

Red-hot inflation, IIP growth improves

CPI print rose more than expected by 4.8%. This translates the Q1FY24 print to 4.6%, matching RBI's projection. Food inflation was the primary driver especially vegetables and pulses. Seasonality played a major role in the same (unadjusted MoM increase in vegetable inflation is 12.2%, whereas seasonally adjusted series have increased by only 4.9%). Even the Jul'23 high frequency data shows considerable risk both on wholesale and retail front for these items and also edible oils. BoB ECI is showing a MoM increase of 3.4%. Going forward, progress of monsoon is a key watchable. Already cereals and pulses are showing some degree of softening on production front. RBI is likely to be watchful of the evolving food price dynamics and would differentiate between transient and permanent shock before taking any call on rates. Vegetable price shock is more of a transient nature and fades out in the second half as seen historically (8 of the past 11 years have seen a drop in vegetable inflation in H2). So we expect some respite on this front. Even core and super core inflation is moderating, reflecting the impact of past transmission on real economy. As per our forecast, headline CPI would settle between 5-5.5% in FY24, with RBI remaining in 'hawkish pause' mode in CY23.

CPI inflation inched up

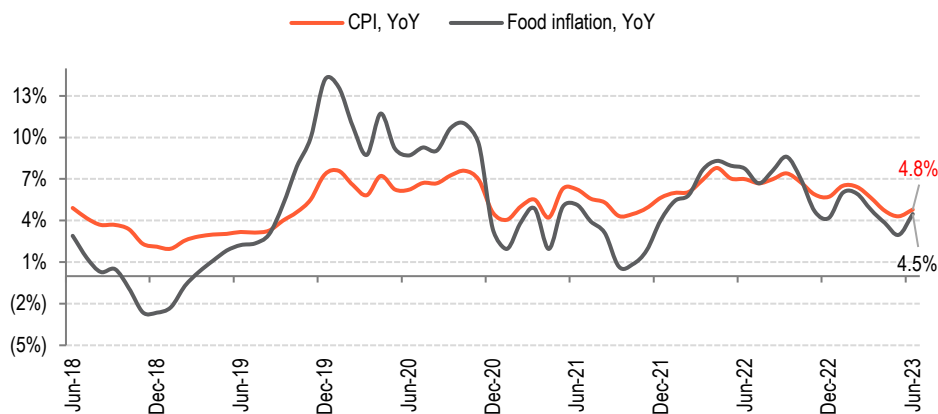
CPI inflation edged up: CPI inflation rose more than our expectation of 4.6% to 4.8% in Jun'23 from 4.3% in May'23, on YoY basis. Notably, this number comes at a base of 7%, which is quite a favourable one. The entire jump in CPI was driven by a 152bps increase in food inflation to 4.5% in Jun'23 from 3.0% in May'23.

Vegetables drove food inflation higher: Items such as vegetables (-0.9% from -7.9%, YoY), pulses (10.5% from 6.6%, YoY), spices (19.2% from 17.9%, YoY) and fruits (1.4% from 0.7%, YoY) have been major drivers of food inflation. Out of 12 broad categories of food inflation, 6 of them noticed inflation higher than 6%, with items such as cereals, pulses and spices remaining in double digits.

On sequential basis, cereals, protein based items such as meat and fish and eggs, vegetables, fruits and pulses have noted considerable increase in Jun'23 compared to May'23.

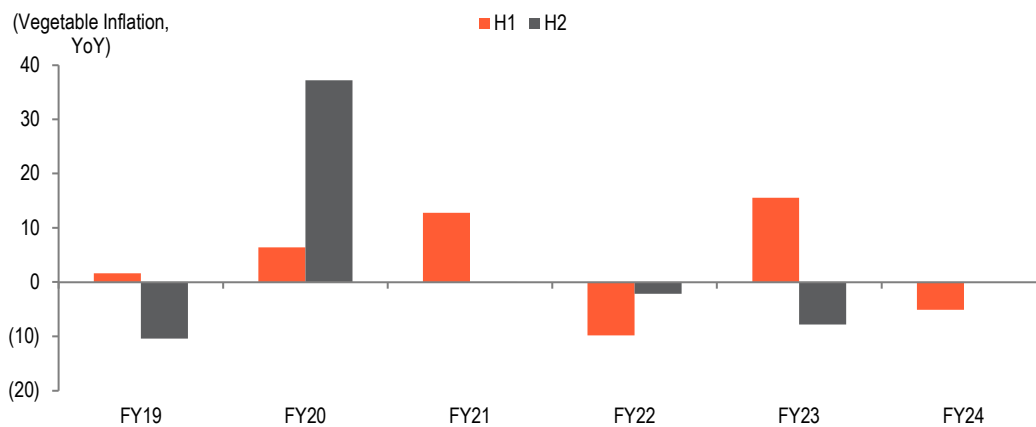
Going forward, with gradual progress of monsoon and arrival of fresh crops, some degree of respite might be seen. As seen historically (since FY13 onwards), H2 vegetable inflation has a tendency to come down (in 8 of the 11 episodes monitored, it has seen the same result). Thus going forward, the temporary price shock may see some respite.

