

INFLATION AND IIP

12 July 2021

Industrial activity slows, inflation eases

India's industrial output slowed down to 29.3% in May'21, led by manufacturing and electricity. Over a 2-year horizon, it has contracted by 13.9% led by capital goods and durables. CPI inflation for Jun'21 eased to 6.26% in Jun'21 with core inflation moderating to 6.2% from 6.5% in May'21. However, food inflation increased to 5.1%, up by 10bps MoM. The supply side pressure on core is likely to continue. Food inflation is expected to be soft, but below normal monsoon is a risk.

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IIP growth eases: Industrial output increased by 29.3% in May'21 from 134.4% in Apr'21. Over a 2-year horizon, IIP has fallen by 13.9% led by 16.4% decline in manufacturing and 8.5% dip in electricity output. This is in sharp contrast to Apr'21 when over a 2-year horizon, IIP was resilient. The decline in production in May'21 is attributable to restrictions imposed in the wake of the second wave. The decline in industrial activity over a 2-year horizon is driven by capital goods (-37% over May'19) and consumer durables (-41% over May'19). This is in sharp contrast to non-oil-non-gold imports which increased by 11.3% over a 2-year horizon in Jun'21 thus indicating a pick-up in domestic demand.

Food inflation inches up slightly: CPI inflation moderated slightly to 6.26% in Jun'21 from 6.3% in May'21. However, food inflation edged up to 5.1% from 5% led by eggs (19.4% from 15.2%), milk (1.9% from 0.6%), oils and fats (34.8% from 30.9%), vegetables (-0.7% from -1.9%) and pulses (10% from 9.4%). On the other hand, cereals (-1.9% from -1.4%) and meat and fish (4.8% from 9.1%) moderated. While government has reduced custom duty on edible oils, the lull in monsoon rain is a cause of worry which may push food prices higher.

Core inflation falls: Core inflation softened to 6.2% in Jun'21 from 6.5% in May'21. This was led by housing (3.7% from 3.9%), health (7.7% from 8.4%), transport and communication (11.6% from 12.4%), recreation and amusement (5% from 6.1%) and personal care and effects (4.8% from 7.4%). A part of the decline is also attributable to base effect as last year, core inflation increased by 40bps MoM. Even so, the cost push in core inflation is likely to continue with pass-through of international crude prices being visible in domestic prices. Higher domestic retail oil prices imply increase in logistics costs as well. In addition, domestic manufacturing firms are yet to accomplish complete pass-through of higher raw material costs.

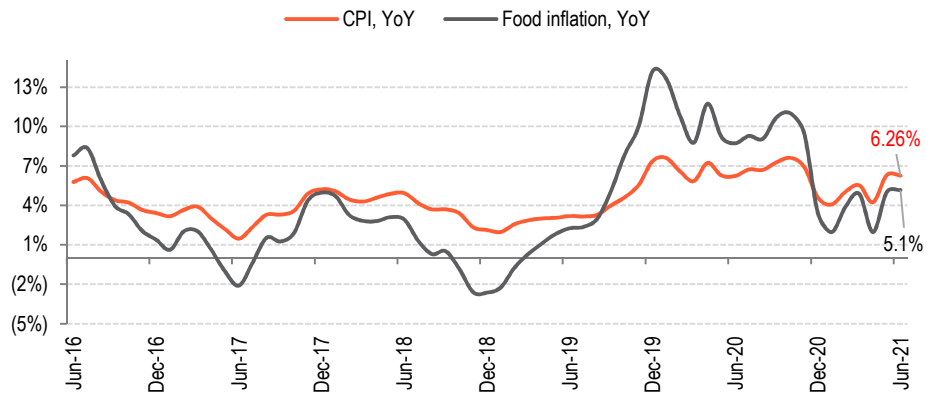
We continue to expect retail inflation at 5.5% in FY22 led by higher core inflation at 6.1%. Monsoon is now below normal and poses an upward risk to our inflation estimate. We expect RBI to normalize monetary policy in Q4FY22 by reducing wedge between reverse repo and repo rate and changing its liquidity stance.

