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Dipanwita Mazumdar | **Aditi Gupta**
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Food inflation: a discomfort

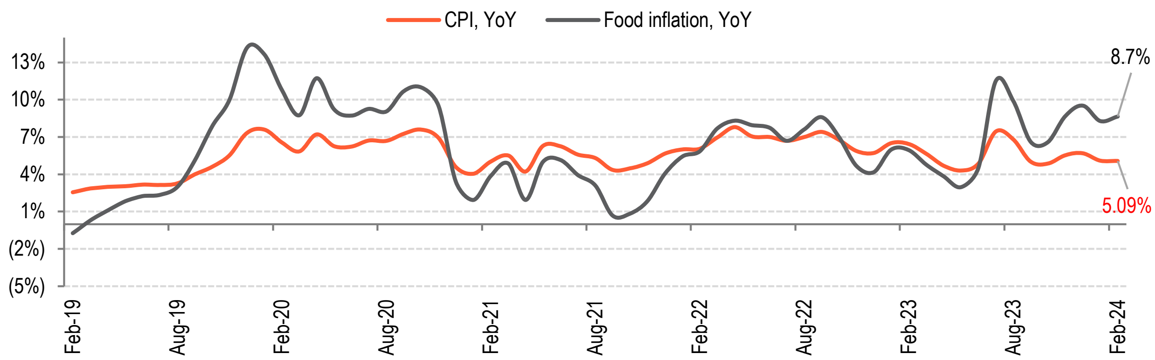
CPI print was in line with our estimate at 5.1%. Some pressure points still remain with respect to food inflation, especially with respect to the trajectory of vegetable inflation. Even high frequency price data of Mar'24 is showing underlying pressure in food inflation. Going forward, weather related uncertainty will be the key risk to the food inflation outlook. We do not foresee CPI to fall below 5% till Jun'24, after which a favourable base might help the headline inflation to move towards the 4% target. Core inflation continued to provide the desired comfort. However, resilient macro-economic conditions and its impact on core needs to be carefully monitored. Already housing has started to play a spoilsport.

RBI at this current juncture will be in a wait and watch mode. We do not expect any rate action in the upcoming policy and space for a rate cut opens up only in H2.

Food bit of a problem, core seen softening

CPI inflation in line with our estimate: CPI inflation was at 5.1% in Feb'24, on YoY basis, broadly unchanged from last month. Food inflation inched up to 8.7% in Feb'24 from 8.3% in Mar'24. Within food, pressure was witnessed in case of meat and fish (5.2% in Feb'24 from 1.2% in Jan'24) and egg inflation (10.7% from 5.6%). This is largely attributable to an unfavourable base. For meat and fish however, some sequential momentum is observed. Apart from this, vegetable inflation also picked up to 30.2% in Feb'24 from 27.1% in Jan'24. Till now, 6 out of 12 broad categories of food inflation have remained above 6%. Among major items only cereals and spices are seeing some moderation in inflation both on a sequential and YoY basis. Notably, for cereals even international prices have also fallen in Feb'24, as per World Bank data.

Figure 1: Food inflation picked up

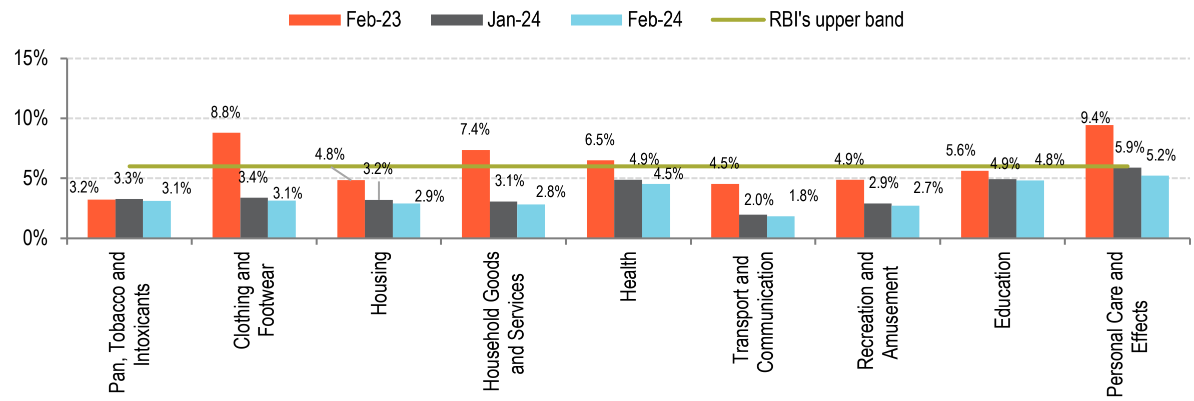


Source: CEIC, Bank of Baroda Research

On sequential basis, food inflation has inched up by 0.1% in Feb'24 from -0.7% decline seen in Jan'24. Amongst major items, vegetable prices have gained considerably, with the pace of deflation slowing down to -0.1% in Feb'24 from -4.2% in Jan'24. Deflation in fruit categories has also moderated to -0.3% from -2.1% in Jan'24. Other than this, even meat and fish, oils and fats and pulses have inched up sequentially. Going forward, trajectory of food inflation remains uncertain. Weather vagaries will be a key risk to the evolution of trajectory of food inflation. The reversal of seasonality in vegetable prices also start from H1 onwards. Thus, food inflation may hold back CPI from falling towards the targeted 4%.

