NSE

Macro Review

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CPI inflation moderates on lower vegetable prices; pick-up in IIP misleading

India's retail inflation (CPI) moderated for the second consecutive month to a four-month low of 5.9% in March, in-line with market expectations (Refinitiv Datastream poll: 5.9%). This was largely on the back of a decline in food inflation, particularly for vegetables, egg, meat & fish, and partly offset by a pick-up in fuel inflation due to higher LPG (hike in non-subsidised LPG cylinder prices in Feb'20) and non-subsidised kerosene prices. Core inflation (excluding food and fuel), however, remained steady at 4%, as the demand environment remained weak.

Industrial production improved to a seven-month-high growth figure of 4.5% in February, beating the Consensus estimate of 3.2%, albeit off a low base, and probably reflects higher number of days in February as compared to last year. While mining production grew at a three-year high of 10%, manufacturing and electricity also reported a decent 3.2% and 8.1% YoY growth respectively.

Even as the future outlook remains highly uncertain at the moment, inflation is expected to come off meaningfully over the coming months. This is likely to be led by further weakening of domestic demand, thereby keeping core inflation in check and lower crude oil prices, partly offset by higher food inflation owing to temporary supply disruptions. Moreover, industrial production is expected to contract significantly in March/April due to the nation-wide lock-down and a sharp decline in global demand owing to COVID-19 outbreak. With inflation being no longer a concern (RBI expects inflation to ease to sub-3% by Q3FY21) and growth expected to fall to unprecedented low levels, we expect the RBI to cut rates further this fiscal, by at least another 50-75bps, *ceteris paribus*, and continue injecting liquidity in the system. A second round of fiscal measures is also expected, given the significant strain across multiple sectors of the economy.

- **Retail inflation moderates further in March on lower vegetable prices:** Retail inflation (CPI) moderated to a four-month low of 5.9% in March, in-line with the Consensus estimate. The moderation was largely on account of a further decline in vegetable inflation (decline in food inflation, led by some price normalisation of vegetables (+18.6% vs. 31.6% in the previous month) as supplies further improved following a temporary disruption due to delayed and unseasonal rainfall in Sep/Oct 2019 as well as fall in meat & fish prices (+9.2% vs. 10.2% in Feb). Excluding vegetables and meat & fish, headline inflation actually hardened by 10bps MoM to the highest level in 42 months. This was largely owing to higher fuel & light inflation, which came in at a 16-month high of 6.6% due to higher LPG and kerosene prices, and a sharp pick-up in personal care & effects inflation to more than 7-year high of 8.8%, probably reflecting a meaningful jump in gold prices. The Government hiked non-subsidised LPG cylinder prices by Rs149/cylinder in February 2020 over and above the Rs19/cylinder increase in the previous month. Petrol/diesel prices, however, saw a dip owing to falling crude oil prices amid global demand concerns.

Retail inflation moderated to a four-month low of 5.9% on lower vegetable prices. Ex-vegetables, headline inflation was broadly steady.

RBI expects inflation to ease to sub-3% by Q3FY21 (4.8%/4.4%/2.7%/2.4% in Q1/Q2/Q3/Q4 FY21)

- **Core inflation remains steady reflecting weak domestic demand:** Core inflation (ex-food ex-fuel) has remained steady at 4.1% in March, reflecting weak demand conditions. A meaningful jump in personal care & effects inflation and sustained impact of higher telecom mobile charges due to tariff hikes by telecom companies in Dec'19 during the month was largely offset by lower petrol and diesel prices. Going forward, core inflation is expected to moderate further amid a sharp deterioration in demand environment due to COVID-19.

Core inflation has remained stable, reflecting weak demand conditions.

- **Low base and higher number of days lead to a pick-up in industrial production:** Industrial production growth improved for the second month in a row to a seven-month high of 4.5% YoY in February from 2.1% in the previous month, higher than the Consensus estimate of 3.2%. This improvement, however, has come on the back of a favourable base (0.2% in Feb'19) and higher number of production days in Feb'20 (29) vs. Feb'19 (28). Manufacturing production grew at a seven-month high of 3.2% YoY but off a 0.3% contraction in Feb'19, with declined by 2.1% YoY, marking the third consecutive month of contraction, with 13/23 sectors reporting positive growth (vs. 11 in the previous month) led by basic metals, chemical & chemical products, and other metallic mineral products, partly offset by huge contraction in motor vehicles, trailers & semi-trailers and computer, electronic & optical products for yet another month. While electricity production grew at by eight-month high of 8.1% YoY, growth in mining production at 10% was the highest in over three years.

