

## IIP contracts sharply in April; Food inflation declines in May as supply improves

Industrial production contracted by 55.5% YoY in Apr'20, much sharper than the revised 18.3% drop in the previous month, and weaker than the Consensus Estimate of -45% (source: Bloomberg). This was led by a huge drop in manufacturing activity as majority of the manufacturing units were shut w.e.f. March 25<sup>th</sup> in the wake of an extended and stringent nation-wide lockdown imposed to contain the spread of COVID-19. Electricity and mining sectors, however, fared relatively better. Within the manufacturing sector, while capital goods, infrastructure/construction goods and consumer durables registered an YoY decline of 83-95%, essential categories such as primary goods and consumer non-durables performed somewhat better. During Mar-April 2020, industrial production fell by 36% YoY. With manufacturing activity resuming marginally in May and further in June as restrictions were eased and lifted off in some cases, industrial production is expected to recover, even as the contraction is likely to persist for another couple of months.

Food inflation (39.1% of the CPI basket) eased 120bps MoM to 9.3% in May 2020 as supply-side pressures abated, led by a sharp fall in vegetable inflation, partly offset by meat & fish where inflation surged to the highest level in the series. Excluding meat & fish, food inflation fell by 350bps MoM to a seven-month low of 8.5%. Within core inflation, while health inflation inched up, housing inflation fell to the lowest level in the series. Price collection of other categories has not happened for the 2<sup>nd</sup> month in a row owing to unavailability of transaction data.

While continued easing of supply-side bottlenecks and expectations of a normal monsoon should further bring down food inflation, a meaningful deterioration in aggregate demand is expected to keep core inflation benign, even as the recent hike in fuel prices may impart some upside pressure. This should keep the room open for further monetary easing. We expect the RBI to cut policy rates by another 25-50bps, *ceteris paribus*.

- Data collection hampered by lockdown: Retail prices are collected from field visits to selected 1114 urban and 1181 villages in the country on a weekly roster. In the wake of nation-wide lockdown, price collection through personal visits were suspended w.e.f. March 19<sup>th</sup>. Data collection for the month of May has taken place from 987 urban and 836 villages for commodities that were transacted and were available during the lockdown. Given the transactions were largely limited to essential products, price movement for several sub-groups were not compiled. Similarly, data flow from factories/establishments in April was impacted due to lockdown and may witness significant revisions.
- Industrial production declines sharply owing to lockdown: Following an 18.3% drop in the previous month, industrial production fell sharply by 55.5% in April 2020, lower than the consensus estimate of -45%. This translates into a decline of 35.7% in March-April. The sharp drop in April was largely led by a 64.3% YoY contraction in manufacturing output as majority of the manufacturing units were shut w.e.f. March 25<sup>th</sup> in the wake of an extended and stringent nation-wide lockdown imposed to contain the spread of COVID-19. The drop in electricity and mining sectors, however, was much lower at 22.6% and 27.4% respectively. While mining activity was hit by limited labour availability despite being categorised as an essential activity, electricity production got impacted amid low demand from industrial and commercial establishments. Except for three out of 23 sub-sectors within the manufacturing space, notably food products, coke & refined petroleum products and pharmaceuticals, medicinal chemical & botanical products (22% of the IIP basket) which recorded a sub-50% drop, rest all sectors reported 50%+ drop, with 13/23 groups registering more than 90% YoY contraction.

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*Industrial production declined by 55.5% in April after an 18.3% drop in the previous month. That said, this has likely hit the bottom and industrial activity is expected to improve, even as YoY contraction is likely to persist for a couple of months more, at least.*

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On the use-based side, capital goods, infrastructure/construction goods and consumer durables got impacted the most, contracting by 92%, 83.9% and 95.7%

respectively. Primary goods and consumer non-durables, largely falling under essential categories, saw a relatively much lower YoY contraction of 26.6% and 36.1% respectively.

