India:

In India, the market bloodbath continued for the fifth straight session as Sensex and Nifty 50 plunged 1.5 per cent. The GIFT NIFTY was down by 0.31 per cent.

Foreign Institutional Investors (FIIs) were net sellers at Rs 4,486 crore, while Domestic Institutional Investors (DIIs) were net buyers at Rs 4,002 crore on 11th Feb'25.[1] The Nifty VIX has increased by 0.47 per cent to reach almost 15 (14.93). The rupee after a continuous decline, recovered 65 paise (0.74 per cent) stayed at 86.84 against the dollar as on 12 Feb'25, supported by RBI's heavy intervention.

The gold prices rose steadily to reach Indian rupee 87,555/10 g of 24k gold (99.9 per cent) in Delhi on 12 Feb'25. The prices increased as people moved from equities towards gold as a "*safe haven*." Nonetheless, there are some corrections globally as spot gold fell 0.1 per cent to $2,895.38 per ounce by 0232 GMT after climbing to a record high of $2,942.70. U.S. gold futures eased 0.4 per cent to $2,922.40.

III. Tariff and Retaliation: A Lose-Lose Game?

The retaliation from other countries may prompt a trade war in future that might become a nasty one before the realisation that it is indeed a lose-lose uncooperative game. The sequential game would not lead to a "Prisoner's Dilemma" since ultimately each player can see the action of others. The important question is whether it would stabilise towards at a "Nash equilibrium" where it ends any further incentive to deviate from the outcome. However, such possibility seems remote as of now. Moreover, some experts have opined that tariff may not be an optimal instrument even for protecting domestic market for a country. This type of policy would lead to trade distortion and a net societal loss termed popularly as 'deadweight loss.' Instead, import quota or non-tariff barriers may be useful instruments. This issue, however, is a subject of debate. A qualitative safeguard in the form of non-tariff barriers could be a better instrument for protecting the domestic market. Importantly, a relative cost-benefit analysis is needed to assess whether such tariff could really meet the domestic steel and aluminium demand of US producers/economic agents or if the costs are lower relatively if imported from other countries.

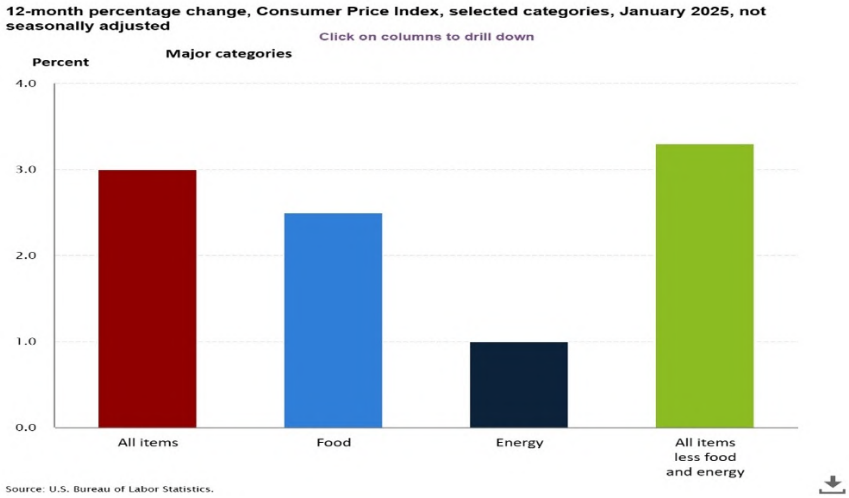
This issue is important, since some countries have shown their retaliatory response. For instance, the European Union said it would respond with "firm and proportionate countermeasures" after US President Donald Trump's decision to impose tariffs on all steel and aluminium imports, escalating fears of a trade war. In Japan, for instance, the auto and non-electrical machinery sectors are most vulnerable to tariffs by the US.

IV. The Challenge of Inflation:

The declaration from the US central bank (CB) that the Fed is in no hurry to cut interest rates again signifies that the CB is cautious in weighing the future course of inflation trends which might be influenced by the looming tariff war. The US CPI in Jan'25 has inched up 0.5 per cent month-over-month and 3 per cent year-over-year,

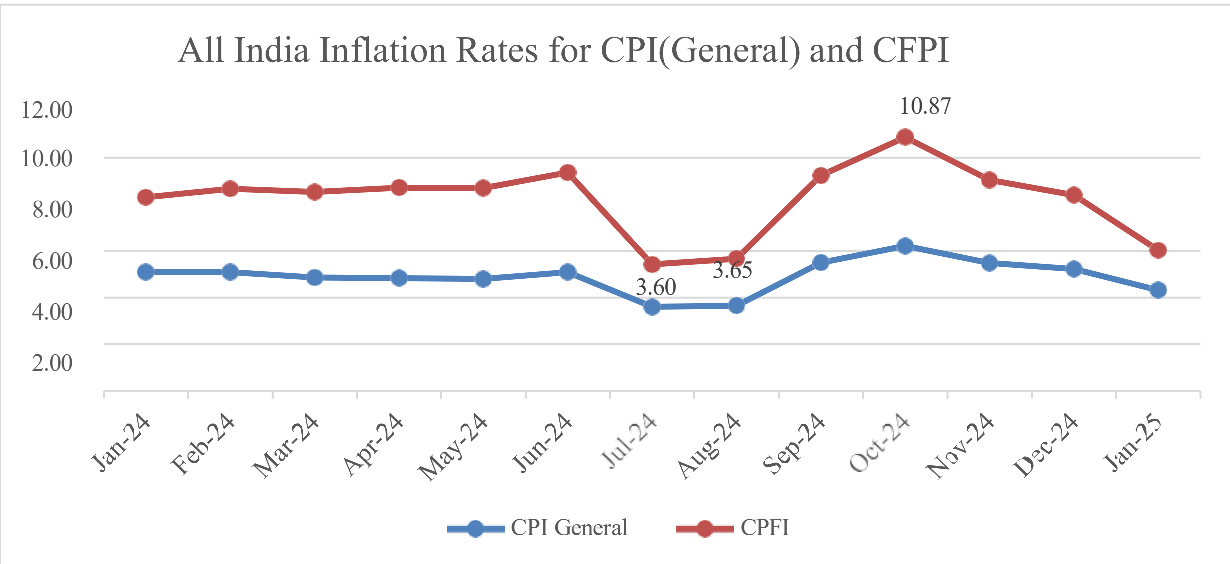
[1] During the trading session, DIIs bought Rs 13,788-crore shares and sold shares worth Rs 9,786 crore, while FIIs purchased shares worth Rs 11,496 crore and offloaded equities worth Rs 15,982 crore.

