

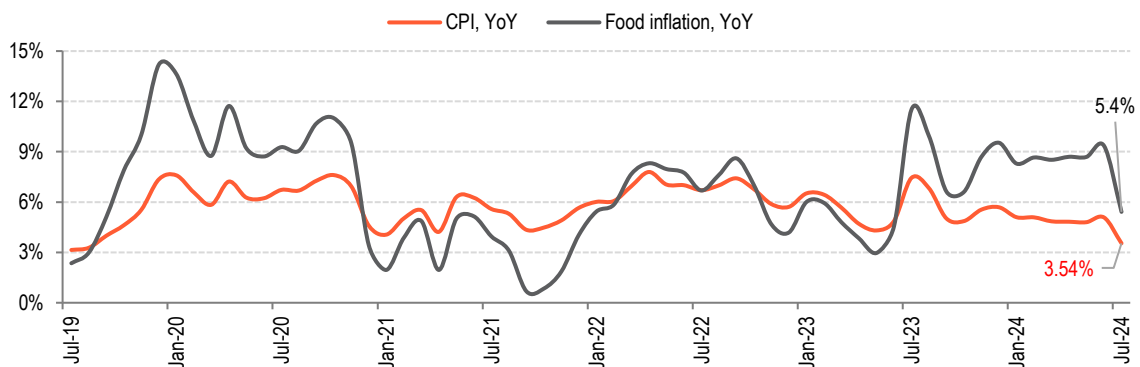
Inflation eases, IIP growth cools

CPI inflation eased to a 59-month low of 3.5% in Jul'24 from 5.1% in Jun'24, led by a favorable base. Food inflation eased on a YoY basis, even as the sequential momentum was upwards. Importantly, after witnessing a downward trend for the past few months, core inflation picked up to 3.4% in Jul'24 due to the hike in telecom tariffs. The outlook for food inflation is positive due to a pickup in rainfall activity across the country. High-frequency price data indicates a softening momentum in prices in Aug'24. Core inflation should also remain subdued given that global commodity prices have remained muted. Risks however remain from an un-anchoring of household's inflation expectations. Overall, we continue to expect inflation in the range of 4.5%-5% in FY25. RBI is likely to be cautious and any move on rates will only be possible once it is sure that inflation has eased on a durable basis. We hence expect a rate cut only in Dec'24. Separately, IIP growth eased more than expected in Jun'24 as it came in at 4.2% from an upwardly revised 6.2% in May'24. This was due moderation in output seen in manufacturing and electricity. However in quarterly terms, IIP growth continues to hold ground with 5.2% growth, compared with 4.7% last year.