A pick-up in IIP growth in February has come on the back of a low base and higher number of production days.

The slowdown in investment and consumption was visible in the sustained lacklustre performance of capital goods and consumer durable goods that declined by 9.7% and 6.4% respectively in February, marking the 14th and 9th consecutive month of contraction.

- **Expect further monetary and fiscal measures:** Headline inflation is expected to moderate further over coming months, thanks to a sharp drop in crude oil prices (-52% YTD to US$31/bbl), partly offset by higher food inflation due to supply disruptions caused by COVID-19 outbreak as well as higher telephone mobile charges. Further, the second order impact of COVID-19 contagion in the form of significant disruption in consumption demand is expected to keep core inflation in check. Growth, on the other hand, is expected to deteriorate sharply, with industrial production set to witness a huge contraction in March/April due to nation-wide lockdown and a sharp hit to global demand.

We expect another 50-75bps cut and additional fiscal measures, targeting affected industries and MSMEs.

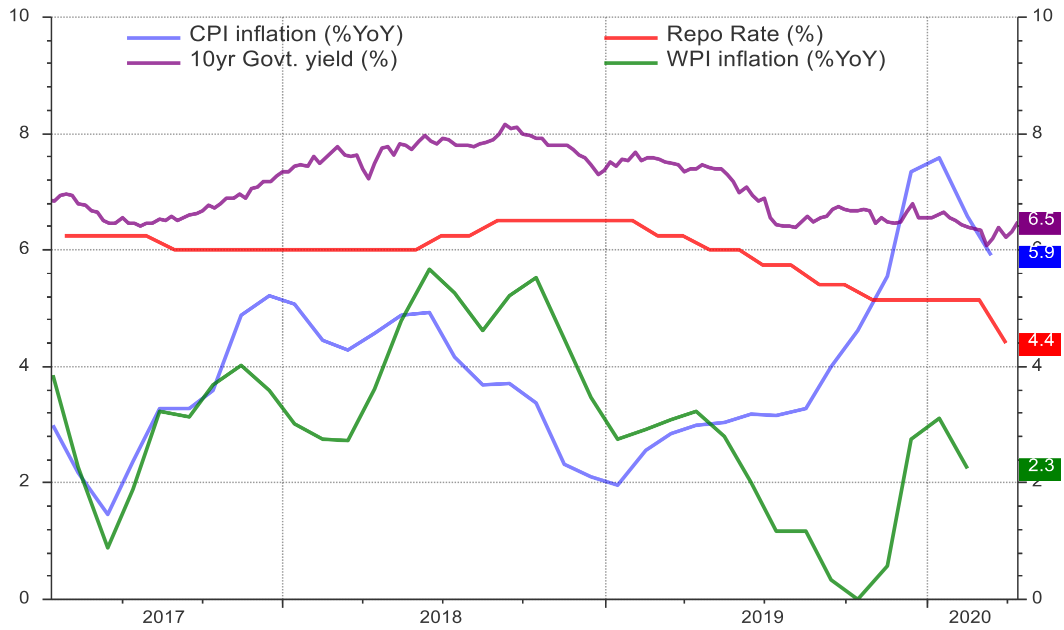
In light of a comfortable inflation trajectory ahead (RBI expects inflation to ease to sub-3% by Q3FY21) and unprecedented shock caused by COVID-19 outbreak on the Indian economy, the MPC's focus would remain on reducing the adverse impact of the pandemic, reviving growth and preserving financial stability. We expect the MPC to cut rates by another 50-75bps cut in policy rates and continue injecting liquidity in the system through conventional as well as unconventional means. With fiscal stimulus announced thus far being relatively underwhelming, the Government is also expected to come out with additional measures to address the concerns of affected industries as well as MSMEs.