- Food inflation declines amid easing supply pressures: The lockdown-induced supply-side bottlenecks that had impacted food prices in April eased meaningfully in May, particularly in perishables. Consequently, food inflation (39.1% of the CPI basket) fell by 120bps MoM to 9.3% in May 2020, largely led by sharp fall in vegetable inflation to 10-month low of 5.3%, partly offset by meat & fish where inflation surged to 16%—the highest since the commencement of the series as supplies remained under pressure. Inflation in oils & fat also surged to more than seven-year high of 12.0%. Inflation in cereals, pulses and spices came off marginally in May but still remain at elevated levels. Excluding meat & fish, food inflation fell by 350bps MoM to a seven-month low of 8.5%. Within core inflation, while health inflation inched up, housing inflation fell to the lowest level in the series. Price collection of other categories has not happened for the 2nd month in a row owing to unavailability of transaction data
- RBI to ease further: Growth trajectory has got adversely impacted due to COVID-19 and attendant containment measures. While supply-side situation is expected to improve at a much faster pace as restrictions gradually get lifted pan-India, aggregate consumption demand is expected to remain weak in the foreseeable future as the second-order effect of lockdown feeds in, thereby further delaying a recovery in the investment cycle. We expect Indian economy to contract by 6% in FY21 (refer to [Q4FY20 GDP data points to a protracted slowdown: revising FY21E to -6.0%](#)). Inflation, however, is expected to remain benign. While further easing of supply-side bottlenecks and expectations of a normal monsoon should result in further decline in food inflation, a meaningful deterioration in aggregate demand is expected to keep core inflation benign, even as the recent hike in fuel prices may impart some upside pressure. This should keep the room open for further monetary easing. We expect the RBI to cut policy rates by another 25-50bps, *ceteris paribus*.

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*Food inflation eased in May led by a sharp fall in vegetable inflation as supply situation improved.*

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*Expect RBI to cut policy rates by another 25-50bps, ceteris paribus.*

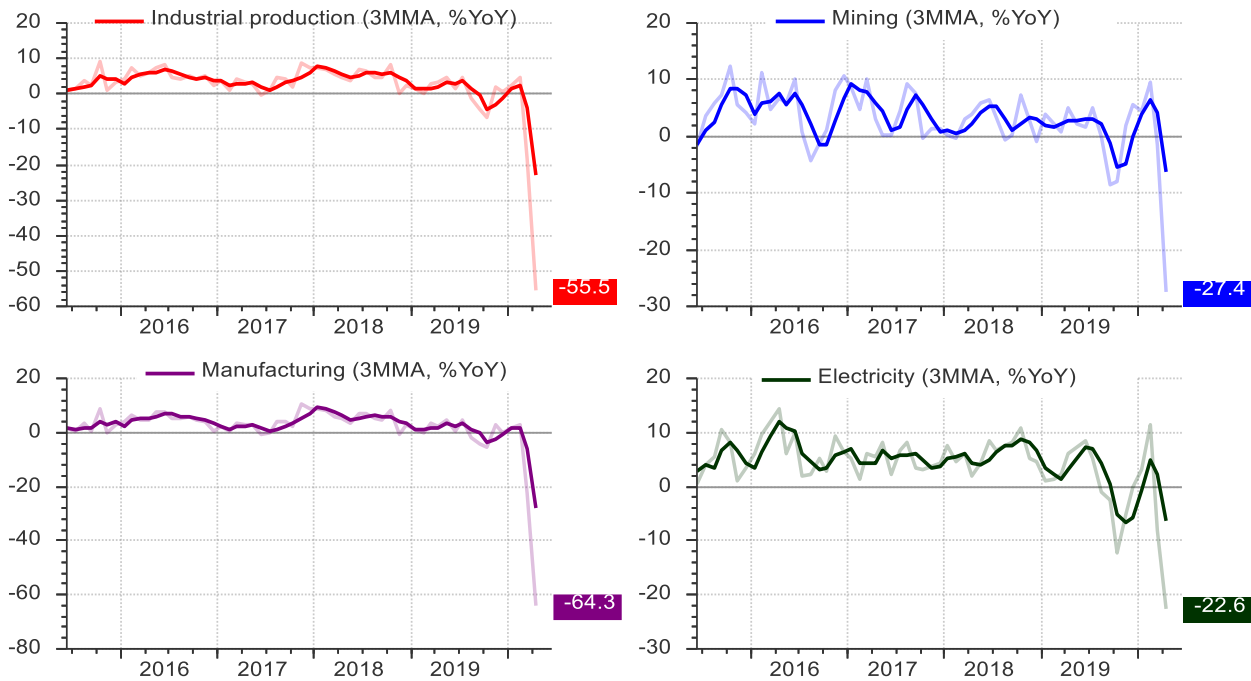
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Figure 1: India industrial production for April 2020 (%YoY)