Favorable base pushes inflation lower

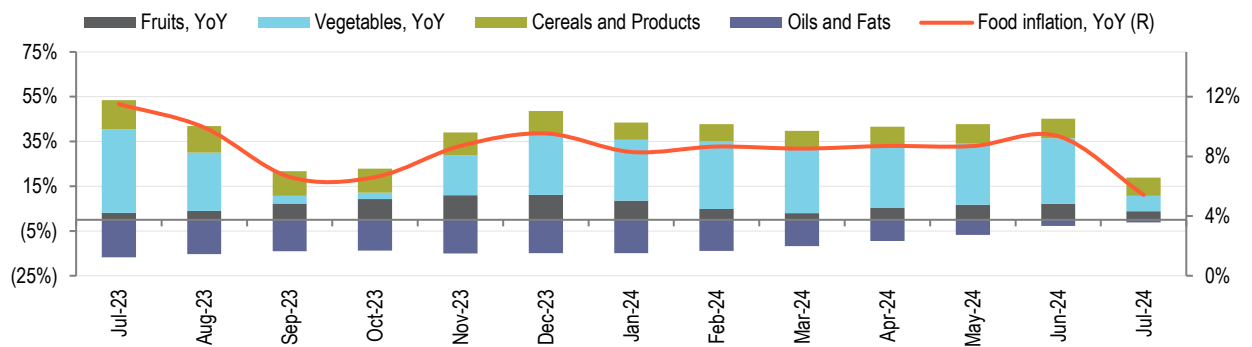
CPI inflation lower than estimate: CPI inflation moderated to 3.5% in Jul'24 (BoB estimate 3.8%), after inching up to a 3-month high of 5.1% in Jun'24. It must be noted that there was a significant base effect at play as inflation had increased by 7.4% in Jul'23. Food inflation eased significantly to 5.4% from 9.4% in Jun'24. This was led by a sharp moderation in prices of vegetables which increased at a much slower pace of 6.8% in Jul'24 compared with 29.3% in Jun'24. Much of the decline in this category can be attributed to base effect (37.4% in Jul'23), as vegetable prices were higher on a MoM basis. Fruit prices also moderated to 3.8% from 7.2% in Jun'24. Inflation in cereal items also decelerated to 8.1% from 8.8% in Jun'24, but remains high. Prices for pulses remained elevated and increased by 14.8% in Jul'24 after increasing by 16.1% in Jun'24. Inflation in this category has continued to register double-digit growth since Jun'23 amid a shortfall in domestic production. Upward momentum was visible in prices of eggs and meat and fish, while milk prices were broadly steady.

Figure 1: CPI inflation eases led by food and base effect



Source: CEIC, Bank of Baroda Research

Figure 2: Slowdown in prices of vegetables



Source: CEIC, Bank of Baroda Research

Core CPI (excl. food and fuel) inches up: Reversing a trend seen over the past few months, core inflation inched up to 3.4% in Jul’24 from 3.1% in Jun’24. The increase was led by acceleration in the transport and communication category which inched up to 2.5% in Jul’24 from 1% in Jun’24. This in turn reflects the impact of a hike in tariffs by all major telecom companies. Inflation in the personal care and effects category also inched up to 8.4% from 8.2% in Jun’24, partly reflecting higher gold prices as well as an increase in selling prices by companies. Other categories of core exhibited moderation.

Fuel and light: Deflation in the fuel and light category exacerbated to 5.5% in Jul’24, compared with 3.6% in Jun’24. There was marginal increase in oil prices in the same period. Even LPG and kerosene prices were lower.

Way forward: The trajectory of inflation hinges heavily on how food prices behave. Food inflation has remained at over 6% for over a year now and there has been a considerable build-up in price pressures in the last few months. In this context, the current inflation print is likely to be welcomed by the RBI. Notably, RBI had revised its inflation projections for the current and the next quarter upwards, primarily due to the upward momentum seen in food prices.

Given that monsoon has advanced mostly in line with expectations, the pressure on food prices is likely to abate further in the coming months. In Jul’24, prices of essential commodities such as tomatoes, potatoes, onion as well as pulses are witnessing a softening momentum. It will however be crucial to gauge how monsoon fairs in the remaining part of the season. So far, Kharif sowing has been above last year’s levels for most food crops. Reservoir storage too has seen a steady improvement and is likely to inch up further as the monsoon progresses, which bodes well for Rabi sowing. Hence, the outlook on food inflation is favorable, despite some uncertainty. The outlook for core inflation is also subdued given that global commodity prices have largely been rangebound. However, the recent uptick in core inflation is cautionary. While much of the increase in core inflation can be traced back to higher telecom tariffs, inflation in the personal care and effects category too has remained fairly elevated at over 8%. The Governor also cautioned against the spillover effects due to elevated food prices having a spillover impact on headline inflation through core. Incidentally, RBI’s latest household inflation expectations showed a pickup in inflation expectations. It is crucial to ensure that these expectations do not become entrenched and become self-fulfilling. Overall, we believe that CPI inflation is likely to average 4.5-5% in FY25. We continue to believe that the room for a rate cut opens up only in Dec’24.

