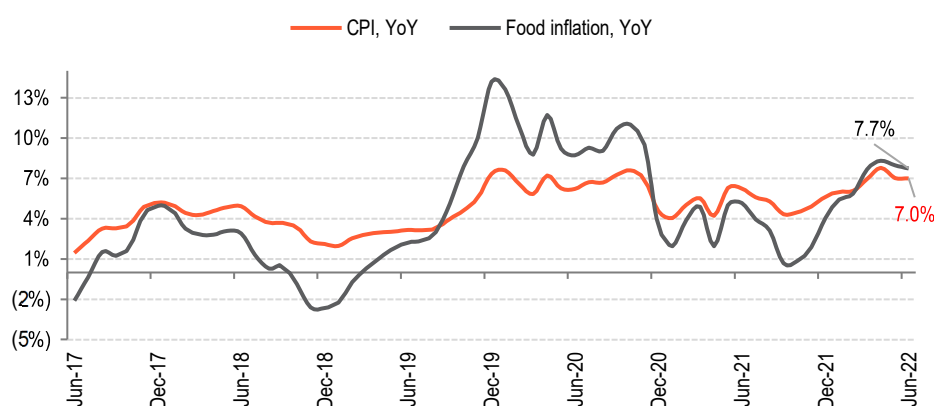


CPI sticky, IIP inched up

Headline CPI remained sticky at 7% in Jun'22 and ending Q1FY23 at 7.3% against RBI's estimate of 7.3%. IIP on the other hand rose sharply to 19.6% supported by favourable base. Sequentially as well industrial production improved and remained broad based reflecting capacity utilization of firms are picking up. On inflation front, some respite is seen on MoM basis as well as in seasonally adjusted data. But the big question is whether this momentum would sustain or not. The current print got comfort from government measures in terms of excise duty cut and edible oil prices. But still considerable upside risks to inflation cannot be ruled out considering services are still running at full capacity, pass through of prices by firms and price stickiness. Thus we maintain our estimate of 6.5% for headline CPI in FY23 and 4.4% for IIP. RBI is expected to continue with its rate action of another 50-75bps in the current cycle on account of catch up effect and price stability.

CPI inflation sticky at 7%: Against our estimate of 6.8% and compared to market consensus of 7.1%, headline CPI print for Jun'22 came in at 7% same seen in May'22, on YoY basis. For Q1FY23, the print stands at 7.3% against RBI's forecast of 7.5%. Food inflation moderated slightly to 7.7% from 8% in May'22. However, inflation rose for major components forming 55% of the overall food basket. These include: cereals whose inflation rose to 5.7% compared to 5.3%, meat and fish (8.6% from 8.2%), milk and products (6.1% from 5.6%), fruits (3.1% from 2.3%) and spices (11% from 9.9%). However, outlook for food inflation in the coming months might get some comfort from government measures to control edible oil prices, normal monsoon (till 7% above LPA) and some downside risks to demand from rising interest rate cycle.

Fig: 1 CPI still at 7%, food shows moderation

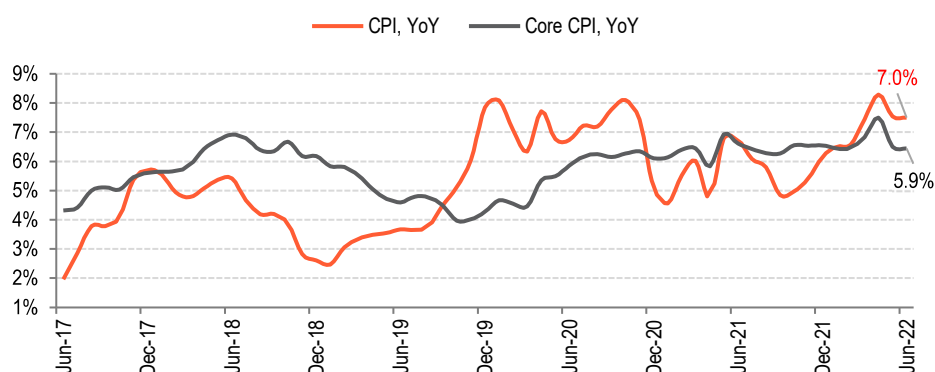


Source: CEIC, Bank of Baroda Research

Core inflation moderated slightly: Core inflation edged down by 10bps to 5.9% in Jun'22 from 6% in May'22, on YoY basis. The major drag down was on account of transport and communication inflation (6.9% from 9.5% in May'22), on account of cut in excise duty on petrol (Rs 8/ltr) and diesel (Rs 6/ltr). However, demand side pressure was clearly visible. Inflation in the Clothing and footwear segment inched up to 9.5% in Jun'22 from 8.9% in May'22. Even housing inflation rose to 3.9% from 3.7%. For household goods and services as well, the uptick was visible (7.5% from 6.8%), recreation and amusement rose to 7% from 6%, education to 4.5% from 4.2%. Despite slight moderation of gold

prices in Jun'22, personal goods and services component inched up to 6.7% from 6.2%. **Overall, 79.2% of the overall core basket registered an increase in inflation on YoY basis.**