		Weight (%)	Apr-20	Mar-20	Apr-19	FY20	FY19
	IIP		(55.5)	(18.3)	3.2	(0.9)	3.8
Sector-based indices	Mining	14.4	(27.4)	(1.4)	5.1	1.6	2.8
	Manufacturing	77.6	(64.3)	(22.4)	2.5	(1.4)	3.8
	Electricity	8.0	(22.6)	(8.2)	6.0	0.9	5.2
Use-based Goods	Primary Goods	34.0	(26.6)	(4.1)	5.1	1.2	3.5
	Capital Goods	8.2	(92.0)	(38.3)	(1.4)	(11.5)	5.7
	Intermediate Goods	17.2	(66.0)	(18.5)	3.0	11.9	(0.2)
	Infra/Construction Goods	12.3	(83.9)	(25.2)	(0.7)	(1.8)	8.2
	Consumer Goods	28.2	(61.9)	(27.0)	4.0	(1.4)	5.6
	Consumer Durables	12.8	(95.7)	(36.5)	2.2	(6.1)	6.5
	Consumer Non-durables	15.3	(36.1)	(20.2)	5.4	2.2	4.9

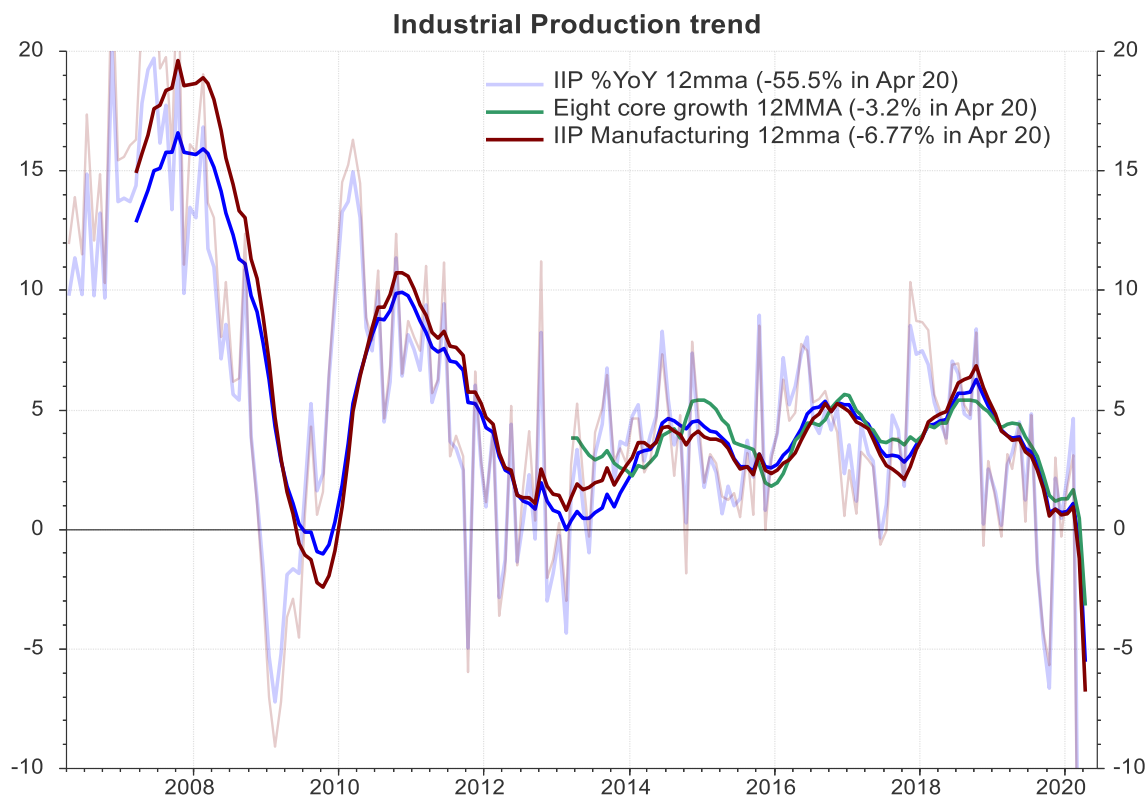
Source: CSO, NSE

Figure 2: India industrial production (3MMA)



