

INFLATION AND IIP

12 May 2020

Growth contracts, food inflation rises

Even with data capturing challenges, underlying trend of higher food prices and lower production (IIP contracted by 16.7%) has been captured. In case of core inflation, only two indices were reported. Health inflation has fallen by 140bps though housing is up by 20bps. Core inflation should moderate as demand shock will impact discretionary demand. The above backdrop calls for using the current policy space for reduction in interest rates as the economy gradually opens up. We see room for another 50bps reduction in policy rates.

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IIP growth slumps: Industrial output contracted by 16.7% in Mar'20 from an increase of 4.5% in Feb'20 largely owing to nationwide lockdown. The response rate of 73% is far lower than 94% for Dec'19. Thus revision in data is inevitable. The decline was led by manufacturing sector which contracted by 20.6% (increase of 3.1% in Feb'20) followed by electricity at 6.8% in Mar'20. Mining sector reported a flat growth. Within manufacturing, capital and consumer durables sectors were the worst hit, as their output contracted by 35.6% and 33.1% respectively. Production of even intermediate goods fell by 18.5% and infrastructure goods by 23.8%. Overall, industrial production slipped and declined by 0.7% in FY20 compared with an increase of 3.8% in FY19.

Food inflation rises: Even with data related challenges, CPI inflation seems to have captured the underlying trend of rising food prices. Consumer food inflation inched up by 170bps to 10.5% in Apr'20 from 8.8% in Mar'20. This was led by 5% increase in vegetable inflation (23.6% in Apr'20 as against 18.6% in Mar'20). Cereal inflation rose to 7.8% as against 5.3% in Mar'20, in line with international prices. Pulses prices rose by 22.8% as against 15.8% in Mar'20. Milk prices also rose sharply by 9.4% compared to 6.5% in Mar'20. Within core, only housing (10% weight) and health (5.9% weight) indices were reported. While housing inflation did inch up to 3.9% (3.7% in Mar'20), health care moderated to 2.8% (from 4.2% in Mar'20).

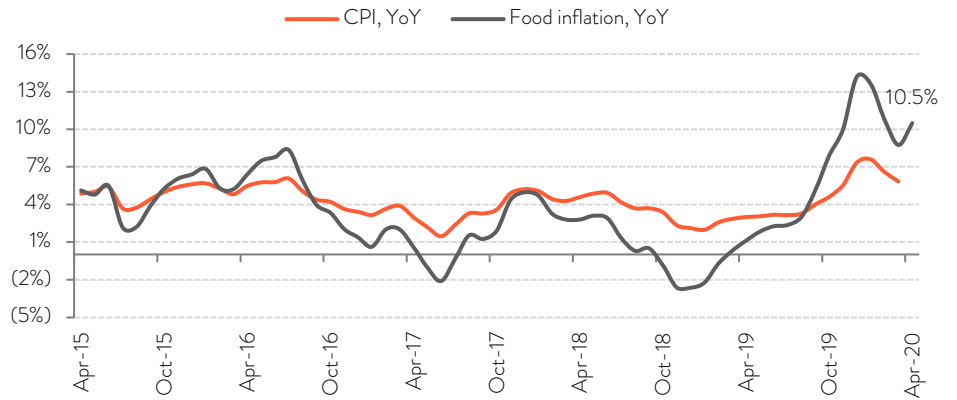
RBI to ease again: Even with data reporting challenges, the underlying trend of lower core inflation and higher food inflation captures the demand and supply challenges. Food inflation should ease once agri supply chain is working. Core inflation will continue to ease due to lower demand as consumer sentiment has been impacted adversely. Large dip in industrial output shows the magnitude of supply side shock. In our opinion, this calls for RBI to ease further by 50bps.

KEY HIGHLIGHTS

- Industrial production fell by 16.7% in Mar'20 from an increase of 4.5% in Feb'20.
- CFPI rises to 10.5% in Apr'20 from 8.8% in Mar'20.
- RBI should use room available to cut rates by 50bps.