Industrial production slows

IIP growth moderates: IIP growth slowed more than expected in Jun'24, as it came in at 4.2% versus BoB estimate of 4.5%, from an upwardly revised 6.2% in May'24. Barring mining (10.3% in Jun'24 versus 6.6% in May'24), growth in output of both manufacturing (2.6% versus 5%) and electricity (8.6% versus 13.7%) eased. This is the slowest rate of growth for manufacturing sector in 7 months. In case of electricity production, early onset of monsoon in certain parts of the country, impacted demand.

This implies, in quarterly terms, in Q1FY25, IIP growth was at 5.2% versus 5.1% in Q4FY24 and 4.7% in Q1FY24. Manufacturing sector output slowed and registered 3.8% growth in Q1 this year (5.1% last year), versus 4.8% in Q4. Mining sector growth (7.9%) on the other hand improved, compared with both Q4 (5.1%) and Q1 (6.3%) of last year. With record heat-wave conditions persisting during Apr-Jun'24 period, electricity output jumped sharply by 10.9%, in comparison with 7.3% increase in Q4 and 1.3% in Q1FY24.

Within manufacturing, a total of 17 sub-sectors noted slower growth in Jun'24, and only 6 sub-sectors recorded an improvement. Major drag in production was visible on account of sectors like tobacco, pharma, computer & electronics, and fabricated metal products. On the other hand, production of food products, wood/rubber/plastic/chemicals and products, and electrical equipment rose in Jun'24.

Use-based classification: Within use-based, all categories noted a slowdown. Consumer durables (8.6% in Jun'24 versus 12.6% in May'24) and infrastructure & construction goods (4.4% versus 6.3%) noted most significant moderation in output. Apart from this, output of primary goods (6.3% versus 7.3%), intermediate (3.1% versus 3.9%) and capital (2.4% versus 2.9%) goods also slowed. Output of consumer non-durables declined as it fell by (-) 1.4% in Jun'24, following 2.5% increase in May'24. This indicates that consumption demand remains under pressure. In quarterly terms as well, only production of non-durables has fallen (-0.5% in Q1FY25 versus 6.8% in Q1FY24), while that of primary goods and consumer durables has improved. Some softening is visible in case of capital and infrastructure/construction goods.

Way forward: IIP growth continues to hold ground in terms of quarterly growth, as it has improved compared with both Q4 and Q1 of last year. Even as demand side pressures impacted production of non-durables, we expect this trend to reverse in the coming months. Higher than normal monsoon and improvement in Kharif sowing is expected to revive rural demand. Cooling down of inflation will also help spur urban demand. Solid improvement in services sector activity is also a reflection of this. As monsoon was strong in the month of Jul'24, and Markit manufacturing PMI also eased a tad in Jul'24, we expect slight moderation in growth next month. However, following that we expect growth to pick up again ahead of the festive season demand and also due to increase in government spending.

Table 1: IIP growth slows down in Jun'24

Sectoral (%)	Weight	Apr-24	May-24	Jun-24	Apr-Jun'23	Apr-Jun'24
IIP	100.0	5.0	6.2	4.2	4.7	5.2
Mining	14.4	6.8	6.6	10.3	6.3	7.9
Manufacturing	77.6	3.9	5.0	2.6	5.1	3.8
Electricity	8.0	10.2	13.7	8.6	1.3	10.9
Use-Based						
Primary Goods	34.1	7.0	8.1	2.9	6.9	5.1
Capital Goods	8.2	2.7	2.9	2.4	5.1	2.7
Intermediate Goods	17.2	3.2	3.9	3.1	3.4	3.4
Infrastructure and Construction Goods	12.3	8.0	6.3	4.4	13.2	6.2
Consumer Durables Goods	12.8	10.0	12.6	8.6	(2.7)	10.4
Consumer Non-Durables Goods	15.3	(2.5)	2.5	(1.4)	6.8	(0.5)

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