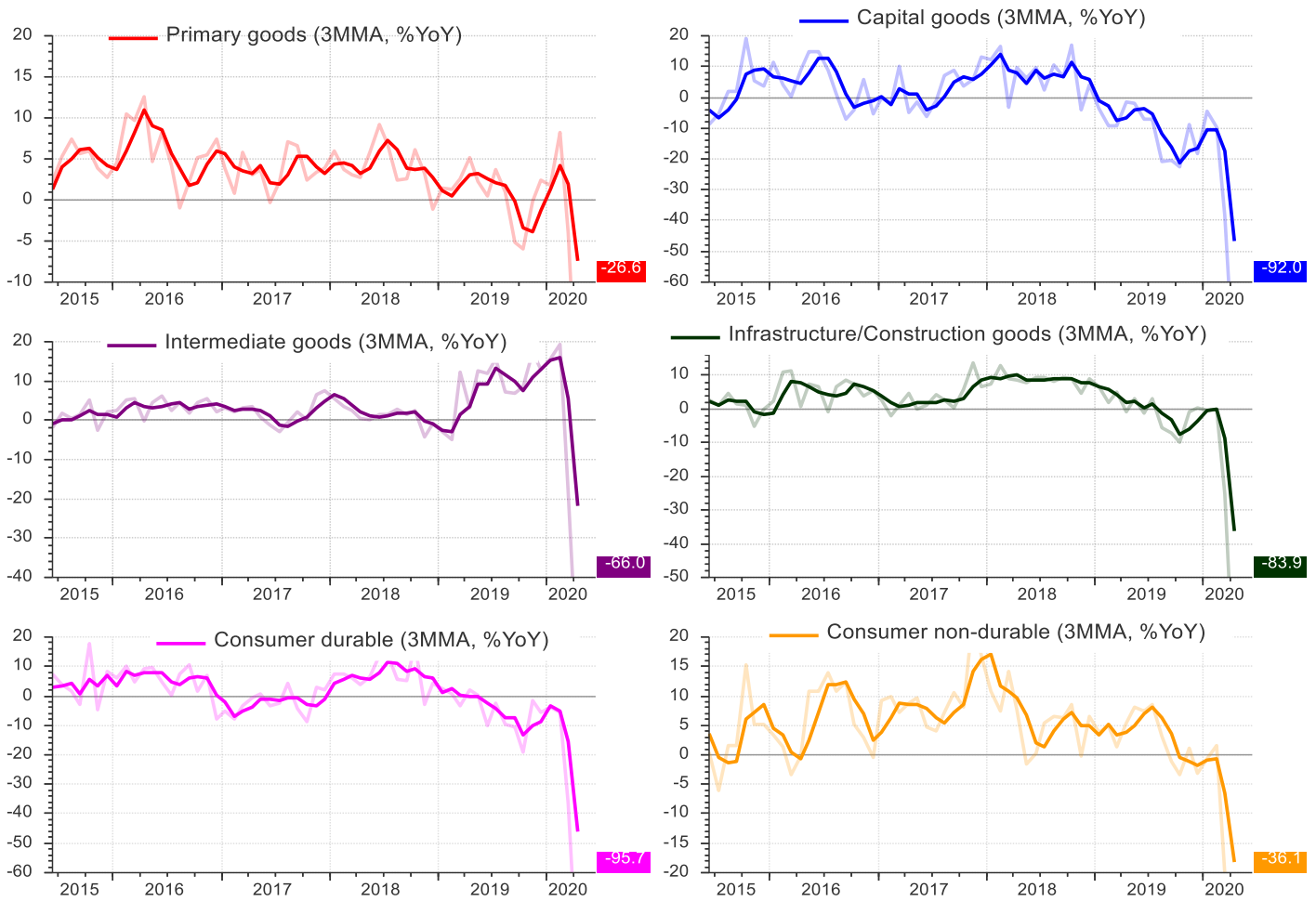
Source: Refinitiv Datastream, NSE

Figure 3: Long-term industrial production trend (12MMA)