Figure 1: Consumer price inflation in March 2020 (%YoY)

	Weight (%)	Mar-20	Feb-20	Mar-19	FY20	FY19
CPI		5.9	6.6	2.9	4.8	3.4
Food & Beverages	45.9	7.8	9.5	0.7	6.0	0.7
Pan, Tobacco & Intoxicants	2.4	4.7	4.1	4.6	4.2	6.2
Clothing & Footwear	6.5	2.1	2.0	2.5	1.6	4.1
Housing	10.1	4.2	4.2	4.9	4.6	6.7
Fuel & Light	6.8	6.6	6.4	2.3	1.3	5.7
Miscellaneous	28.3	4.4	4.5	5.7	4.4	5.8

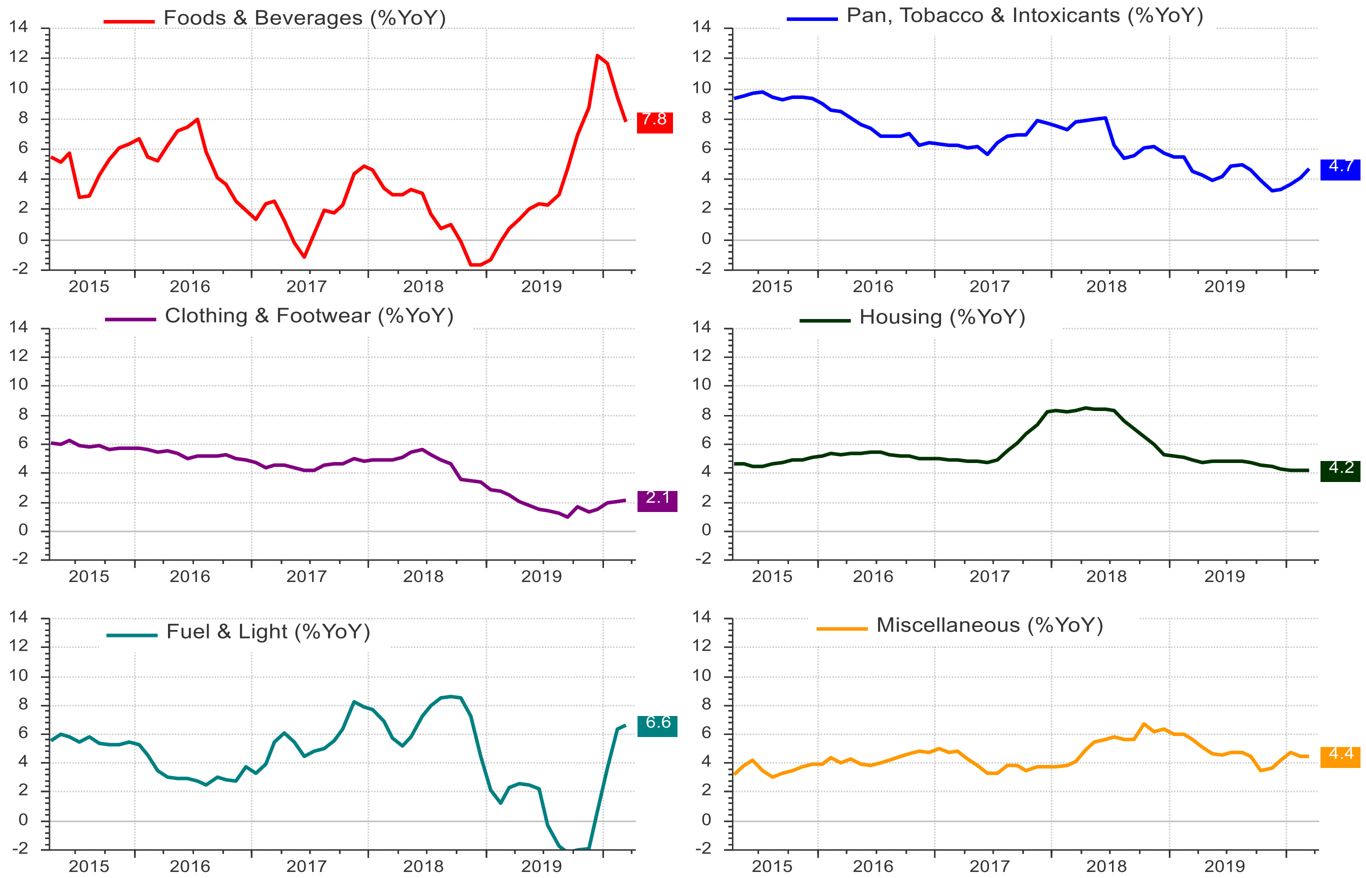
Source: CSO, NSE

Figure 2: India inflation vs. interest rates



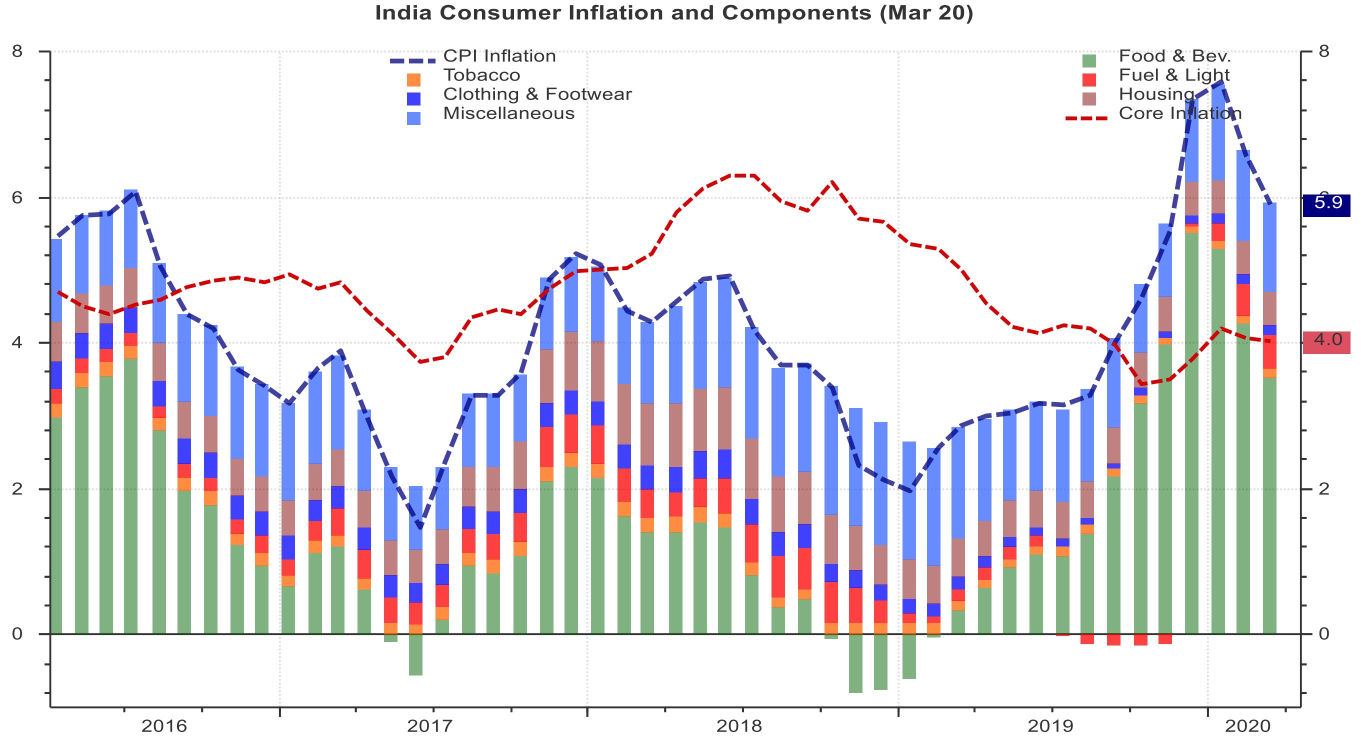
Source: Refinitiv Datastream, NSE

Figure 3: India consumer price inflation (CPI)



