EcoScope
The Economy Observer

From food to fuel, inflation risks are broadening

- India's CPI inflation rose to 4.8% YoY in Aug'26 from 4.5% in Jul'26, moving further above the RBI's 4% target. Food inflation accelerated to 6.0% in Aug'26 from 5.5% in Jul'26. Rural inflation at 5.2% was significantly higher than urban inflation at 4.3%. The August increase was still largely driven by food prices.
- Within the food basket, price pressure remained highly uneven, with high inflation in several vegetables and food items. The food basket saw steep increases in onion (+48.3%), ginger (+73.8%) and garlic (+43.6%), although this was partly offset by continued deflation in tomato (-31.1%) and potato (-13.1%).
- Importantly, the August inflation increase was not confined to food. Transport inflation remained elevated at 4.6%, while restaurant and accommodation services inflation rose to 8.4%. Personal care and miscellaneous goods and services inflation stood at 15.2%, largely reflecting elevated precious metal prices. In contrast, education, health and housing inflation remained contained. Thus, while the core inflation backdrop is relatively benign in several demand-sensitive categories, services and selected discretionary categories continue to show pricing pressure. Core inflation (CPI excluding food and fuel) increased to 4.2% in Aug'26 from 3.9% in Jul'26.
- The CPI print, however, needs to be viewed against a materially worsening global commodity backdrop. Brent crude oil prices are once again hovering around USD110/bbl (highest in four months), while the global oil and gas market is in a particularly tricky situation amid heightened geopolitical and supply risks. This is especially relevant for India as the economy is entering a fresh oil shock, with producer prices already elevated. WPI inflation stood at 9.9% in Aug'26, with Fuel & Power inflation at 22.9%, mineral oils at 38.5% and crude petroleum & natural gas at 34.4%. Manufacturing inflation remained high at 8.4%, indicating significant upstream price pressures that could eventually feed into CPI.
- While the current CPI inflation is below the RBI's FY27 projection and core inflation is yet to show a broad-based acceleration, the risk has shifted from the level of inflation to its trajectory. Steady Brent crude prices around USD100–110/bbl could raise transportation, logistics, chemical and manufacturing costs and increase the risk of second-round pass-through into services and core inflation in 3QFY27. The August WPI data reinforces this concern, with output prices remaining firm even as aggregate manufacturing input prices have started to ease.

RBI may not wait for 3Q inflation to broaden

- The RBI appears to be increasingly preparing for a more difficult inflation and liquidity environment. It has already initiated sizeable liquidity absorption measures ahead of the Oct'26 policy, including the latest INR1t OMO sales announced on Friday, along with VRRR operations. In our view, the scale and timing of these operations suggest that the RBI is becoming more proactive in managing surplus liquidity and preventing financial conditions from becoming excessively accommodative.
- We now see a meaningful possibility of an RBI rate hike in Oct'26, rather than waiting for the broadening of inflationary pressures to become fully visible in 3Q data. Given the lag in monetary transmission, the RBI may prefer to act pre-emptively if crude remains elevated and inflation expectations begin to move higher.

Global rates add to the domestic bond-market pressure

- The external rate backdrop has also turned less supportive. The US 10Y yield has crossed 5% for the first time since 2023, while the Indian 10Y G-sec yield touched 7% on Friday. Higher US yields, elevated crude and active domestic liquidity absorption are now reinforcing each other, limiting the scope for a meaningful decline in Indian bond yields.
- We, therefore, retain our 7.0-7.2% range for the Indian 10Y yield for the remainder of FY27. More importantly, we see the potential for 75-100bp of rate hikes in the current tightening cycle if the oil shock persists and begins to expand into core inflation and inflation expectations.

Outlook

- The August CPI print by itself remains manageable, but the forward-looking inflation risk has increased materially. Food inflation is already close to 6%, WPI inflation is near 10%, brent crude has returned to around USD110/bbl, and global bond yields have surged. We expect the combination of elevated food prices and renewed energy pressures to push CPI inflation above 6% in 3QFY27, taking inflation beyond the RBI's upper tolerance threshold. We retain our FY27 CPI inflation forecast at 5.1%, above the RBI's 5.0% projection, reflecting greater risks from crude, food and second-round effects.