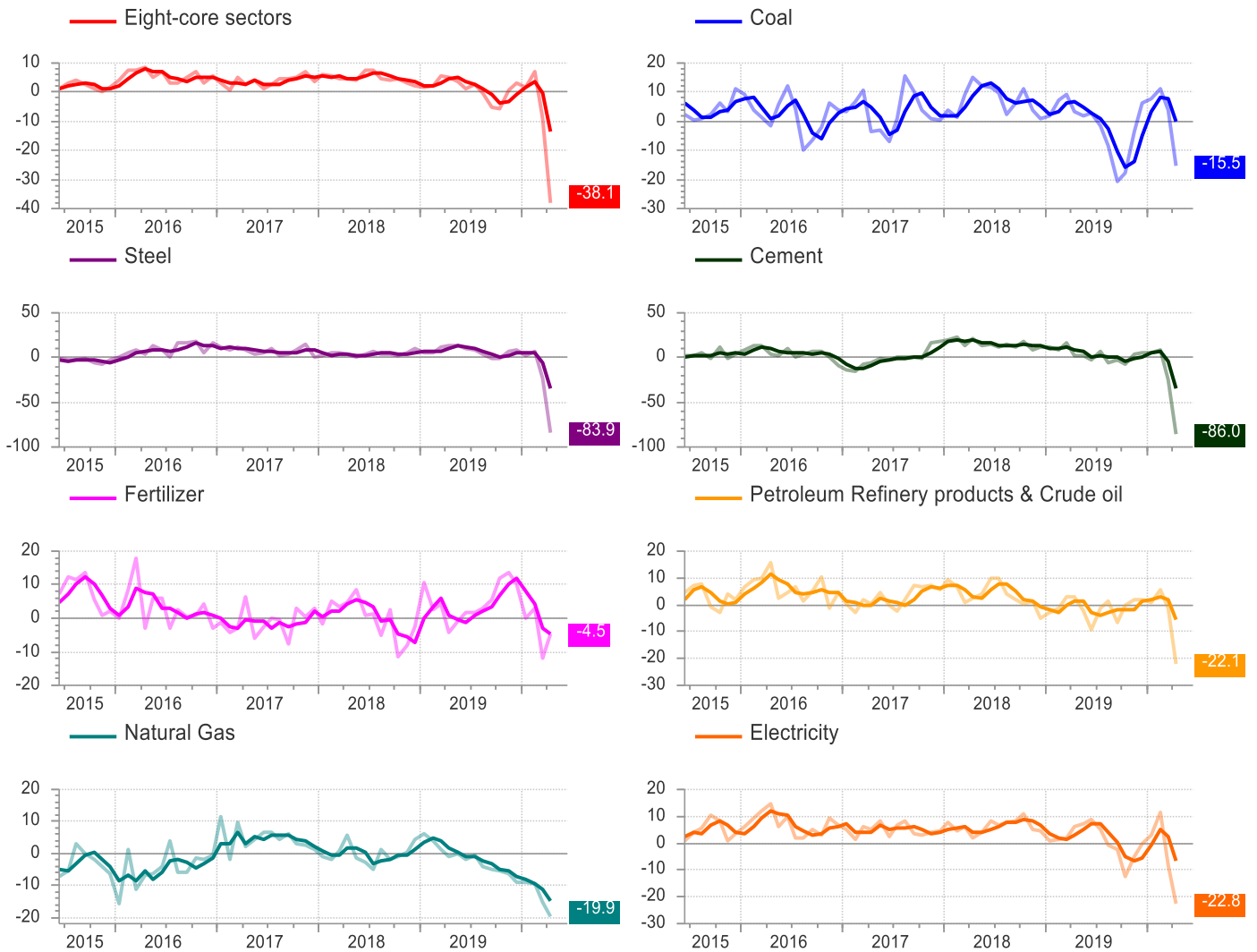
Source: Refinitiv Datastream, NSE

Figure 4: India industrial production use-based goods (3MMA)



Source: Refinitiv Datastream, NSE

Figure 5: India eight-core sector growth (3MMA)



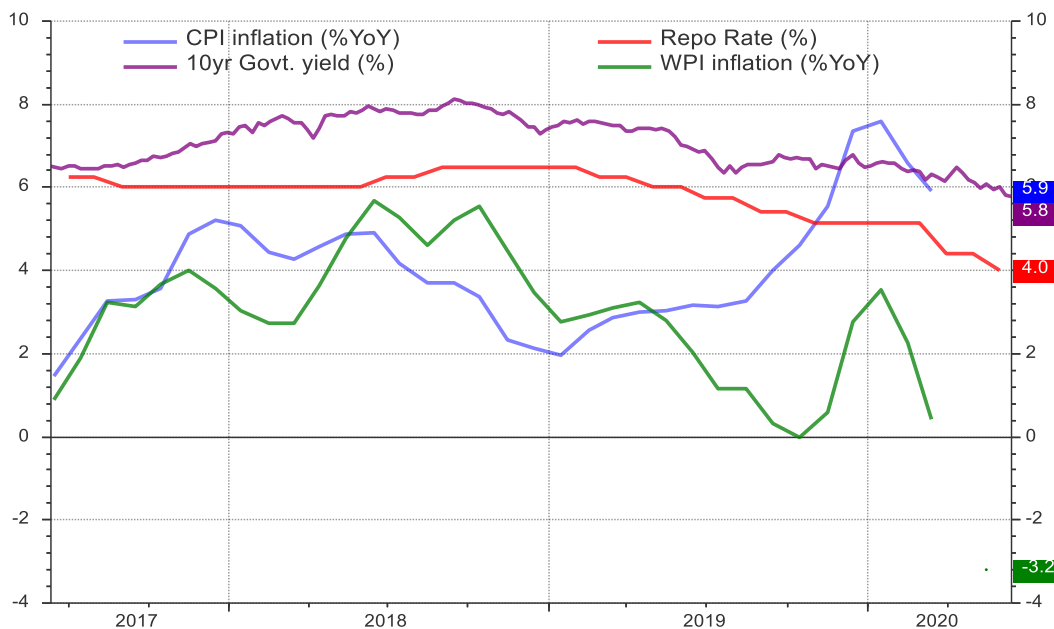
Source: Refinitiv Datastream, NSE

Figure 6: Consumer price inflation in May 2020 (%YoY)

