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Dipanwita, Jahnavi
Economists

CPI cools, IIP growth improves

CPI print cooled off to its lowest since Apr'21 to 4.3% in May'23. This was supported by a favourable base of 6.95% in May'22 and also significant drop in food inflation by 90bps. Even some high frequency price indicators of Jun'23 are showing moderation in food inflation with BoB ECI running lower at 0.5% in Jun'23 (till 12 Jun 2023) compared to 1.4% in May'23, on YoY basis. Going forward we expect CPI to be at 4.5% in Q1, slightly below at RBI's projection of 4.6% for Q1FY24. For full year our estimate stands in the range of 5.0-5.5%. We expect headline CPI to peak in Q3FY24. Hence we rule out the possibility of any rate action in CY23 based on the growth inflation dynamics. Further, the inflation trajectory require some vigil with regard to cereal inflation and upward spiraling of vegetable prices due to seasonality factor.

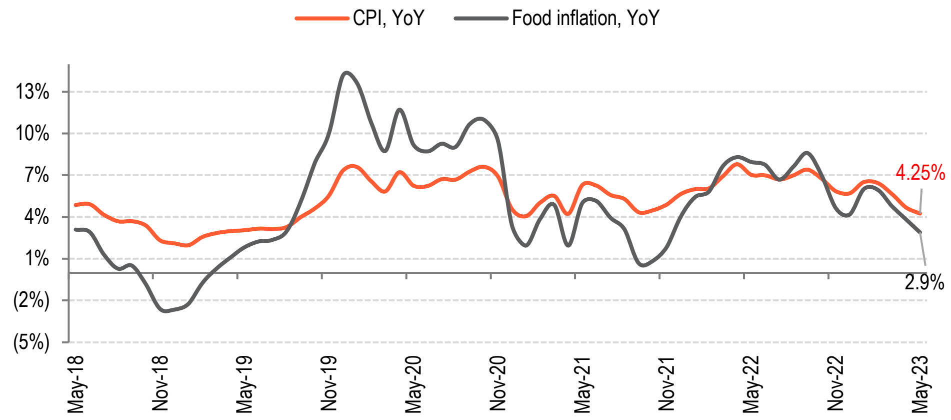
CPI inflation eases further

CPI inflation eased: CPI inflation dropped to its lowest since Apr'21 to 4.3% from 4.7% in Apr'23, on YoY basis. This is slightly below our estimate of 4.5%. The significant moderation in CPI was on the back of favourable food inflation and also supported by an elevated base of 6.95% in May'22.

Food inflation moderates: CPI food index moderated to 2.9% in May'23 from 3.8% in Apr'23, on YoY basis. Amongst major food items, oils and fat (-16% from -12.3%), vegetables (-8.2% in May'23 from -6.5% in Apr'23), fruits (0.7% from 2.1%) and cereals (12.7% from 13.7%) have noted considerable drop in inflation. However, 5 out of 10 major food items still remain above 6%, with cereal and spices inflation remaining in double digits.

On sequential basis, cereals, protein based items such as meat and fish and eggs, vegetables as well as spices noted an increase in inflation. Going forward, the outlook on food inflation seems murky and contingent on the evolution of El Nino. However, government's efforts to assuage supply side concerns would provide some degree of comfort.

Figure 1: CPI cools down; led by food



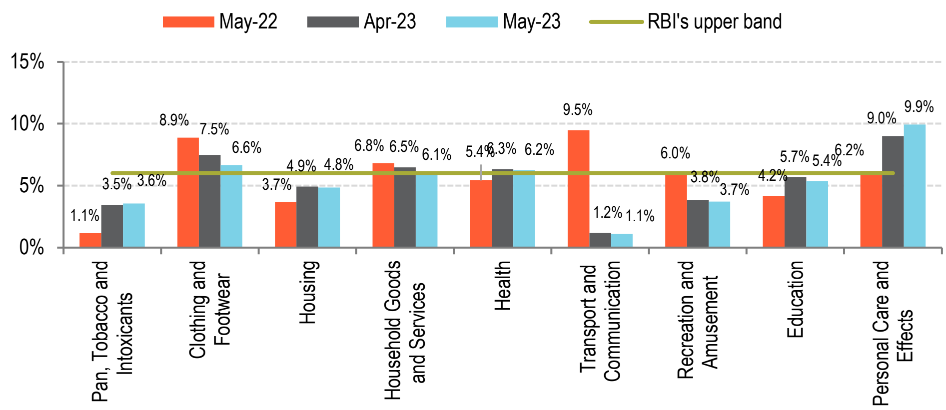
Source: CEIC, Bank of Baroda Research

Core CPI (excl. food and fuel) came down to 5.1% from 5.2% in Apr’23. Fair degree of moderation was visible in clothing and footwear inflation (6.6% in May’23 from 7.5% in Apr’23). Within miscellaneous component, except personal care and effects, moderation were visible across all items, with considerable drop visible in case of household goods and services component (6.1% from 6.5%).

