

INFLATION AND IIP

12 October 2020

Inflation remains uncomfortably high, IIP improves

India's industrial recovery continued with a decline of 8% in Aug'20 as against 10.8%. Most indicators suggest significant improvement in Sep'20. Inflation has increased further to 7.3% in Sep'20 led by food inflation at 10.7%. Within food as many as 6 items reported double digit increase. Core inflation also remains entrenched at 5.7% due to transport (retail fuel) and personal effects (gold). While inflation is expected to moderate, it will remain above RBI's target. RBI will focus on accommodative liquidity to propel growth.

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IIP in recovery mode: Industrial output contracted at a slightly slower pace of 8% in Aug'20 compared with a decline of 10.8% in Jul'20. Mining and manufacturing output recovered. Electricity output too declined by only 1.8% in Aug'20. Within manufacturing, intermediate (decline of 6.8% in Aug'20 from 11.7% in Jul'20), infrastructure (decline of 2.3% in Aug'20) and consumer durable goods (contracted by 10.3% in Aug'20) saw maximum improvement. Data released for Sep'20 is even more encouraging with positive momentum seen in electricity output, exports, fuel demand and manufacturing PMI.

CPI rises, driven by food: After noting a slight dip in Aug'20, CPI inflation edged up in Sep'20 to 7.3%, an 8-month high. Food inflation rose sharply from 9.1% in Aug'20 to 10.7% in Sep'20 led by vegetables (20.7% in Sep'20 versus 11.5% in Aug'20), eggs (15.5% versus 10.1%) and meat and fish (17.6% versus 16.5% in Aug'20). Prices of 10 out of total 12 items under CFPI increased by more than 4%, with 6 items registering double digit increase. Inflation in protein based items may not moderate so easily. However some moderation was visible in cereal prices at 4.7% versus 5.9% in Aug'20.

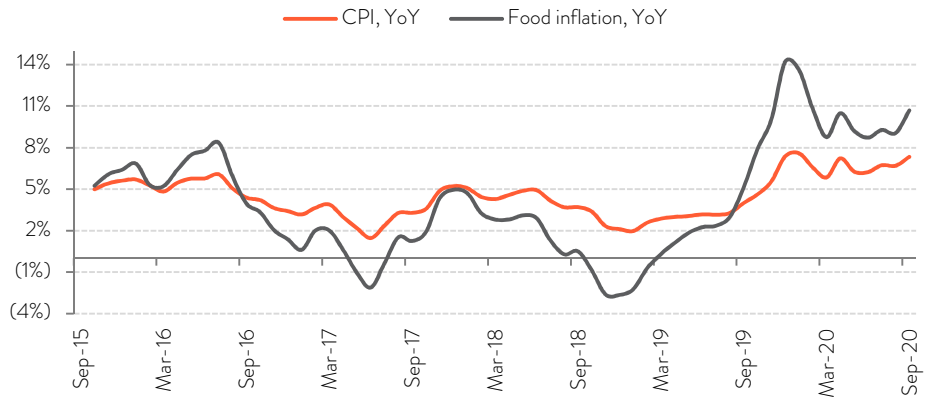
Core inflation moderates: Core inflation moderated by 10bps to 5.7% in Sep'20 from 5.8% in Aug'20. This was driven by lower inflation in the personal care items (12.3% in Sep'20 from 14.5% in Jul'20). Notably gold prices fell by 2.4% in Sep'20 on a MoM basis. Housing and recreation reported a decline as well. On the other hand, inflation in transport and communication (11.5% in Sep'20 versus 11% in Aug'20) and education (2.2% in Sep'20 versus 1.7%) edged up. A weak demand side is reflected in moderation in most categories of core inflation apart from transport and personal effects (supply side). We expect inflation at 5.1% and 4.4% in Q3 and Q4FY21 (avg.) thus ruling out any further rate cuts. However, liquidity conditions will remain accommodative to support growth.

KEY HIGHLIGHTS

- CPI inflation rises to 7.3% in Sep'20 from 6.7% in Aug'20 led by food inflation.
- Core inflation edged down by 10bps to 5.7% in Sep'20.
- IIP growth contracted at a slower pace of 8% versus a dip of 10.8% in Jul'20.