	Weight (%)	May-20	Apr-20	May-19	FY20	FY19
CPI		NA	NA	3.0	4.8	3.4
Core CPI inflation*	44.9	NA	NA	4.2	4.0	5.8
Food & Beverages	45.9	7.4	8.6	2.0	6.0	0.7
Food	39.1	9.3	10.5	1.8	6.7	0.1
Cereals and products	9.7	7.4	7.8	1.2	2.8	2.1
Meat & fish	3.6	16.0	NA	8.1	9.3	4.0
Egg	0.4	8.7	9.0	1.8	4.5	2.3
Milk and products	6.6	8.9	9.4	0.3	2.9	1.8
Oils and fats	3.6	12.0	10.8	0.8	2.9	2.1
Fruits	2.9	2.1	2.7	(5.2)	0.7	2.3
Vegetables	6.0	5.3	23.6	5.5	21.3	(5.2)
Pulses and products	2.4	21.1	22.8	2.1	9.9	(8.3)
Sugar and confectionary	1.4	6.1	10.3	0.3	0.8	(7.0)
Spices	2.5	12.6	12.8	1.3	4.4	2.2
Non-alcoholic beverages	1.3	3.1	2.2	3.2	2.6	2.6
Pan, Tobacco & Intoxicants	2.4	NA	NA	3.9	4.2	6.2
Clothing & Footwear	6.5	NA	NA	1.8	1.6	4.1
Housing	10.1	3.7	3.9	4.8	4.5	6.7
Fuel & Light	6.8	1.4	2.9	2.5	1.3	5.7
Miscellaneous	28.3	NA	NA	4.6	4.4	5.8
Health	5.9	4.3	2.8	8.0	6.2	7.1

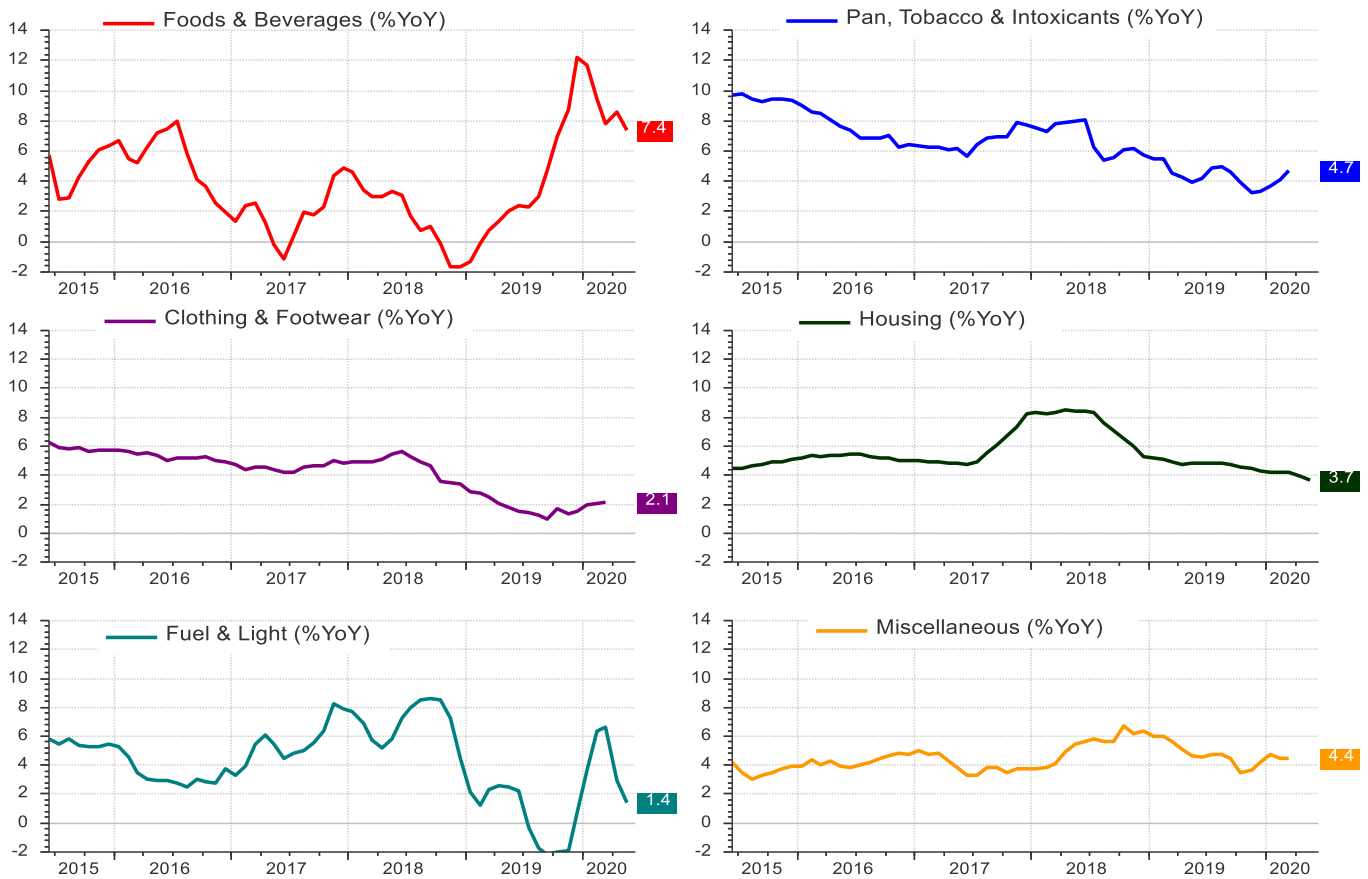
Source: CSO, NSE. \* Headline inflation excluding food & beverages, pan, tobacco & intoxicants and fuel & light. NA = Not Available.