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- **With the RBI already undertaking aggressive liquidity absorption, we believe the policy reaction function is shifting toward pre-emptive tightening. An October rate hike is now a meaningful possibility, particularly if crude remains elevated. We retain our 7.0–7.2% 10Y yield range for the rest of FY27 and expect 75-100bp of cumulative rate hikes in the current cycle under a sustained oil-shock scenario.**

Exhibit 1: Inflation increased to 4.8% in Aug'26 from 4.5% in Jul'26

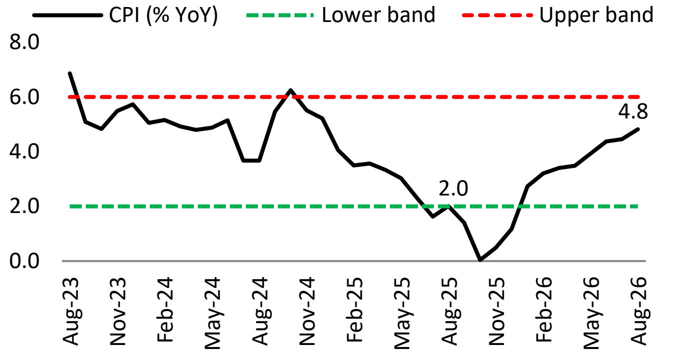
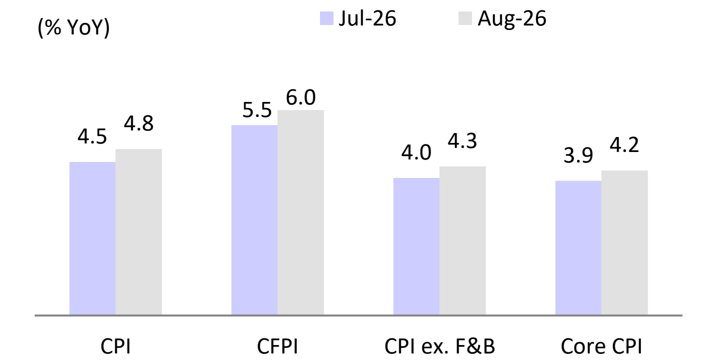


Exhibit 2: Food inflation increased to 6.0% in Aug'26; core inflation increased to 4.2%



Source: CEIC, MOSPI, MOFSL

Exhibit 3: Rural inflation rose to 5.2% in Aug'26, compared with 4.3% in urban areas

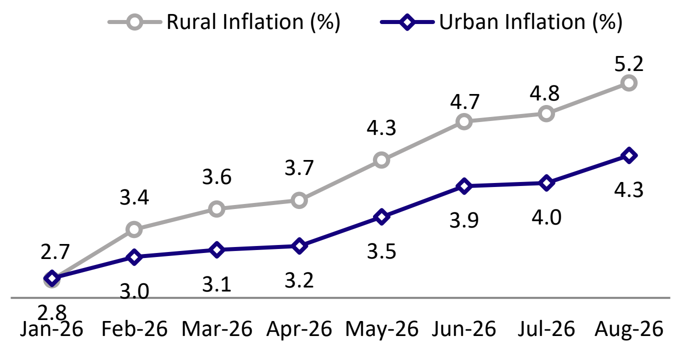


Exhibit 4: Top five items with the highest inflation (% YoY)

Item	Weight	Jul'26	Aug'26
Silver Jewellery	0.31	109.9	107.1
Ginger	0.26	83.6	73.8
Onion	0.70	22.5	48.3
Garlic	0.37	35.4	43.6
Gold/Diamond/Platinum Jewellery	0.62	33.0	35.5

Source: CEIC, MOSPI, MOFSL

Exhibit 5: CPI by division (% YoY)