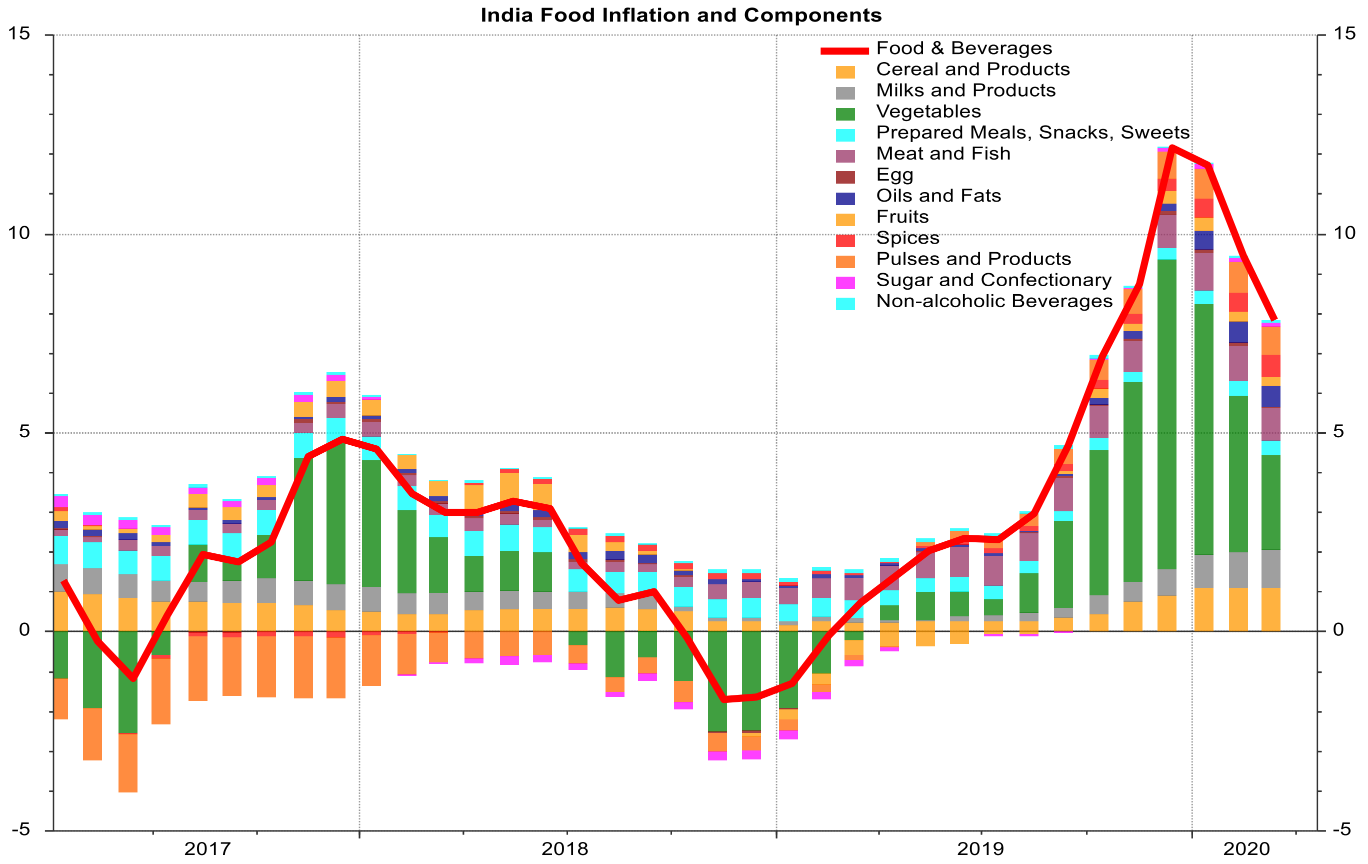
Source: Refinitiv Datastream, NSE

Figure 4: Category-wise contribution to India consumer price inflation (CPI)



Source: Refinitiv Datastream, NSE

Figure 5: Category-wise contribution to India Food and Beverages inflation (CPI)