Figure 7: India inflation vs. interest rates



Source: Refinitiv Datastream, NSE

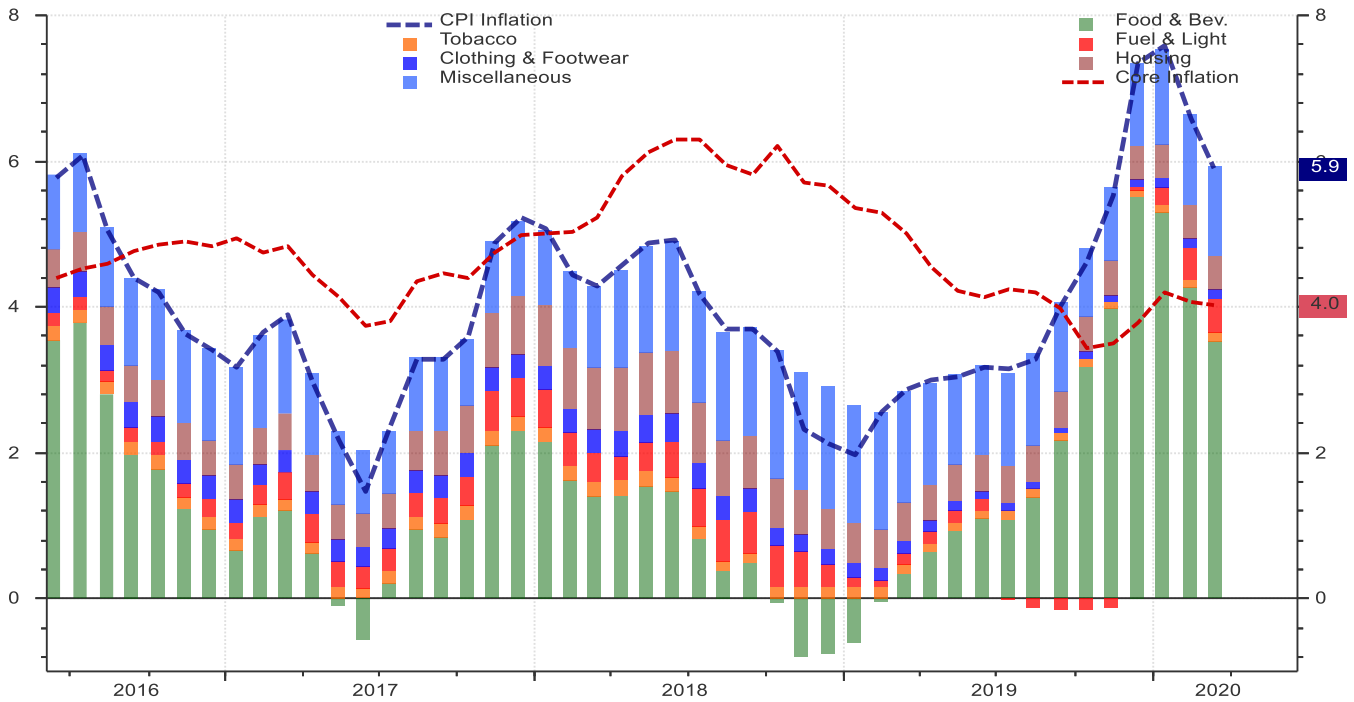
Figure 8: India consumer price inflation (CPI)



Source: Refinitiv Datastream, NSE. Note: Data for Pan, tobacco & intoxicants, Clothing & footwear and Miscellaneous categories is only up to March 2020.