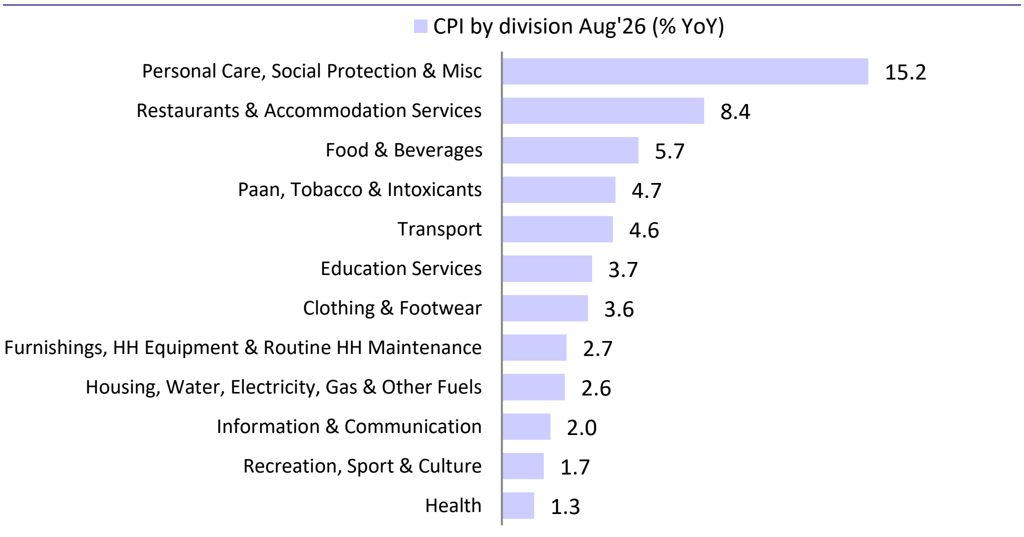


Exhibit 6: Division-wise inflation in Aug'26 (% YoY)

Category	Mar 2026	Apr 2026	May 2026	June 2026	July 2026	Aug 2026
Consumer Price Index	3.4	3.5	3.9	4.4	4.5	4.8
Consumer Food Price Index	3.9	4.2	4.8	5.3	5.5	6.0
Food & Beverages	3.7	4.0	4.5	5.1	5.2	5.7
Paan, Tobacco & Intoxicants	4.2	4.8	4.8	4.8	4.8	4.7
Clothing & Footwear	2.7	2.8	3.0	3.2	3.4	3.6
Housing, Water, Electricity, Gas & Other Fuels	2.0	1.7	1.7	2.0	2.2	2.6
Furnishings, Household Equipment & Routine HH Maintenance	1.4	1.6	1.9	2.2	2.4	2.7
Health	1.8	1.6	1.5	1.4	1.3	1.3
Transport	0.0	0.0	1.8	4.3	4.4	4.6
Information & Communication	0.3	0.5	0.3	0.4	0.6	2.0
Recreation, Sport & Culture	2.5	2.1	2.0	1.8	1.6	1.7
Education Services	3.3	3.1	3.0	3.3	3.6	3.7
Restaurants & Accommodation Services	2.9	4.2	5.7	6.9	7.7	8.4
Personal Care, Social Protection & Misc	18.6	17.7	18.5	16.7	14.7	15.2
Excluding Food & Beverages	3.2	3.2	3.6	4.0	4.0	4.3
Excluding Food & Beverages and Fuel & Light	3.7	3.7	3.9	3.9	3.9	4.2

Source: CEIC, MOSPI, MOFSL

Exhibit 7: Rural inflation was higher than urban inflation in Aug'26 (% YoY)

Division Name	Rural	Urban	Combined
Food and beverages	5.9	5.3	5.7
Paan, tobacco, and intoxicants	4.5	5.2	4.7
Clothing and footwear	4.2	2.6	3.6
Housing, water, electricity, gas, and other fuels	3.3	2.2	2.6
Furnishings, household equipment, and routine household maintenance	3.1	2.2	2.7
Health	1.3	1.3	1.3
Transport	4.7	4.5	4.6
Information and communication	2.2	1.7	2.0
Recreation, sport, and culture	2.1	1.4	1.7
Education services	2.9	4.3	3.7
Restaurants and accommodation services	8.6	8.2	8.4
Personal care, social protection, and miscellaneous goods and services	16.0	14.1	15.2
All India	**5.2**	**4.3**	**4.8**

Exhibit 8: Division-wise CPI weights (new structure comparison)

Division	Rural 2012	Rural 2024	Urban 2012	Urban 2024	Combined 2012	Combined 2024
Food and beverages	50.9	42.0	32.8	30.3	42.6	36.8
Paan, tobacco, and intoxicants	3.3	3.7	1.4	2.1	2.4	3.0
Clothing and footwear	7.4	7.1	5.6	5.5	6.5	6.4
Housing, water, electricity, gas, and other fuels	8.0	11.8	27.3	25.0	16.9	17.7
Furnishings, household equipment, and routine household maintenance	3.6	4.6	3.7	4.3	3.7	4.5
Health	6.8	6.8	4.8	5.3	5.9	6.1
Transport	5.6	8.6	7.1	9.0	6.4	8.8
Information and communication	2.8	3.6	3.9	3.6	3.3	3.6
Recreation, sport, and culture	1.5	1.4	1.6	1.7	1.5	1.5
Education Services	2.5	2.4	4.7	4.5	3.5	3.3
Restaurants and accommodation services	3.2	2.8	3.5	4.0	3.2	3.3
Personal care, social protection, and miscellaneous goods and services	4.4	5.2	3.6	4.9	4.0	5.0