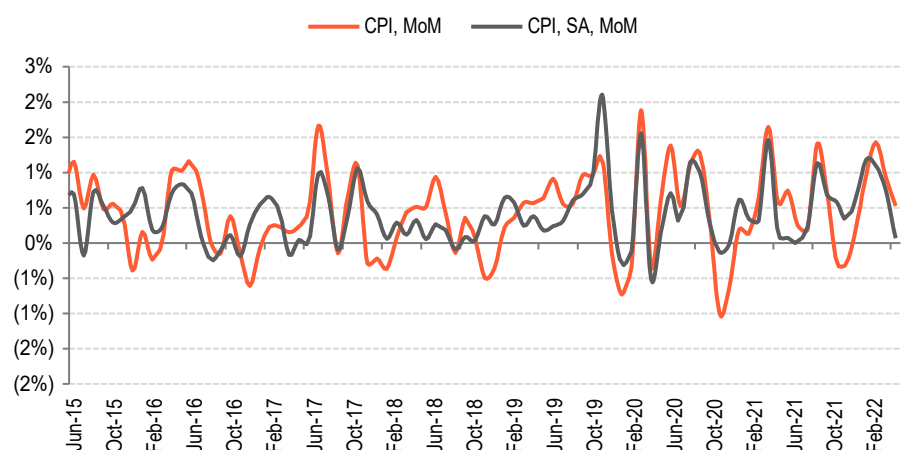
Fig: 2 Core at 5.9%



Source: CEIC, Bank of Baroda Research

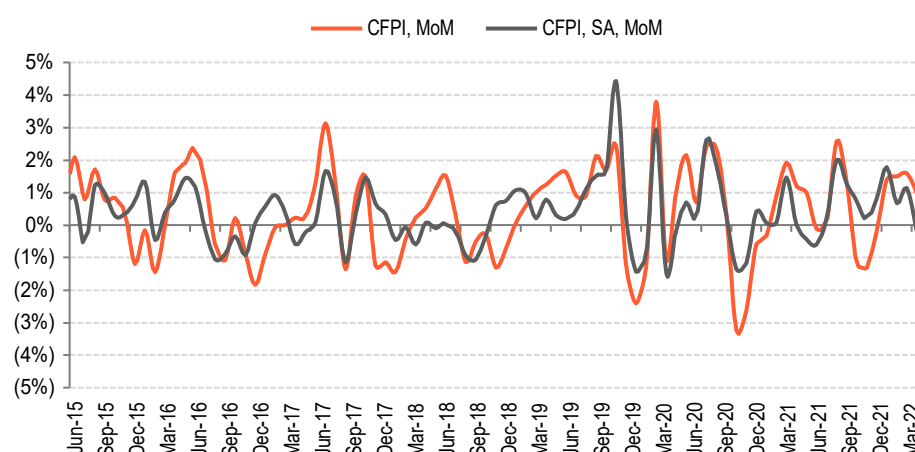
On sequential basis, moderation is visible: On MoM basis, CPI edged down to 0.5% from 0.9% in May'22. Even food inflation inched down to 1% from 1.6%. Within food apart from eggs (5.2% from -1.3%) and fruits (-0.8% against -0.9%), all items noted some moderation. Notably, the degree of moderation for oils and fats on a MoM basis was the sharpest (-0.7% from 1.5%). Core inflation remained flat against 0.5% increase in May'22. Within core, as expected transport and communication, fell the sharpest to -1.2% from 0.2%. On seasonally adjusted basis as well, CPI and food inflation moderated to 0.1% and -0.2% respectively in Jun'22 from 0.8% and 1.1% in May'22.

Fig 3: On Seasonally adjusted basis, moderation is seen in Jun'22 for the CPI series...



Source: CEIC, Bank of Baroda Research

Fig 4: ...Even for food inflation



Source: CEIC, Bank of Baroda Research

Inflation still a concern: The current month's print gets some respite from government's reduction of excise duty on petrol and diesel. There has also been sequential drop in major items of food inflation on account of declining commodity prices across the board. The question is whether it would sustain? Prices are generally sticky in nature and till now the pass through of higher wholesale into CPI inflation is yet to be translated. Further, domestic fuel prices doesn't have the scope to be reduced further as OMCs might look at their margins before doing so. Services are still running at full capacity as seen in the marked improvement of the latest PMI services data. We expect inflation to still be heated at around 6.5% in FY23.

Industrial Production

IIP growth inched up: Industrial output rose to highest since May'21 to 19.6% in May'22 against our estimate of 14.5% and consensus of 20.8%. This led by sharp improvement in manufacturing sector output which rose by 20.6% from 5.8%, on YoY basis. Within manufacturing, beverages (128% versus 28% in Apr'22), leather and leather products (48.9% from 5%), wood and wood products (56% from 9.2%), electrical equipment (59.6% from 8.5%), motor vehicles etc. (88.7% from 6.5%) and other transport equipment (128.5% from 0.4%), noted considerable jump. Even electricity output rose by 23.5% from 11.8%. Mining rose by 10.9% from 8%. A favourable base did uplift the overall print.

Capital goods production improved: Within use-based, capital goods production rose to 54% from 13.3%. Even consumer durables segment noted considerable jump of 58.5% from 7.4%. Primary goods output rose by 17.7% from 10.1%.

Sequential momentum: Even on MoM, basis, IIP rose by 2.3% from -9.5% in Apr'22, showing broad based improvement, with mining rising by 3.4% from -19.5%, manufacturing by 2.1% from -9.3% and electricity by 2.8% from 1.8%.

Recovery may face challenge: The economy appears to be on solid footing on the back of the pickup in economic activity and reflected by high frequency indicators including GST collections, air passenger traffic and port cargo. However, the recovery is laden with challenges on the back of concerns surrounding stickiness of inflation, impact of the ongoing Russia-Ukraine conflict on energy prices and concerns over global economic slowdown.

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