12 October 2022

Jahnavi, Sonal and Aditi
Economists

A double whammy for the economy

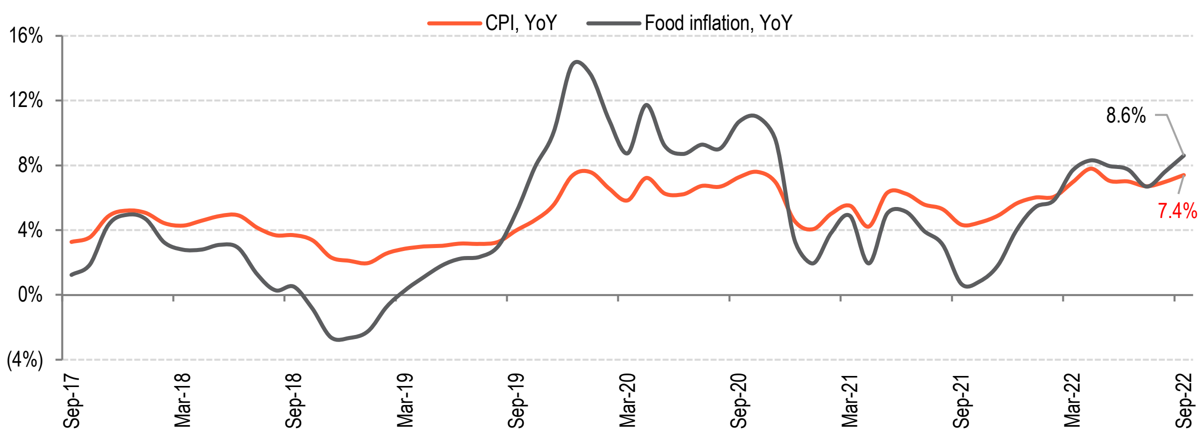
Headline CPI rose to 7.4% in Sep'22 from 7% in Aug'22, led by food and core inflation. Food inflation accelerated further to 8.6% in Sep'22 from 7.6% in Aug'22, led by cereals, pulses and vegetables. Core inflation too quickened to 6.1% from 5.8% in Aug'22, due to recovery in demand. This is unlikely to cool down anytime soon as high frequency indicators are also showing traction. In addition, with unseasonal rains in Oct'22 hitting major crop producing states, we see further upside risks to food inflation and thus expect headline inflation to range between 6.75-7% in the next two months. We also expect RBI to continue hiking rates till repo rate reaches 6.5%. Additionally, in a setback to growth, IIP contracted by (-) 0.8% in Aug'22 following 2.2% increase in Jul'22. Broad-based slowdown was visible, with manufacturing output declining by (-) 0.7%. Drawdown of inventory could be one of the reasons. Going ahead, with prevailing tight global monetary conditions, geo-political tension, rebound in oil prices, and impending global growth slowdown, risks to domestic recovery remain.

CPI inflation quickens to a 5-month high

CPI inflation inched up:

CPI for Sep'22 came in at 7.4%, slightly higher than our estimate of 7.3%, and up from 7% in Aug'22. With this, CPI has averaged 7% in Q2FY23, marginally lower than RBI's estimate of 7.1%. Food inflation continues to remain elevated and was up by 8.6% in Sep'22 versus 7.6% in Aug'22. Out of 12 food and beverage items of inflation, 9 have shown a pickup in prices. Amongst them, vegetable inflation rose by 18.1% from 13.3% in Aug'22, cereals and products rose by 11.5% from 9.6%, pulses were up by 3% versus 2.6%, and milk and milk products rose by 7.1% from 6.4%. Prices of eggs fell less sharply in Sep'22, than in the previous month. Commodities where inflation was seen moderating included: oils & fats, fruits, and non-alcoholic beverages. Going forward, impact of unseasonal rains in Oct'22 on sowing and harvest, and trajectory of oil prices will have to be closely watched. RBI expects inflation to average at 6.4%, however we believe significant upside risks to this persist

Figure 1: CPI rose to 7%, aided by food inflation

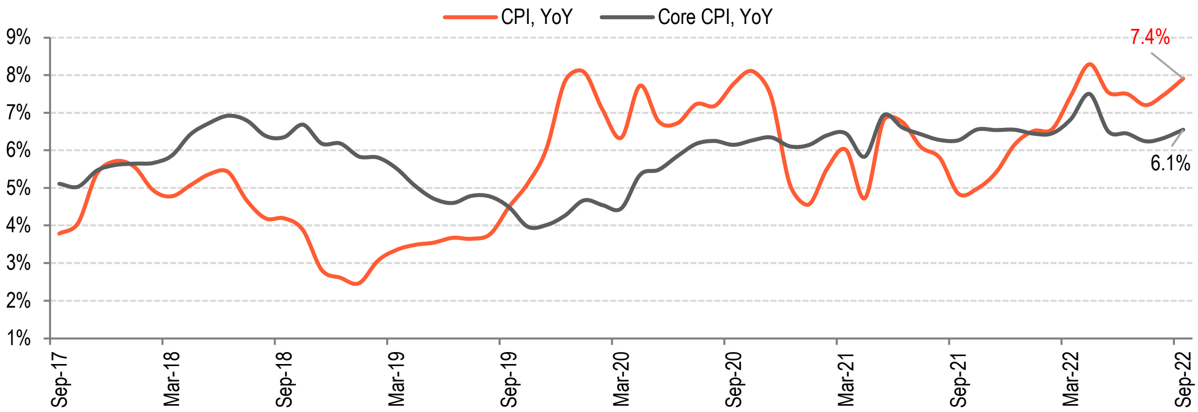


Source: CEIC, Bank of Baroda Research

Core inflation picks up:

