

INFLATION AND IIP

12 August 2021

Industrial activity slows, inflation eases

India's IIP eased to 13.6% in Jun'21 led by base effect. Notably, over a 2-year horizon, output is down by 5.2% led by capital goods and durables. FMCG has expanded. CPI inflation has cooled off to 5.6% in Jul'21 (6.3% in Jun'21) led by food inflation at 4% (110bps MoM decline). Core too softened to 6% (6.2% in Jun'21). We expect inflation at 5.5% and growth to pick up to 9.7% in FY22. This should give RBI room to normalize policy in Q4FY22 by changing its liquidity stance and raising reverse repo rate.

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IIP growth eases: Industrial output moderated to 13.6% in Jun'21 from 29.3% in May'21. Base effect explains this. Consumer durables, capital and intermediate goods seem to be driving growth. It is more useful to look at growth from a 2-year horizon. On that count, Industrial output is 5.2% lower (-14.3% in May'21) led by 6.2% decline in manufacturing and 2.6% dip in electricity output. Capital goods (-21% over Jun'19) and consumer durables (-15% over Jun'19) have declined the most—pandemic impact. Infra, primary goods and intermediate goods have contracted only marginally. Only FMCG (essential goods) output has expanded.

Food inflation cools down: CPI inflation moderated significantly to 5.6% in Jul'21 from 6.3% in Jun'21 led by decline in food inflation to 4% from 5.1%. Within food, vegetable prices fell by 7.7% (-0.7% in Jun'21), while that of fruits rose by 8.9% as against 11.8% in Jun'21 and that of pulses increased by 9% as against 10% in Jun'21. Oils and fats too decelerated to 32.5% from 34.8%. Perhaps reduction in custom duty on edible oils worked. Inflation in egg, meat and fish and milk products accelerated. Perishables are likely to pull down food inflation in the coming months on the back of a high base (vegetables inflation was 12.7% in H1FY21).

Core inflation eases further: Core inflation softened to 6.0% in Jul'21 from 6.2% in Jun'21. What eased? Transport and communication at 10.5% (11.6% in Jun'21), education at 3% (3.4% in Jun'21), personal care and effects at 3.8% (4.7% in Jun'21) and household goods and services at 4.9% (5.7% in Jun'21). Health care inflation remained elevated and recreation and amusement too inched up as restrictions are relaxed. Cost push inflation is likely to be visible in coming months as full pass-through of higher commodity prices is yet to happen. While global commodity prices have eased a little in the last few weeks on the back of rising Covid-19 cases, a rebound when cases decline cannot be ruled out.

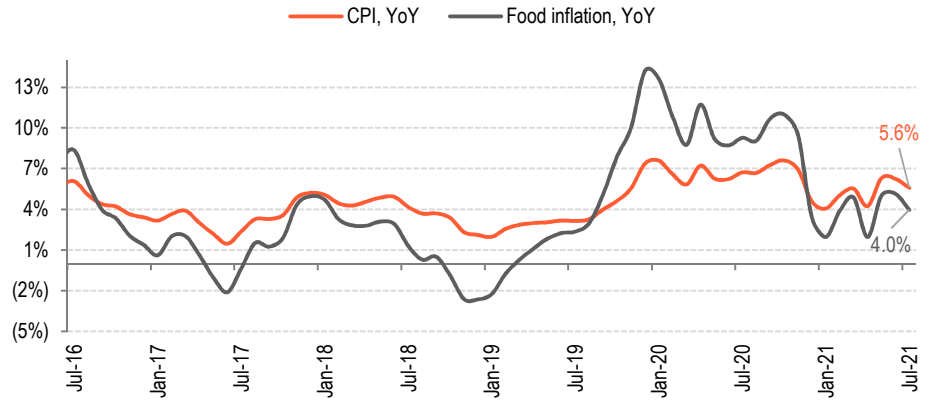
We expect retail inflation at 5.5% in FY22 led by core inflation at 6.1%. Monsoon is improving and bodes well for food inflation. Growth outlook is also improving. This should give RBI room to normalize monetary policy in Q4FY22 by reducing wedge between reverse repo and repo rate and changing its liquidity stance.

