

Supply side measures to moderate inflationary pressures

- **Government reduced excise duty on petrol and diesel leading to 9% and 7% reduction in retail prices**
- **States such as Kerala, Maharashtra and Rajasthan followed up with reduction in state duties. Lower customs duties on inputs and higher export taxes to lead to reduction in prices of iron ore, steel and plastic products among others**
- **Excise cut higher than estimated in Budget. Lower RBI dividend and disinvestment receipts imply fiscal shortfall of 0.3-0.4% of GDP. This will put upward pressure on yields**
- **Direct and indirect impact on CPI at around 0.3%. Lower global prices along with disinflationary impulse from global monetary tightening may alter CPI trajectory next year. Close call between 40bps and 50bps hike in June policy**

Sharp reduction in fuel taxes: Government of India reduced excise duty on petrol and diesel by INR 8/litre and INR 6/litre. This will result in INR 9.5/litre and INR 7/litre reduction in petrol and diesel prices at the retail level. This implies a 9% and 7% reduction in petrol and diesel prices. In addition, states such as Kerala, Maharashtra and Rajasthan have also announced reduction in state taxes.

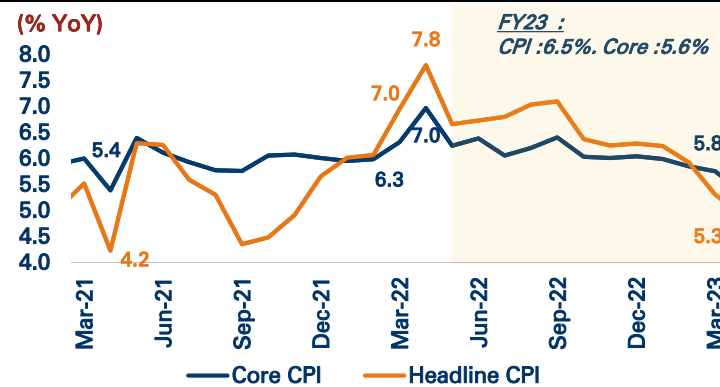
Customs and export duties also altered: Government of India has also reduced customs duty on a number of raw materials such as coking coal, coke and semi-coke. Even customs duty on naphtha and PVC has been reduced by 1.5% and 2.5% respectively. In addition to this, in order to improve domestic availability of steel and iron ore, export duties have been imposed or increased on iron ore concentrates, pig iron, flat-rolled products of iron or alloy and non-alloy steel among others.

Impact on inflation: Given a weight of 2.2% and 0.15% for petrol and diesel respectively in CPI basket, the direct impact on CPI inflation of reduction in taxes is around 20bps. In addition to this, there will be second order impact in the form of lower logistics and input costs. Changes in customs duties on iron ore, coking coal, plastics and export duty on iron ore and steel products will also reduce the need to pass-through higher international prices into domestic prices. Export restrictions on wheat has led to stability in domestic wheat prices which otherwise had seen a sharp increase otherwise. All put together, we believe these steps will lower the inflation trajectory by around 30bps in FY23. We expect CPI inflation to average 6.5% in FY23.

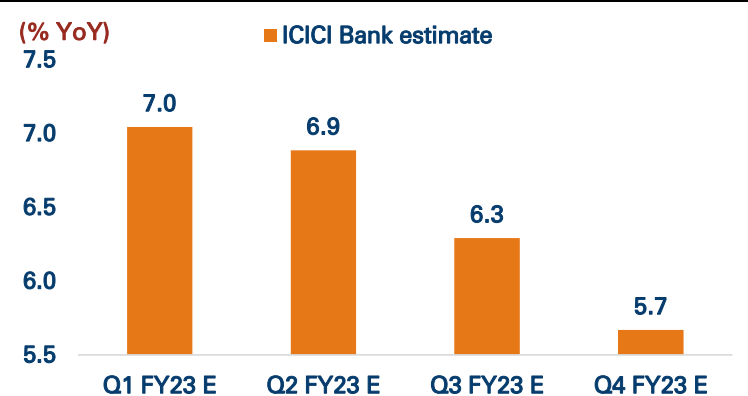
Fiscal impact and yields: While the Budget had estimated a decline in excise duty collections from INR 3.94tn in FY22 to INR 3.35tn in FY23 (a net reduction of INR 600bn), the impact of current revisions is estimated at INR 1tn. Even RBI dividend at INR 303bn is lower than last year's actual dividend of INR 991bn and Budget estimate of dividend from RBI and PSBs/ FIs at INR 739bn. Disinvestment receipts are also likely to be lower than INR 650bn estimated in the Budget. At the same time, fertilizer and food subsidy will be higher by INR 1tn and INR 600-700bn respectively. While higher tax collections will offset subsidies, the shortfall emerging from excise duty cut, RBI dividend and disinvestment is estimated to be 0.3-0.4% of GDP. This will put upward pressure on yields—short-end and long-end—as government looks at additional resource mobilisation. We expect yields to move to 7.5-7.75% range in the coming months.