Source: CEIC, MOSPI, MOFSL

Details:

CPI inflation: Headline pressures are beginning to broaden

- India's CPI inflation accelerated to 4.82% YoY in Aug'26 from 4.45% in Jul'26, marking the third consecutive month above the RBI's 4% target. The August increase was led by food inflation, but the broader inflation picture is becoming less comfortable as services inflation remains firm and the sharp renewed rise in global crude prices introduces a fresh source of imported inflation. Food inflation accelerated to 5.95% YoY from 5.52%, while rural inflation remained materially higher than urban inflation at 5.23% vs 4.31%, respectively.
- The food-price increase remains the principal driver of the headline acceleration. Within the food basket, price pressures remain highly uneven, with sharp inflation in several vegetables and food items. Onion inflation accelerated to 48.3% YoY from 22.5% in Jul'26, while garlic inflation rose to 43.6% from 35.4%. Ginger inflation, although moderating, remained exceptionally high at 73.8%. At the same time, tomato prices remained in deep deflation at -31.1%, while potato inflation stood at -13.1%. The divergence highlights the continuing supply-side nature of food inflation, with declines in some vegetables being more than offset by sharp increases in others.
- Importantly, the August inflation increase was not confined to food. Transport inflation remained elevated at 4.6%, while restaurant and accommodation services inflation rose to 8.4%. Personal care and miscellaneous goods and services inflation remained exceptionally high at 15.2%, largely reflecting elevated precious-metal prices. Education inflation stood at 3.7%, while clothing and footwear inflation was 3.6%. Thus, while the core inflation backdrop remains relatively benign in several demand-sensitive categories, services and selected discretionary categories continue to show pricing pressure. Core inflation increased to 4.2% in Aug'26 from 3.9% in Jul'26.

Food remains the immediate inflation risk

- The food-inflation outlook remains the key determinant of headline CPI over the next few quarters. The August data show that the food shock is becoming broader, with CFPI inflation rising to 5.95% from 5.52%. Rural food inflation remained higher at 6.13%, compared with 5.64% in urban India, reinforcing the view that food supply conditions remain an important source of regional and rural inflation pressure.
- There are, however, some offsets. Several important vegetables continue to record deflation, which should help contain the aggregate food basket if supply conditions normalise. The key risk is therefore not necessarily a broad-based acceleration across all food items, but the possibility that persistent increases in a few high-weight items prevent food inflation from moderating meaningfully.
- This makes the evolution of the monsoon, reservoir levels, crop arrivals and subsequent rabi sowing particularly important. Any weather-related disruption could prolong food inflation and increase the probability that elevated food prices begin to feed into broader inflation expectations.

The oil shock has returned

- The inflation outlook has become materially more challenging following the renewed rise in brent crude oil prices toward USD110/bbl (highest in 4 months).

This is particularly significant for India given its high dependence on imported crude. The global oil and gas situation is also unusually difficult, with geopolitical risks and concerns around the security of supply creating the possibility of further price volatility.

- The timing is particularly uncomfortable because WPI inflation is already running at 9.92%, with Fuel & Power inflation at 22.9%, mineral oils at 38.5% and crude petroleum & natural gas at 34.4% in Aug'26. Manufacturing inflation also remained elevated at 8.4%, with chemicals at 14.3%, textiles at 12.6% and rubber & plastics at 11.2%. Hence, the economy is entering a fresh oil shock with upstream producer prices already elevated.
- The immediate impact on CPI may be limited if domestic fuel prices are not fully adjusted, but the indirect effects can be more meaningful. Higher crude prices feed into transportation, logistics, chemicals, plastics, synthetic fibres and other intermediate goods, while also increasing input costs across the manufacturing and services sectors. The key risk is therefore not simply the direct fuel component of CPI, but second-round pass-through from higher energy and producer prices.

WPI is an important early warning indicator

- The divergence between CPI and WPI is becoming increasingly relevant. While CPI inflation is still below 5%, WPI inflation is close to 10%, reflecting a much stronger upstream price shock. The August WPI data show that this pressure is not limited to energy: manufacturing inflation remains broad-based and output producer prices continue to rise.
- At the same time, there is one important mitigating factor. The trial manufacturing IPPI declined by around 1.6% MoM in August, largely because of a sharp fall in petroleum-related input prices. If input prices remain soft, corporates may be able to absorb part of the higher energy shock without immediately passing it through to consumers. However, with brent crude oil now back around USD110/bbl, the sustainability of this moderation is clearly at risk.

