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Inflation eased: Veggie spike cooled a bit

CPI print remained broadly aligned with our estimate of 6.9% in Aug'23 and came in at 6.8% far lower compared to 7.4% seen in Jul'23. Food inflation especially vegetable inflation provided the desired relief. Government's supply side efforts came into play in cooling of prices of perishables to a certain extent. Even wholesale mandi prices are also on a downtrend and much of the pass through from wholesale to retail price channels has already been observed.

The Sep'23 high frequency price data is also showing softening of prices. Our BoB ECI has fallen by 1.7% (sequentially) and moderated by 3% (YoY). Sep'23 is likely to witness sharp correction in prices. We maintain our estimate of 5.5% for headline CPI in FY24. Q3 and Q4 will remain well anchored within the 6% target band.

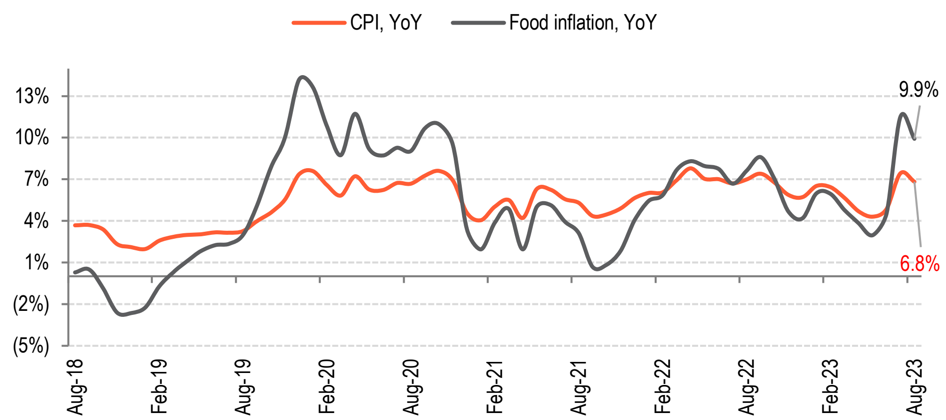
CPI excluding vegetables has remained below the 6% mark for 5 consecutive months in a row. Even core has eased quite a bit. RBI will be cautiously on pause balancing and counterbalancing the underlying factors throughout this year.

CPI inflation cooled off

Food pacified headline CPI: CPI inflation came in at 6.8% in Aug'23 (YoY basis) broadly in line with our estimate of 6.9% and far lower compared to 7.4% print observed in Jul'23. The likely comfort came in from 157bps drop in food inflation which moderated to 9.9% from 11.5% in Jul'23. Amongst broad categories, 5 out of 12 of them noticed moderation in inflation. Amongst them, vegetable inflation edged down significantly to 26.1% in Aug'23 from 37.4% in Jul'23. Government supply side initiatives such as subsidizing sale of those vegetables whose prices were increasing, target release of stocks and imposing export duties have actually resulted in controlling food inflation of these items to a certain extent. Other than vegetables, cereals (-118bps fall), milk (-61bps) and pulses (-29bps) have witnessed fair degree of moderation in inflation.

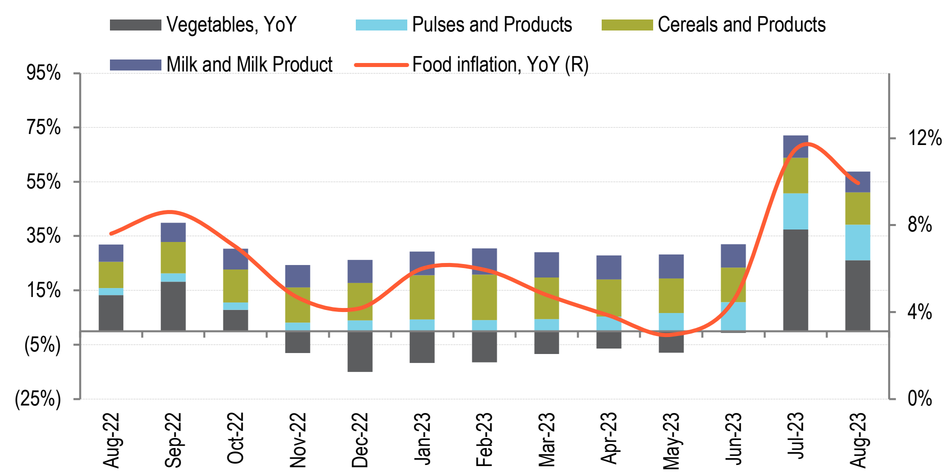
On sequential basis, food inflation has fallen by 0.7% in Aug'23 *(on a seasonally adjusted basis, it has fallen at a sharper pace by 0.9% in Aug'23)* compared to 6.7% increase in Jul'23. Sequentially, in broad categories of food, 6 of them noticed moderation. Amongst them, majority is on account of fall in vegetable prices by 5.9% in Aug'23 from 38.2% increase seen in Aug'23. Other than this, fruits inflation have edged down to 0.2% from 4.4%. Even comfort was visible for egg and pulses category. So the broad fear of vegetable and pulses price spiral is considerably tamed compared to previous month.

Figure 1: CPI softened; led by food



Source: CEIC, Bank of Baroda Research

Figure 2: Vegetables dragged down food inflation



Source: CEIC, Bank of Baroda Research

Core CPI (excl. food and fuel) has moderated to 4.8%. All sub components of core noticed a drop in inflation in Aug '23. Amongst them, considerable impact was visible for demand side components such as personal care and effects (-78bps, YoY drop), and household goods and services (-45bps). Drop in international gold prices (-1.7%, on sequential basis) also contributed towards this decline. It can be said that the impact of past transmission of higher rate is shaping up and resulting in softening demand conditions. Even inflation in clothing, footwear, recreation, amusement and education have edged down.