Key highlights

- CPI inflation edged down to 6.26% in Jun'21 from 6.3% in May'21.
- Food inflation edged up to 5.1%. Core inflation moderated to 6.2%.
- IIP moderates to 29.3% in May'21. It has fallen by 13.9% over a 2-year horizon.

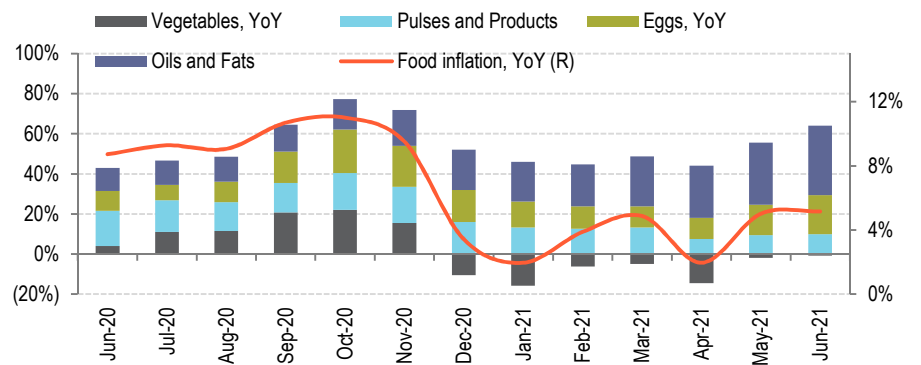


Fig 1 – CPI edged down slightly, however food inflation inched up



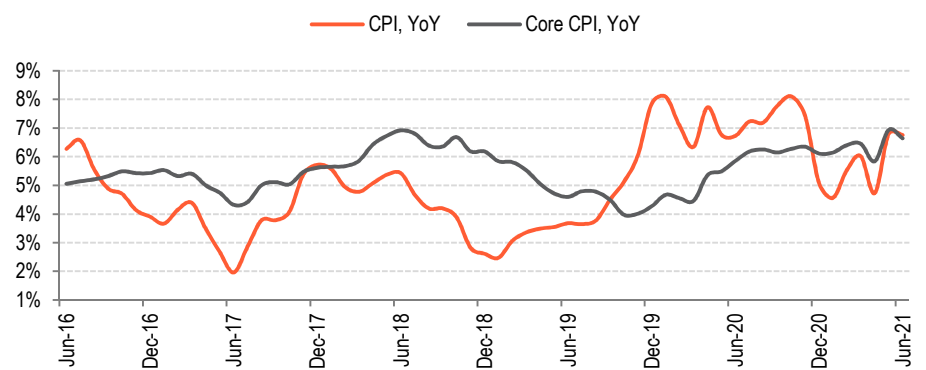
Source: CEIC, Bank of Baroda Research

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



Source: CEIC, Bank of Baroda Research

Fig 3 – Core inflation moderates



Source: CEIC, Bank of Baroda Research

Fig 1 – IIP growth slows in May'21

Sectoral (%)	Weight	May-21	May-20	Apr-May'22	Apr-May'21
IIP	100.0	29.3	(33.4)	68.8	(45)
Mining	14.4	23.3	(20.4)	29.4	(23.7)
Manufacturing	77.6	34.5	(37.8)	88.8	(51.7)
Electricity	8.0	7.5	(14.9)	21.7	(18.7)
Use-Based					
Primary Goods	34.1	15.8	(19.6)	25.6	(23.0)
Capital Goods	8.2	85.3	(65.9)	243.4	(78.8)
Intermediate Goods	17.2	55.2	(39.7)	109.7	(51.1)
Infrastructure and Construction Goods	12.3	46.8	(39.0)	149.3	(61.1)
Consumer Durables Goods	12.8	98.2	(70.3)	315	(82.7)
Consumer Non-Durables Goods	15.3	0.8	(9.7)	33.8	(28.2)

Source: CEIC, Bank of Baroda Research

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