while core CPI (excluding food and energy) rose 0.4 per cent and 3.3 per cent, beating forecasts. The future course of inflation would be important regarding the impact on bond market. The US 10-year treasury yield is around 4.60 per cent.



V. Indian CPI softens, but Challenges Remain:

On the other hand, the Reserve Bank of India (RBI) has reduced the repo rate from 6.50 per cent to 6.25 per cent amid the softening of the CPI inflation in India at 4.31 per cent YoY in January vis-à-vis 5.22 per cent year on year (YoY) in Dec'24. The food inflation softened at 6.0 per cent YoY (8.4 per cent in Dec), while core inflation saw a mild pick-up at 3.66 per cent YoY (3.58 per cent in Dec). The consumer food price index (CFPI) has reduced at 6.02 per cent. Notably on year-on-year basis (YOY) [i.e. inflation in Jan'25 compared to Jan'24] inflation in 'oils & fats' have increased the most at 15.64 per cent followed by 'personal care &effects' at 10.58 per cent. The fruits and vegetables inflation have softened at 12.22 per cent and 11.35 per cent, respectively. Inflation remains relatively higher in Kerala (6.76 per cent), Odisha (6.05 per cent), Chhattisgarh (5.85 per cent), Haryana (5.1 per cent), Bihar (5.06 per cent).



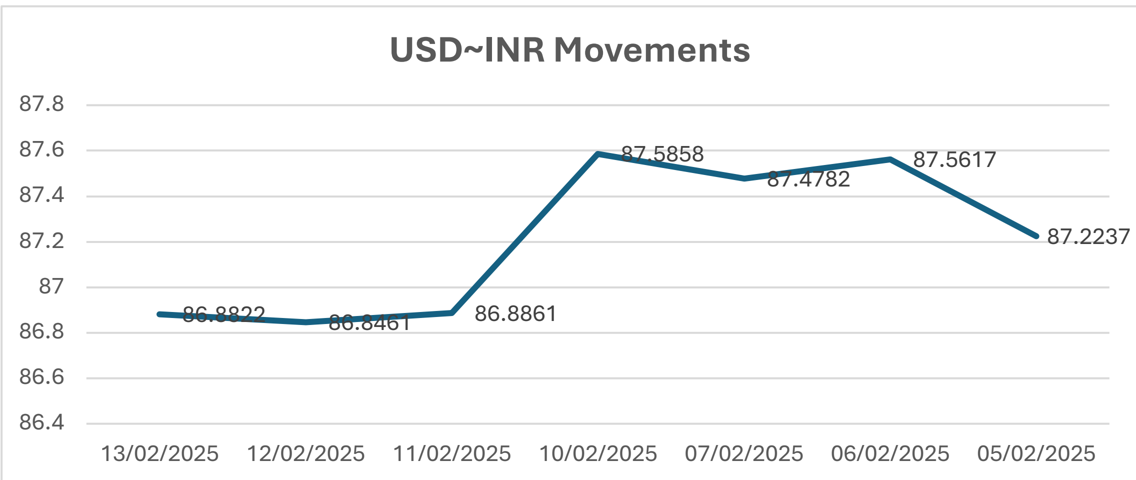
Source: MosPI, CMIE.

While the CPI softening in India is a positive, however, the industrial production has been slowed during Dec'24 at 3.2 per cent which was 5.2 per cent (Quick Estimate) in November 2024. The growth rates of the three sectors, Mining, Manufacturing and Electricity for the month of December 2024 are 2.6 per cent, 3.0 per cent and 6.2 per cent, respectively. Manufacturing remains subdued as out of 23 sub-sectors, 15 of them resulted in weaker growth in Dec'24. Within use-based classification, primary goods and consumer non-durables have shown subdued growth.

Source: MosPI.

Globally, the crude oil prices softened partly due to news that the U.S. and Russia are in talks to possibly end the war in Ukraine which led to some respite for risk assets. These developments could ease geopolitical risks, although markets remain watchful about the impact of U.S. tariffs on inflation.

The Indian Rupee recovered to some extent after crossing the USD/INR 87 mark on 3 Feb'25, which continued to decline until 10 Feb'25. Subsequently, the Rupee recovered to $/₹ 86 mark, but it still faces downward pressure. India's central bank aggressively sold between $4 billion and $7 billion to support the rupee. Going forward, it is important for India to manage its macro variables effectively while maintaining clear communications in a changing forex market.



Source: RBI.