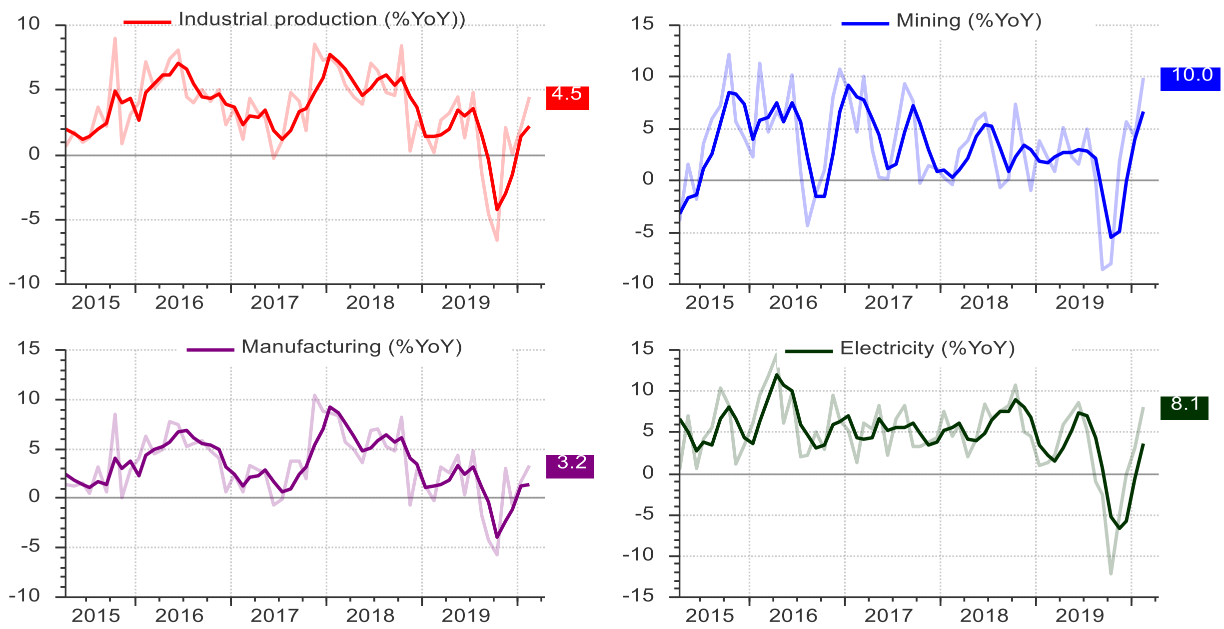
Source: Refinitiv Datastream, NSE

Figure 6: India industrial production for February 2020 (%YoY)

		Weight (%)	Feb-20	Jan-20	Feb-19	FY20TD	FY19TD
	IIP		**4.5**	**2.1**	**0.2**	**0.9**	**4.3**
Sector-based indices	Mining	14.4	10.0	4.3	2.2	1.9	3.9
	Manufacturing	77.6	3.2	1.6	(0.3)	0.6	4.3
	Electricity	8.0	8.1	3.1	1.3	1.5	4.6
Use-based Goods	Primary Goods	34.0	7.4	1.8	1.3	1.1	3.5
	Capital Goods	8.2	(9.7)	(4.3)	(9.3)	(11.4)	5.7
	Intermediate Goods	17.2	22.4	15.9	(5.0)	12.2	(0.2)
	Infra/Construction Goods	12.3	0.1	(2.3)	1.9	(2.2)	8.2
	Consumer Goods	28.2	(2.6)	(1.7)	3.3	(1.5)	5.6
	Consumer Durables	12.8	(6.4)	(3.8)	0.9	(6.2)	6.5
	Consumer Non-durables	15.3	-	(0.3)	5.0	2.0	4.9