Figure 9: Category-wise contribution to India consumer price inflation (CPI)

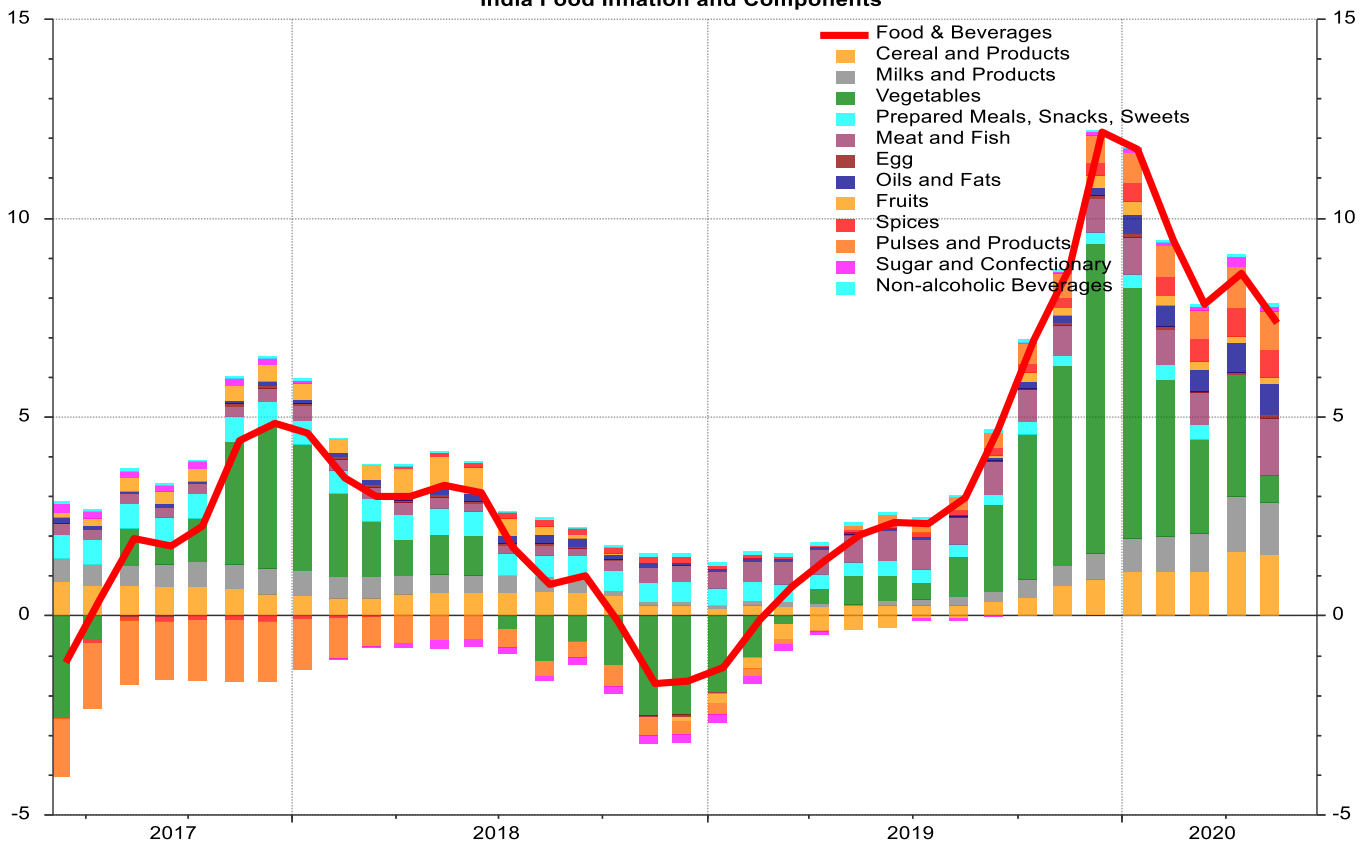
**India Consumer Inflation and Components (Mar 20)**



Source: Refinitiv Datastream, NSE.

Figure 10: Category-wise contribution to India Food and Beverages inflation (CPI)

**India Food Inflation and Components**



Source: Refinitiv Datastream, NSE.



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