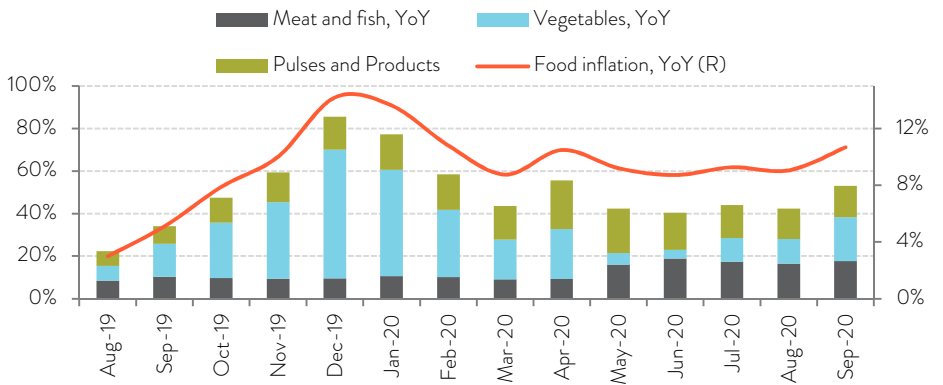


FIG 1 – CPI INFLATION RISES TO AN 8-MONTH HIGH DRIVEN BY FOOD



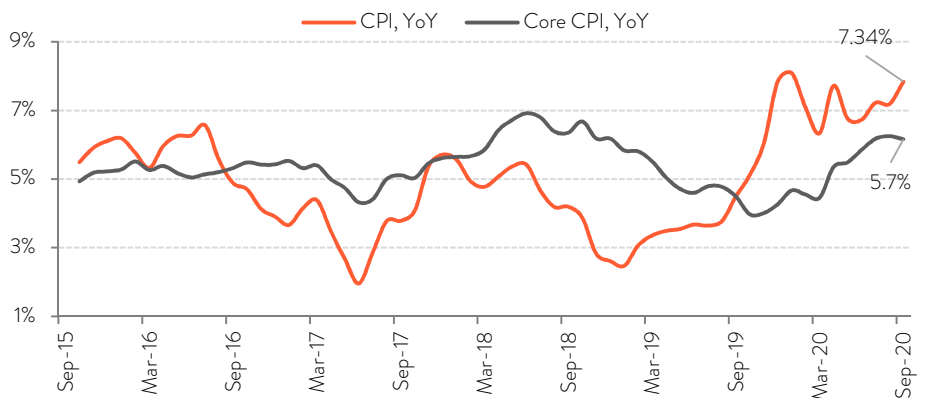
Source: CEIC, Bank of Baroda Research

FIG 2 – VEGETABLE PRICES LED THE INCREASE

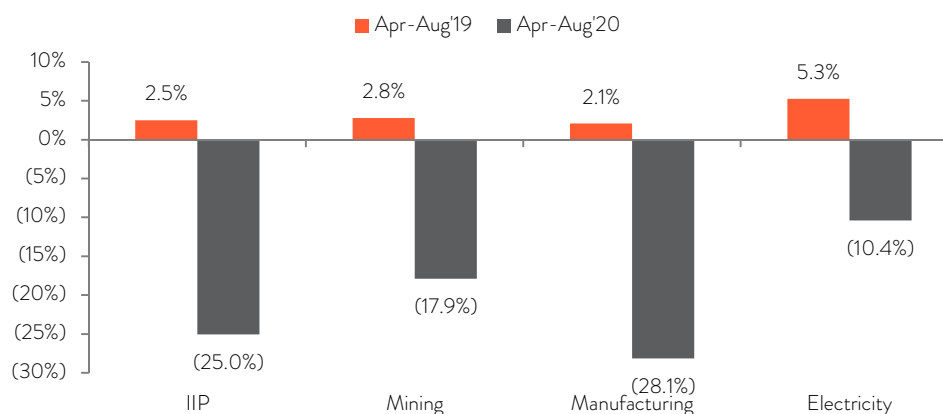


Source: CEIC, Bank of Baroda Research

FIG 3 – CORE EDGED DOWN



Source: CEIC, Bank of Baroda Research

FIG 4 – BROAD BASED SLOWDOWN IN IIP ON FYTD BASIS

Source: CEIC, Bank of Baroda Research

FIG 5 – IIP GROWTH RECOVERS IN AUG'20

Sectoral (%)	Weight	Aug-20	Jul-20	Aug-19	Apr-Aug'20	Apr-Aug'19
IIP	100.0	(8.0)	(10.8)	(1.4)	(25.0)	2.4
Mining	14.4	(9.8)	(12.8)	0	(18.2)	2.8
Manufacturing	77.6	(8.6)	(11.6)	(1.7)	(27.9)	2.0
Electricity	8.0	(1.8)	(2.5)	(0.9)	(10.4)	5.2
Use-Based						
Primary Goods	34.1	(11.1)	(10.8)	1.0	(16.5)	2.5
Capital Goods	8.2	(15.4)	(22.8)	(20.9)	(47.8)	(7.9)
Intermediate Goods	17.2	(6.8)	(11.7)	7.3	(28.3)	10.1
Infrastructure and Construction Goods	12.3	(2.3)	(8.6)	(5.7)	(30.8)	(0.4)
Consumer Durables Goods	12.8	(10.3)	(23.0)	(9.7)	(47.2)	(4.1)
Consumer Non-Durables Goods	15.3	(3.3)	1.8	3.1	(9.0)	6.5

Source: CEIC, Bank of Baroda Research

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