Core CPI (excl. food and fuel) edged up to 6.1% in Sep'22 from 5.8% in Aug'22 as well. Even RBI's preferred measure of core CPI (core excl. pan, tobacco and intoxicants) rose to 6.3% in Sep'22 compared with 6.1% in Aug'22. Barring amusement and recreation and personal care and effects, all other components of core inflation showed acceleration. Maximum traction was seen in housing (7.7% in Sep'22 from 7.5% in Aug'22) and clothing and footwear (10.2% versus 9.9% in Aug'22) inflation. Lower gold prices contributed to a decline in inflation in the personal care and items to 6.8% compared with 7% in Aug'22. Pickup in demand due to improved economic activity and festive season has contributed to higher inflation in Sep'22.

Figure 2: Core CPI inches up



Source: CEIC, Bank of Baroda Research

Inflationary pressures remain:

CPI reading for Sep'22 highlights the inherent risks in the inflation basket. Food prices have grown at an average pace of 7.8% in H1FY23, compared with 3.3% in H1FY22. Lower kharif output of several crops such as rice, pulses and oilseeds are likely to feed into prices. Furthermore, the recent unseasonal rainfall in several parts of the country has also raised concerns over its impact on food prices. Hence, food inflation is likely to remain elevated in the near-term. Even for core CPI, recent demand indicators have shown resilience and with the upcoming festive season, consumption may see a further upward momentum. As a result, even core inflation is likely to continue remain stick at current levels. So far, RBI has raised repo rate by a cumulative 140bps in the current cycle. However, with inflationary pressure showing no signs of abating, we expect RBI to hike rates further. We see the end-period repo rate at 6.5%. This should help to anchor inflation expectations going forward. We do see upside risks to our FY23 CPI forecast of 6.5% (H1FY23 at 7.2%).

Industrial production falls

IIP growth slips:

As against our expectations (3.5%), industrial output contracted for the first time in over 18 months to 0.8% in Aug'22 from 2.2% in Jul'22. This was led by broad based slowdown, with both manufacturing and mining output declining by 0.7% (+3.0% in Jul'22) and 3.9% (-3.3% in Jul'22) respectively in Aug'22.

Electricity output decelerated (7-month low) further to 1.4% in Aug'22 compared with 2.3% in Aug'22. Within manufacturing, output contracted the most in case of wearing apparel (-18.3% in Aug'22 versus 15.2% in Jun'22), pharma (-19% versus -4.8%) and electrical equipment (-28.2% versus -15.5%). Output of printing, chemicals and basic metals also moderated in Aug'22 from the previous month. However, compared with the levels seen in 2019 (pre-pandemic period), IIP growth was up by 4% in Aug'22 versus 2% in Jul'22.

Broad based disappointment:

Within use-based too, broad based moderation was noticed across all sectors. Output of consumer non-durables contracted sharply to more than 2-year low in Aug'22 (9.9%) compared with contraction of 2.8% in Jul'22. Consumer durable output also declined and slipped down (-2.5%) against an increase of 2.3% in Jul'22. Furthermore, sharp moderation was registered under intermediate (0.6% versus 3.8%) and infra goods (1.7% versus 3.8%). Production of primary goods (1.7% versus 2.5%) and intermediate goods (5% versus 5.7%) also registered slower growth.

Headwinds to recovery:

Second half of FY23 is expected to provide significant support to growth on the back of favourable base. Production is also likely to be buoyant on the back of the festive demand. International agencies such as IMF have warned of global recession in some countries this year, thought it noted that compared to other countries 'India has been doing fairly well and is expected to grow robustly next year'. However, tight global monetary conditions, price pressures, and Ukraine-Russia conflict might derail the recovery.

Table 1: IIP growth contracts by 0.8%

Sectoral (%)	Weight	Aug-22	Jul-22	Aug-21	Apr-Aug'22	Apr-Aug'21
IIP	100.0	(0.8)	2.2	13.0	7.7	29.0
Mining	14.4	(3.9)	(3.3)	23.3	4.2	25.0
Manufacturing	77.6	(0.7)	3.0	11.1	7.9	31.6
Electricity	8.0	1.4	2.3	16.0	10.6	15.4
Use-Based						
Primary Goods	34.1	1.7	2.5	16.9	9.1	18.2
Capital Goods	8.2	5.0	5.7	20.0	18.7	60.3
Intermediate Goods	17.2	0.6	3.8	11.8	7.6	40.4
Infrastructure and Construction Goods	12.3	1.7	3.8	13.5	7.2	45.8
Consumer Durables Goods	12.8	(2.5)	2.3	11.1	14.5	55.0
Consumer Non-Durables Goods	15.3	(9.9)	(2.8)	5.9	(1.9)	10.3

Source: CEIC, Bank of Baroda Research

Disclaimer

Visit us at www.bankofbaroda.com

For further details about this publication, please contact:

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