Key highlights

- CPI inflation edged down to 5.6% in Jul'21 from 6.3% in Jun'21.
- Food inflation fell to 4%. Core inflation moderated to 6%.
- IIP moderates to 13.6% from 29.3% in May'21. It has fallen by 5.2% over a 2-year horizon.

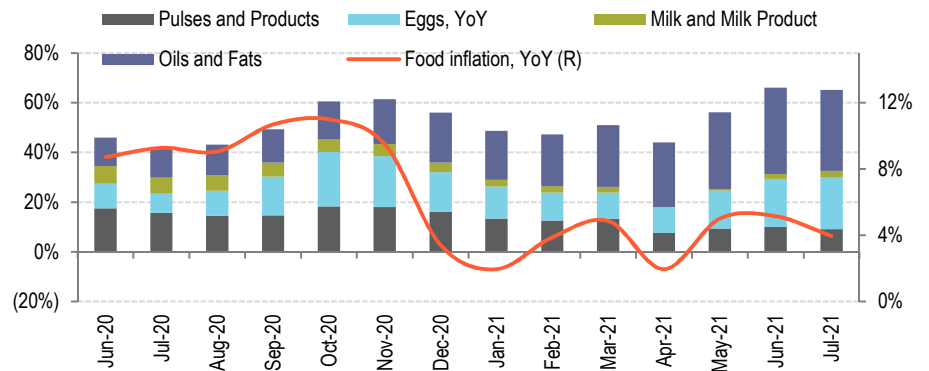


Fig 1 – CPI moderated significantly



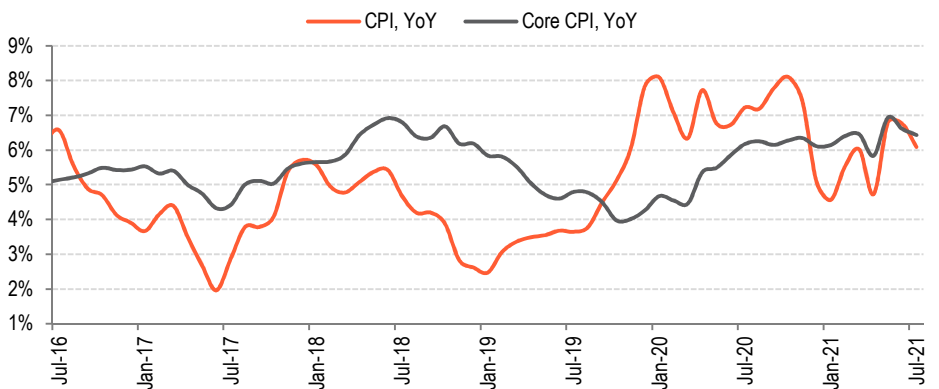
Source: CEIC, Bank of Baroda Research

Fig 2 – ...Led by vegetables, pulses, and oils and fats



Source: CEIC, Bank of Baroda Research

Fig 3 – Core inflation moderates



Source: CEIC, Bank of Baroda Research

Fig 4 – IIP growth eases in Jun'21

Sectoral (%)	Weight	Jun-21	Jun-20	Apr-Jun'22	Apr-Jun'21
IIP	100.0	13.6	(16.6)	45.0	(35.6)
Mining	14.4	23.1	(19.5)	27.4	(22.3)
Manufacturing	77.6	13.0	(17.0)	53.7	(40.2)
Electricity	8.0	8.3	(10.0)	16.8	(15.8)
Use-Based					
Primary Goods	34.1	12.0	(14.5)	20.7	(20.2)
Capital Goods	8.2	25.7	(37.4)	110.2	(64.8)
Intermediate Goods	17.2	22.6	(20.7)	69.7	(40.8)
Infrastructure and Construction Goods	12.3	19.1	(18.3)	82.0	(46.9)
Consumer Durables Goods	12.8	30.1	(34.8)	132.6	(67.6)
Consumer Non-Durables Goods	15.3	(4.5)	6.9	18.1	(16.9)

Source: CEIC, Bank of Baroda Research

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