The sequential picture however shows core has increased at the same pace as seen last month by 0.4%, with major sequential pickup visible in housing inflation. However, excluding housing the sequential pickup is lower than last month at 0.3%. Further, for categories such as education and recreation and amusement considerable drop is seen even on a sequential basis.

Going forward, the festive demand in October might give some push to core but it will be broadly range bound within 5%.

Fuel and Light inflation rose to 4.3% in Aug'23 from 3.7% in Jul'23, on YoY basis. But the sequential picture showed some losing momentum as LPG prices have moderated in the month. Going forward, due to government's slashing of LPG prices, this component is likely to witness around 20bps fall in Sep'23.

Way forward: CPI in Aug'23 have already started showing impact of contained food prices especially vegetable prices. Even the Sep'23 high frequency price data has seen a downtrend. 16 out of 20 commodities tracked by us are showing reduced pace of sequential increase in prices. Notably, prices of tomatoes have fallen by 48% in Sep'23 (till 11 Sep'23). Our in house BoB-ECI has fallen by 1.7% on a sequential basis and is running at a slower pace of at 3% on YoY basis. According to our forecasts, Q3 and Q4 headline CPI print seems to remain well anchored to the 6% target band.

Upside risks do persist from erratic monsoon which is already reflected in the sowing data, where pulses and oilseeds amongst major food crops pose concerns. This will be soon reflected in the production estimates for this year. The production related disruptions may be corrected by the government through its continued efforts either through release of stocks from its buffer or through imports.

Oil is also playing a spoilt sport. Compared to previous Monetary Policy Report projections of US$ 85/bbl, crude has firmed up considerably to ~US$ 90/bbl on account of production cuts and export curtailment. *However, the pass through to domestic retail prices is unlikely as per our assumption. Pump prices have remained inflexible since May'22. We believe in the current environment, when food prices are elevated, domestic retail pump prices are unlikely to change much if the oil price shock is not persistent.*

Growth in Industrial Production accelerates

IIP growth improves: IIP growth expanded to a 5-month high to 5.7% in Jul'23, above our expectations (5%) and compared with a growth of 3.8% in Jun'23. This was largely led by broad based improvement across all sectors. Growth in manufacturing and electricity sector expanded to 10.7% and 8% against a growth of 7.6% and 4.2% respectively in Jun'23. Output of manufacturing moved up to 4.6% in Jul'23 against a growth of 3.1% in Jun'23. Amongst manufacturing sectors, at least 15 out of 23 subdivisions have registered higher growth in Jul'23. Manufacture of pharma (12% versus 4.1% in Jun'23), motor vehicles (8.9% versus 7.6%), other non-metallic minerals (6.5% versus 4.9%) and coke and petroleum products (4.2% versus 3.2%) recorded highest improvement. Slower pace of contraction was registered in manufacture of food products (5.2% versus -3.0%), computer, electronic (-16.8% versus -32.3%) and wearing apparel (-22.5% versus -23.3%) amongst others.

On a FYTD basis (Apr-Jul), industrial growth has eased to 4.8% in FYTD'24 from 10% in FYTD'23. Manufacturing and electricity growth has moderated to 4.8% and 2.9% respectively in FYTD'24, while mining growth has expanded by 7.3% in FYTD'24 (6.1% in FYTD'23).

On a MoM basis, IIP growth has declined by (-) 1.1% in Jul'23 whereas seasonally adjusted series have declined at a much accelerated pace by (-) 2.3%.

FMCG shines: Within use-based, barring intermediate and infra goods output, other sectors registered much higher growth in Jul'23. Growth in primary goods jumped up to 7.6% against a growth of 5.3% in Jun'23. Even capital goods output doubled in Jul'23 at 4.6% against 2% in Jun'23. Consumer durable output declined albeit at a slower pace to (-) 2.7% compared with (-) 6.7% in Jun'23. FMCG output rose to 7.4% in Jul'23 after easing down to 0.3% growth in Jun'23. However, moderation in output of intermediate and infra goods was noticed with growth decelerating to 1.9% (4.6% in Jun'23) and 11.4% (12.9% in Jun'23) respectively in Jul'23.

Way Forward: On the back of positive momentum, IIP growth has climbed upwards in Jul'23. Going ahead, domestic demand continues to showcase a mixed picture with strong GST collections, manufacturing PMI and steady credit growth. However, erratic South-West Monsoon might have some impact on inflation and on rural demand, thereby requires careful monitoring. Uneven distribution of rainfall along with lower reservoir levels might impinge on the overall output levels and even impinge on rabi sowing. Slower export demand due to weaker global demand economic also remains watchful.

Table 1: IIP growth scales up

Sectoral (%)	Weight	Jul-23	Jun-23	Jul-22	Apr-Jul'24	Apr-Jul'23
IIP	100.0	5.7	3.8	2.2	4.8	10.0
Mining	14.4	10.7	7.6	(3.3)	7.3	6.1
Manufacturing	77.6	4.6	3.1	3.1	4.8	10.2
Electricity	8.0	8.0	4.2	2.3	2.9	13.2
Use-Based						
Primary Goods	34.1	7.6	5.3	2.5	4.5	11.0
Capital Goods	8.2	4.6	2.0	5.1	4.8	22.4
Intermediate Goods	17.2	1.9	4.6	3.7	2.8	9.5
Infrastructure and Construction Goods	12.3	11.4	12.9	4.8	12.2	8.8
Consumer Durables Goods	12.8	(2.7)	(6.7)	2.3	(2.7)	19.7
Consumer Non-Durables Goods	15.3	7.4	0.3	(2.9)	6.8	0.1

Source: CEIC, Bank of Baroda Research

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