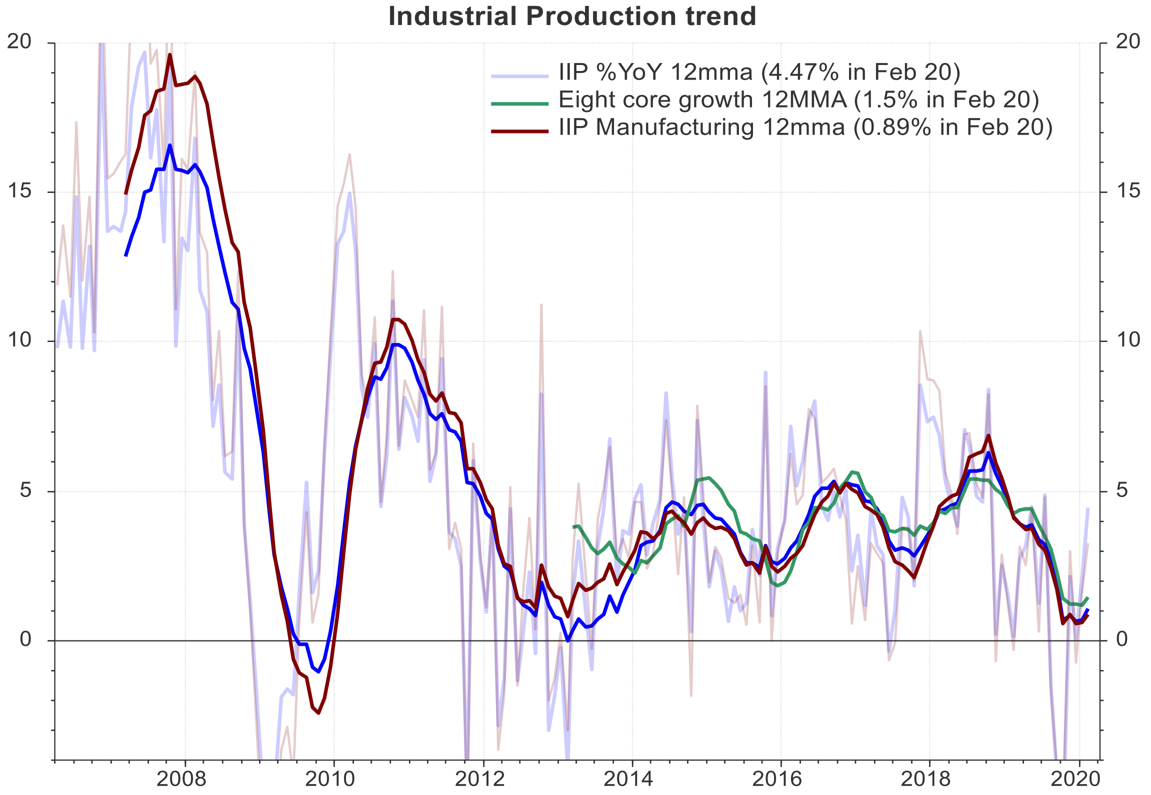
Source: CSO, NSE

Figure 7: India industrial production (3MMA)



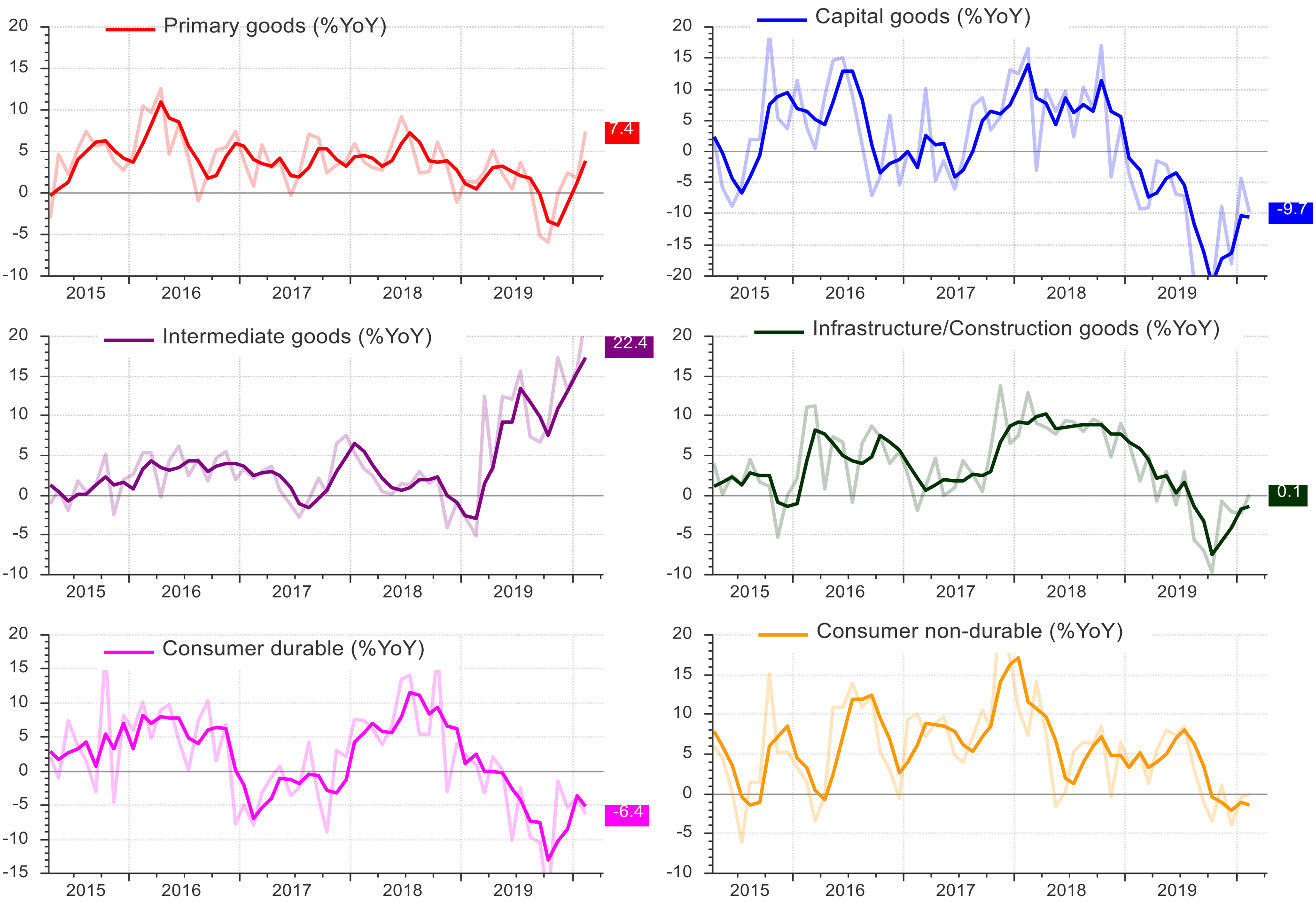
Source: Refinitiv Datastream, NSE

Figure 8: Long-term industrial production trend (12MMA)