Figure 1: CPI inched up; led by food



Source: CEIC, Bank of Baroda Research

Figure 2: Vegetable inflation has the tendency to fall in H2:



Source: CEIC, Bank of Baroda Research, H1FY24 is till Q1FY24

Core CPI (excl. food and fuel) remained stable at 5.1%. The miscellaneous component however noticed an increase from 4.9% in May'23 to 5.2% in Jun'23. This was driven by transport and communication inflation (2.5% in Jun'23 from 1.1% in May'23, YoY). But this is purely a base phenomenon. Even education inflation went up and this component actually showed a momentum on a sequential basis. *Other demand driven components of core such as household goods and services showed moderation both on YoY and sequential basis, thus enumerating the fact that past transmission of repo rate hike are translating into real demand.*

Super core measures softened: CPI excl. vegetable and pulses was at 5.1% in Jun'23, only marginally higher compared to 5% seen in May'23, on YoY basis.

Fuel and Light inflation softened to 3.9% in Jun'23 from 4.7% in May'23, as Kerosene prices moderated.

Way forward: CPI in Jun'23 was largely driven by seasonality in prices. Heatwave conditions and erratic rains have resulted in sudden spike in few components of vegetable inflation. The high frequency data of prices in Jul'23 show that on retail front, prices of cereals, masoor dal, edible oil and vegetables are posing upside risk. On wholesale front as well, edible oil and vegetables are witnessing fair degree of increase, hence pronounced pass through to these prices in the coming days cannot be ruled out in entirety. The sowing data shows that production of rice, pulses, oilseeds and cotton have softened compared to last year. Hence price monitoring along with the progress of monsoon (currently 2% above LPA) remains crucial in the coming days. Further demand side pressure still remains hazy. Financials of major companies have shown steady urban demand and improving rural demand on account of better income, thus some upside risk to core also remains, albeit it has moderated considerably in the past few months. Overall we expect headline CPI to be in the range of 5-5.5% in FY24. However, before taking a call on rates it would be prudent to watch whether current increase in inflation is a one-off event or not. We expect RBI to remain on hold for now, in CY23.

Growth in Industrial Production accelerates

IIP growth improves: IIP growth expanded to a 3-month high of 5.2% in May'23, above our expectations (4.5%) and compared with a growth of 4.2% in Apr'23. This was largely led by broad based improvement across all sectors. Growth in manufacturing and mining sector expanded to 5.7% and 6.4% against a growth of 5.2% and 5.1% respectively in Apr'23. Output of electricity was back in green in May'23 at 0.9% after contracting by (-) 1.1% in Apr'23. Amongst manufacturing sectors, at least 14 out of 23 subdivisions have registered higher growth in May'23. Manufacture of motor vehicles (13.4% versus 3.6%) registered the highest improvement, followed by leather products (1.8% versus -6.5%), rubber products (6.3% versus 1.8%) and non metallic minerals (10.2% versus 6.1%). Slower pace of contraction was registered in manufacture of furniture (-20.5% versus -29.4%), wearing apparel (-20.9% versus -29.1%) and computer, electronic product (-5.7% versus -11.1%).

On a MoM basis, IIP growth has improved by 3.2% in May'23 whereas seasonally adjusted series have increased by only 1.7%.

Consumer durable and Capital goods shines: Within use-based, barring FMCG and infra goods output, other sectors registered much higher growth in May'23. Growth in capital goods output doubled in May'23 at 8.2% against 4.6% in Apr'23. Consumer durable output moved back to the positive territory as it expanded to 1.1% in May'23 against a contraction of (-) 2.5% in previous month. Intermediate goods output edged upwards to 1.6% (0.4% in Apr'23). Moderation in output of infra and FMCG goods was noticed with growth decelerating to 7.6% (10.8% in Apr'23) and 14% (15% in Apr'23) respectively in May'23.

Way Forward: On the back of positive momentum, IIP growth has climbed upwards in May'23. Going ahead, domestic demand continues to showcase a mixed picture with strong GST collections, manufacturing PMI and steady credit growth. However, slow pickup of South-West Monsoon with

some states still in the deficient territory, requires careful monitoring. Rural demand also hinge on how well and spatially distributed rainfall is received across the country. Concerns over global economic slowdown will add to the ongoing woes around weak export demand.

Table 1: IIP growth scales up

Sectoral (%)	Weight	May-23	Apr-23	May-22	Apr-May'23	Apr-May'24
IIP	100.0	5.2	4.5	19.7	4.8	12.9
Mining	14.4	6.4	5.1	11.2	5.8	9.7
Manufacturing	77.6	5.7	5.2	20.7	5.5	12.7
Electricity	8.0	0.9	(1.1)	23.5	(0.1)	17.4
Use-Based						
Primary Goods	34.1	3.5	1.9	17.8	2.7	14.0
Capital Goods	8.2	8.2	4.6	53.3	6.5	30.1
Intermediate Goods	17.2	1.6	0.4	17.5	1.0	12.1
Infrastructure and Construction Goods	12.3	14.0	15.0	18.4	14.5	10.7
Consumer Durables Goods	12.8	1.1	(2.5)	59.1	(0.6)	28.3
Consumer Non-Durables Goods	15.3	7.6	10.8	1.4	9.3	0.3

Source: CEIC, Bank of Baroda Research

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