On sequential basis, household goods and services gained momentum, which reflected buoyant underlying demand conditions. Even inflation in health and recreation and amusement picked up. Impact of falling gold prices (both domestic and international prices) in May’23, has led to softening in personal care and effects component on sequential basis.

Super core measures softened: Core excluding transport and communication and personal care and effects have moderated considerably to 5.5% in May’23 from 5.7% in Apr’23, on YoY basis. Even abridged core (core excluding pan, tobacco and intoxicants) eased to 5.2% from 5.3%.

Figure 2: Core inflation moderates:



Source: CEIC, Bank of Baroda Research

Fuel and Light inflation softened to 4.6% from 5.5% in Apr’23 led by fall in Kerosene prices.

Way forward: The latest CPI reading have provided some comfort especially with regard to moderation in food prices. Even in Jun’23, high frequency price indicators for pulses component (Gram, Moong and Masoor), sugar, salt, milk and potato have shown a respite on MoM basis. On the other hand, risks may emanate from cereal prices especially we need to be vigil with regard to price of rice, which is showing a sequential momentum in Jun’23. Further, the vagaries of monsoon might downplay any correction in cereal prices in the near term. On demand front, pressure would continue to persist as majority of high frequency growth indicators have retained their pace in May’23 (especially services PMI, credit growth, vehicle registration and mobility indicators). Companies have started passing on high input costs to consumers from Q3FY23 onwards as seen in their financials. The same is likely to continue in Q1FY24 as well, for which some upside risks to core inflation cannot be ruled out in the near term. For Q1FY24, we expect headline CPI at 4.5% against RBI‘s trajectory of 4.6% and our full year forecast stands at 5.0-5.5%.

Industrial Production Shines

IIP growth expands: IIP growth came in higher than our expectations (1.2%) and surprised positively, firing up the growth cylinder as it registered a growth of 4.2% in Apr’23 against 1.7% in Mar’23. The jump in growth was led by manufacturing sector (holds highest weight) as it registered a growth of 4.9% in Apr’23 compared with 1.2% in Mar’23. Within manufacturing, a stronger outlook was noticed with 14 of 23 subdivisions improving in Apr’23. The sharpest improvement was noticed in pharma (24.5% versus -2.5%), computer, electronic (-11.1% versus -28.7%), other manufacturing (-4.6% versus -14 %), other non-metallic minerals (6.1% versus -1.7%) and food products (1.9% versus -5.8%). However, manufacture of furniture (-29.4% versus -9.3%) and beverages (-9.6% versus 3.3%), witnessed steep contraction.

Electricity output contracted at a much slower pace by (-) 1.1% in Apr’23 from (-) 1.6% in Mar’23 and is expected to improve further. On the other hand, mining output eased to 5.1% in Apr’23 against a growth of 6.8% in Mar’23.

Robust growth in FMCG: Within use-based, mixed outlook was seen across sectors. Output of primary goods slowed down to 8-month low of 1.9% in Apr’23 against 3.3% in Mar’23. Even output of capital and intermediate goods output moderated down to 6.2% (8.1% in Mar’23) and 0.8% (1% in Mar’23). However, Infra goods registered a healthy output, clocking double digit growth to 5-month high of 12.8% in Apr’23 compared with a growth of 5.4%. Consumer durables output contracted at a much slower pace at (-) 3.5% in Apr’23 (-8.4% in Mar’23). FMCG output outshined across all the sector scaling upwards with a growth of 10.7% after declining by (-) 3.1% in Mar’23.

Way Forward: Domestic demand has been lately showcasing recovery with steady credit growth, improvement in port cargo, higher manufacturing PMI and toll collection offering some respite. However, risk to inflation due to El Nino, along with patchy monsoon or any lagged effect due to policy tightening might have adverse impact on overall growth. Exports demand will continue to face headwinds amidst the fears of global economic slowdown.

Table 1: IIP growth climbs upwards in Apr'23

Sectoral (%)	Weight	Apr-23	Mar-23	Apr-22
IIP	100.0	4.2	1.7	6.7
Mining	14.4	5.1	6.8	8.4
Manufacturing	77.6	4.9	1.2	5.6
Electricity	8.0	(1.1)	(1.6)	11.8
Use-Based				
Primary Goods	34.1	1.9	3.3	10.3
Capital Goods	8.2	6.2	8.1	12.0
Intermediate Goods	17.2	0.8	1.0	7.1
Infrastructure and Construction Goods	12.3	12.8	5.4	4.0
Consumer Durables Goods	12.8	(3.5)	(8.4)	7.2
Consumer Non-Durables Goods	15.3	10.7	(3.1)	(0.8)

Source: CEIC, Bank of Baroda Research

For further details about this publication, please contact:

Economics Research Department
Bank of Baroda
chief.economist@bankofbaroda.com