Core CPI (excl. food and fuel) has moderated further to 3.3%: Core inflation softened further to 3.3% in Feb'24 from 3.6% in Jan'24, on YoY basis. All components of core inflation showed moderation. Amongst them, health (4.5% in Feb'24 from 4.9% in Jan'24), household goods and services (2.8% from 3.1%, due to favourable base) and clothing and footwear witnessed considerable moderation. The sequential momentum of core inflation has also lost steam, softening to 0.2% in Feb'24 from 0.3% in Jan'24, on MoM basis. Amongst major items, inflation has softened considerably for health, personal care and effects (due to moderation in gold prices), education and recreation and amusement. However, the trajectory of housing needs some monitoring.

<u>Figure 2: Core remains comfortable</u>



Source: CEIC, Bank of Baroda Research

Fuel and Light inflation fell by -0.8% in Feb from -0.6% in Jan'24, on YoY basis and by -0.1% from 0.4 %, on a sequential basis, as Kerosene prices showed moderation.

Way forward: High frequency price data of Mar'24 is showing some pick up. 8 out of 20 essential commodities are showing a sequential pickup in prices. The correction in trajectory of onion and potato prices is already happening. Our BoB ECI for Mar'24, is running at 5.6% on YoY basis. We do not rule out the possibility that Mar'24 might also end with a CPI print slightly above 5%. Over the medium term, we do not foresee inflation to drop below 5% till Jun'24. FMCG companies have announced an increase in MRP, which also might impact inflation in the near term. However, a favourable base kicks in from Q2 onwards, which might push back inflation to the targeted 4% level.

Comfort on core inflation would continue. However, evolution of housing trajectory is crucial especially when the increase in HRA kick starts.

Industrial production edges lower

IIP growth decelerates: IIP growth slowed down from an upwardly revised 4.2% in Dec'23 to 3.8% in Jan'24. This was marginally higher than our estimate of 3.5%. The slowdown was led by manufacturing output which decelerated to 3.2% in Jan'24 from 4.5% in Dec'23. On the other hand, both mining and electricity output witnessed an improvement from Dec'23. Mining output rose by 5.9% compared with 5.2% in Dec'23. Electricity output saw a substantial pick up from 1.2% in Dec'23 to 5.6% in Jan'24.

Within manufacturing, a total of 14 subsectors marked an improvement in growth in Jan'24, relative to Dec'23. Sharp improvement was visible in production of wood and wood products (4.2% versus -12.4%), fabricated metals (21.4% versus 8.9%) and motor vehicles (18% versus 9.2%). Apart from this, output of leather and related products and machinery and equipment increased for the first time in the last 3-months. Improvement was also visible in the production of textiles and wearing apparel. On the other hand, production of computer and electronics, coke and refined petroleum, pharmaceuticals and food products declined in Jan'24.

Industrial output in FYTD24 has increased at a faster pace of 5.9% versus 5.6% in the same period last year. This is led by improvement in manufacturing (5.4% versus 4.9%) and mining (8.3% versus 5.8%). Electricity output is sharply lower at 6.8% versus 10.1% in FYTD23.

Consumer durables outshine: Within use-based, consumer durables output increased sharply by 10.9% in Jan'24, supported by base effect. Capital goods output too improved to 4.1% in Jan'24 versus 3.6% in Dec'23. On the other hand, output of consumer non-durables declined for the first time in 10-months at -0.3% from an increase of 2.4% in Jan'24. Infrastructure goods output was also marginally weaker at 4.6% versus 5.1% in Dec'23. Slowdown was also apparent in case of primary goods as output rose at a slower pace of 2.9% in Jan'24 versus 4.8% in Dec'23.

Way forward: India's growth has remained on a strong footing. High frequency indicators such as manufacturing PMI, GST collections and robust credit growth have been underlining the strength in the domestic economy. As a result, IIP growth in FYTD24 is higher than last year. We expect a further improvement in industrial activity led by a pickup in consumption growth. Interestingly, production of consumer goods has seen an improvement in the last 2-months which bodes well for growth going forward. Rural demand is also expected to rebound, amidst easing inflationary pressure. Apart from this, the government's continued thrust on capex is likely to benefit infrastructure linked sectors as well. Headwinds will come from weak external demand environment which will have a bearing on exports.

Table 1: IIP growth improves

Sectoral (%)	Weight	Dec-23	Jan-24	Jan-23	FYTD23	FYTD24
IIP	100.0	4.2	3.8	5.8	5.6	5.9
Mining	14.4	5.2	5.9	9.0	5.8	8.2
Manufacturing	77.6	4.5	3.2	4.5	4.9	5.4
Electricity	8.0	1.2	5.6	12.7	10.1	6.8
Use-Based						
Primary Goods	34.1	4.8	2.9	9.8	8.0	6.5
Capital Goods	8.2	3.6	4.1	10.5	13.5	6.9
Intermediate Goods	17.2	3.9	4.8	1.4	4.3	4.8
Infrastructure and Construction Goods	12.3	5.1	4.6	11.3	8.5	10.0
Consumer Durables Goods	12.8	5.3	10.9	(8.2)	2.1	2.0
Consumer Non-Durables Goods	15.3	2.4	(0.3)	6.5	(0.2)	4.6

Source: CEIC, Bank of Baroda Research

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For further details about this publication, please contact:

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