Does this change RBI trajectory? The decision by Government has altered direction of CPI, particularly after two back-to-back negative inflation surprises. While MPC minutes did indicate that RBI had factored in April's 7.8% print, the extent of surprise in the print versus RBI estimate is not known. Global monetary tightening is likely to give disinflationary impulse to commodity prices in coming months. Notably, prices of industrial metals have already corrected from peak. If supply shocks ease, CPI inflation next year can be materially different. This may give RBI comfort in the upcoming meetings and thus reduce the need to front-load rate hikes. We believe it is a close call between a 40bps and a 50bps rate hike in June meeting now instead of a 50bps rate hike expected earlier.

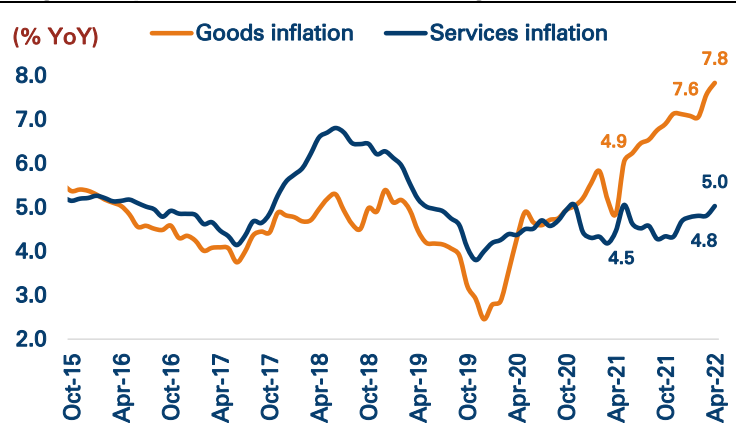
We expect CPI inflation at 6.5% in FY23...



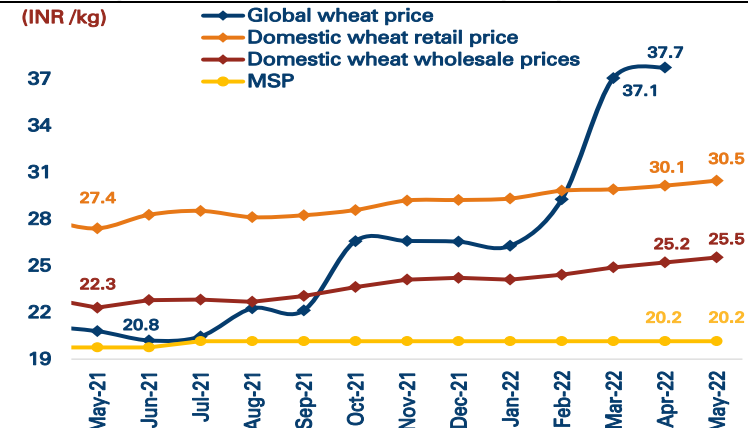
Inflation below 6% in March quarter



Higher input costs led to elevated goods inflation...



Wheat prices to remain stable led by export ban



Other measures taken by government to curb higher inflation

| Measure | Earlier rate (%) | Revised rate (%) |
|--|------------------|------------------|
| Import duties reduction on items | | |
| Ferro-Nickel | 2.5 | Nil |
| Coking coal | 2.5 | Nil |
| Anthracites/Pulverized coal injection (PCI) coal | 2.5 | Nil |
| Coke and semi-coke of coal, of lignite or of peat, whether or not agglomerated | 5.0 | Nil |
| Naphtha | 2.5 | 1.0 |
| Methyloxirane (propylene oxide) | 5.0 | 2.5 |
| Polymers of Vinyl Chloride (PVC) | 10.0 | 7.5 |
| Export duties levied/increased on items | | |
| Export of iron ores and concentrates | 30.0 | 50.0 |
| Export of iron pellets | Nil | 45.0 |
| Pig iron and spiegeleisen in pigs, blocks or other primary formats | Nil | 15.0 |
| Flat-rolled products of iron or non-alloy steel of a width of 600 mm or more, hot-rolled, not clad, plated or coated | Nil | 15.0 |
| Flat rolled products of iron or non-alloy steel of a width of 600 mm or more, cold-rolled (cold-reduced), not clad, plated or coated | Nil | 15.0 |
| Flat rolled products of iron or non-alloy steel of a width of 600 mm or more, clad, plated or coated | Nil | 15.0 |
| Flat-rolled products of stainless steel, of a width of 600 mm or more | Nil | 15.0 |
| Other bars and rods of stainless steel; angles, shapes, and sections of stainless steel | Nil | 15.0 |
| Bars and rods, hot-rolled, in irregularly wound coils, of other alloy steel | Nil | 15.0 |

Source : CEIC , Ministry of Finance, ICICI Bank Research

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