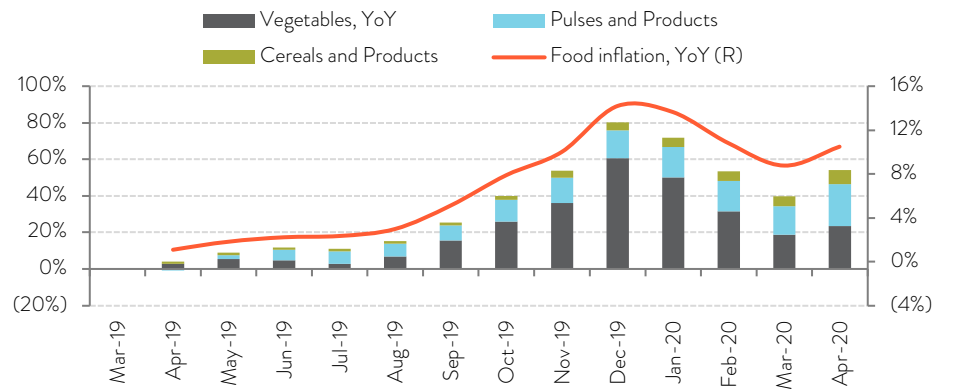


FIG 1 – FOOD INFLATION ROSE TO 10.5% VS 8.8% IN MAR'20



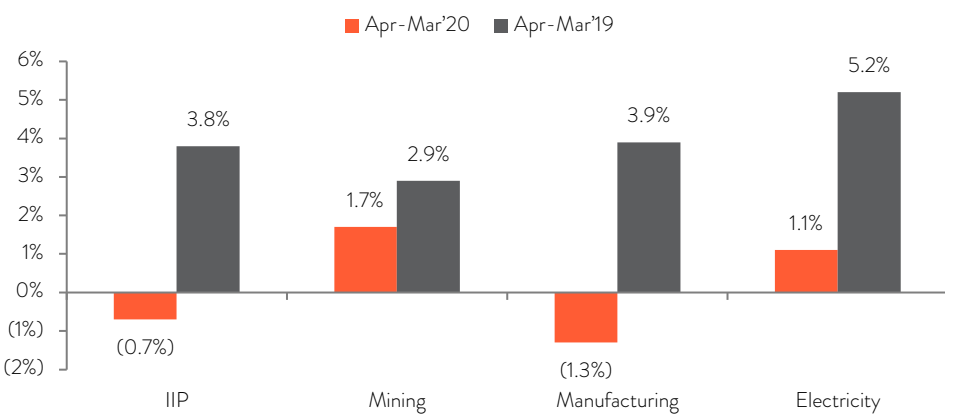
Source: CEIC, Bank of Baroda Research

FIG 2 – ...INCREASE IS BROAD BASED



Source: CEIC, Bank of Baroda Research

FIG 3 – IIP SLUMPS IN FY20



Source: CEIC, Bank of Baroda Research

FIG 4 – IIP GROWTH CONTRACTS IN MAR'20

Sectoral (%)	Weight	Mar-20	Feb-20	Mar-19	Apr-Mar'20	Apr-Mar'19
IIP	100.0	(16.7)	4.6	2.7	(0.7)	3.8
Mining	14.4	0.0	9.7	0.8	1.7	2.9
Manufacturing	77.6	(20.6)	3.1	3.1	(1.3)	3.9
Electricity	8.0	(6.8)	11.5	2.2	1.1	5.2
Use-Based						
Primary Goods	34.1	(3.1)	8.3	2.6	0.8	3.5
Capital Goods	8.2	(35.6)	(9.5)	(9.1)	(13.7)	2.7
Intermediate Goods	17.2	(18.5)	19.4	12.4	8.8	0.9
Infrastructure and Construction Goods	12.3	(23.8)	(0.1)	5.1	(4.0)	7.3
Consumer Durables Goods	12.8	(33.1)	(5.8)	(3.2)	(8.4)	5.5
Consumer Non-Durables Goods	15.3	(16.2)	1.5	1.4	0.5	4.0

Source: CEIC, Bank of Baroda Research

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