Rural inflation remains higher than urban inflation

- The rural-urban divergence remains important for the policy outlook. Rural CPI inflation increased to 5.23% in Aug'26 compared with 4.31% in urban India, a gap of nearly 1pp. The differential continues to reflect stronger food-price pressures in rural markets.
- This matters because persistent rural food inflation can have a greater impact on household inflation expectations and wage demands, potentially making the shock more persistent than suggested by the headline number alone. At the same time, relatively contained urban inflation and moderate inflation in several demand-sensitive categories suggest that broad-based demand-led inflation has not yet emerged.

Core inflation remains the key variable to watch

- The current inflation episode is still supply-driven, with food and energy accounting for much of the pressure. There is not yet clear evidence of a generalized demand-side inflation cycle. Inflation in several categories remains relatively contained, while the August CPI release shows only moderate increases across housing, household goods, health, communication and education.

- However, the policy risk is increasingly about where inflation goes next rather than where it is today. A prolonged oil shock could raise transportation and production costs, while persistent food inflation could affect wage expectations. Together, these could cause the current supply-side shock to broaden into core inflation during Q3FY27.
- This is where the August WPI data become particularly important. The combination of 9.9% WPI inflation, elevated manufacturing output prices and renewed crude inflation suggests that the pipeline for future CPI pass-through is becoming stronger.

October hike increasingly likely

- The inflation outlook has changed sufficiently for us to reassess the RBI’s reaction function. Until recently, the relatively benign CPI trajectory and contained core inflation argued for patience. That equation is now becoming less favourable.
- The RBI has already started sizeable liquidity absorption operations ahead of the October policy, including the latest INR1tn OMO sales announced on Friday, alongside VRRR operations. The aggressive liquidity management suggests that the RBI is not waiting for the inflation data to fully confirm the second-round effects before beginning to tighten financial conditions.
- In our view, this is an important signal. If brrent crude remains around USD100–110/bbl and the Q3 inflation trajectory begins to incorporate the pass-through from higher energy and producer prices, the RBI may prefer to act in October rather than wait for Q3 inflation to formally broaden. Monetary policy operates with a lag, and waiting for the full inflationary impact to appear in the data could leave the RBI responding too late.
- We therefore now see a meaningful probability of a rate hike in the October policy itself. The trigger would not necessarily be the August CPI print alone, but rather the combination of renewed oil inflation, elevated WPI, firming inflation expectations, tighter global financial conditions and the risk of second-round effects in Q3.

Global rates are adding to the pressure

- The external backdrop has also become materially less supportive. The US 10Y yield has crossed 5% for the first time since 2023, reflecting the combination of higher inflation risks, fiscal concerns and expectations of higher-for-longer US rates. This creates additional pressure on emerging-market bond yields and limits the RBI’s room to ignore global rate repricing.
- Indian bond yields have already reacted, with the 10Y G-sec yield touching 7% on Friday. Higher crude, higher US Treasury yields and domestic liquidity absorption are now operating in the same direction. We therefore retain our 7.0–7.2% range for the Indian 10Y yield for the remainder of FY27.
- More importantly, we now see the potential for 75–100bp of cumulative rate hikes during the current tightening cycle, depending on the persistence of the oil shock and the extent to which inflation expectations and core inflation respond.

Outlook

- The August CPI print by itself remains manageable, but the forward-looking inflation risk has increased materially. Food inflation is already close to 6%, WPI inflation is near 10%, brent crude has returned to around USD110/bbl and global bond yields have moved sharply higher. We expect the combination of elevated food prices and renewed energy pressures to push CPI inflation above 6% in 3QFY27, taking inflation beyond the RBI's upper tolerance threshold. We retain our FY27 CPI inflation forecast at 5.1%, above the RBI's 5.0% projection, reflecting greater risks from crude, food and second-round effects.
- With the RBI already undertaking aggressive liquidity absorption, we believe the policy reaction function is shifting toward pre-emptive tightening. An October rate hike is now a meaningful possibility, particularly if crude remains elevated. We retain our 7.0–7.2% 10Y yield range for the rest of FY27 and expect 75–100bp of cumulative rate hikes in the current cycle under a sustained oil-shock scenario.

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