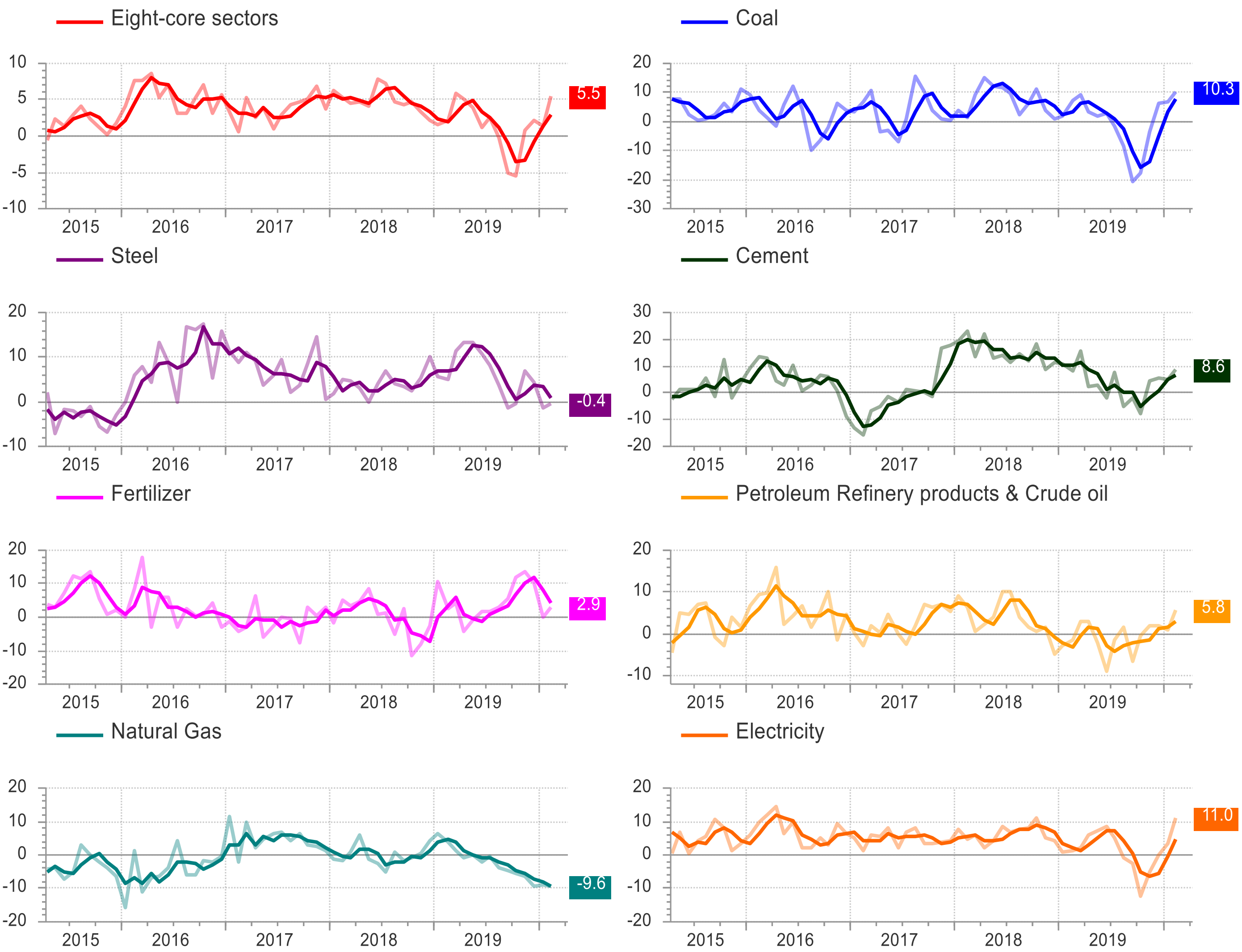
Source: Refinitiv Datastream, NSE

Figure 9: India industrial production use-based goods (3MMA)



Source: Refinitiv Datastream, NSE

Figure 10: India eight-core sector growth (3MMA)



Source: Refinitiv Datastream, NSE

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