

Rising food prices drive CPI inflation; April IIP surprises positively

India's retail inflation (CPI) inched to a 7-month high of 3.1% in May'19 (NSE est.: 2.8%, consensus: 3.1%) from the revised print of 3.0% in Apr'19 led by a 65bps rise in food inflation. This was the fourth consecutive month of a sequential rise in inflation that was mainly driven by food prices, especially vegetables, sugar and pulses. Further, the expectations of a normal to below-normal monsoon season, also pushed up food prices in May. On the other hand, core inflation (ex-food ex-fuel) dipped to a 22-month low of 4.2% in May'19, led by a broad-based decline in miscellaneous items for the month. The index of industrial production (IIP) surprised positively rising to a 6-month of 3.4% in April (NSE est.: 1.8%, consensus: 0.8%), with all major items—mining, manufacturing and electricity—witnessing a pick-up during the month.

With inflation well within the RBI's target range and the Monetary Policy Committee's (MPC) new accommodative stance, we reaffirm our call of an incremental 50bps rate cut this fiscal, with 25bps cut expected in the August policy. However, the monsoon uncertainty, Union Budget (to be presented on July 5) and transmission of past rate cuts would be a determining factor for the rate trajectory going forward.

- **Inflation inches to a 7-month high:** Retail inflation (CPI) came in at 3.1% in May'19 from the revised 3.0% in Apr'19, marginally higher than our estimate of 2.8%, led by the spike in food & beverages inflation (by 65bps). This was the fourth consecutive month of sequential rise in inflation, on account of an increase in prices of vegetables (5.5%), pulses (2.1%) and sugar (0.3%) that have reversed their deflationary trend seen over past several months. Contrastingly, inflation in pan, tobacco and intoxicants fell to 3.9% in May—lowest in the series thus far. Fuel & light inflation also fell marginally to 2.5% in May (2.6% in April) owing to lower oil prices. While inflation is seen rising in the near-term, we believe RBI's forecast for the inflation trajectory at 3.0-3.1% in H1FY20 and 3.4-3.7% in H2FY20 is likely to be met.
- **Core inflation continues to soften:** India's core inflation, excluding food and fuel inflation, fell to a 22-month low of 4.2% in May, as there was a broad-based decline across miscellaneous items. Most of the fall in core inflation was due to the sharp drop in fuel inflation even though health and education continued to impart positive impulses. Inflation in household goods & services, health and education softened further to 4.6%, 8.0% and 6.7% respectively. While housing inflation remained flat at 4.8% in May, inflation in the transportation & communication segment fell sharply to 1.6% in May from previous 12-month average of 5.0%. With aggregate demand in the economy likely to remain weak in the near-term, we expect core inflation to moderate gradually over the fiscal year.
- **Industrial production surprises positively:** Industrial production firmed up to a 6-month high of 3.4% in April, much above our and street estimate of 1.8% and 0.6% respectively. Mining activity picked up pace rising to 5.1% in April, while electricity came in-line with the eight-core print rising to 6.0%. The manufacturing sector (~78% of the IIP basket) had the highest contribution to IIP, rising to 2.8% from 0.1% in March. Among mfg. sectors, 14/22 sectors reported positive growth with apparel, wood and production of media leading the pack, while two-wheelers, hypo-lipidemic agents and stainless steel utensils were the laggards. Among use-based goods, capital goods, intermediate goods and consumer durables turned positive for the month, while infrastructure goods moderated to 1.7% (from 6.4% in March) on account of a slowdown in activity in the pre-election month.
- **Way forward:** We believe inflation is likely to remain well within RBI's comfort zone of 4% +/-2%, as even though food inflation is imparting an upward bias on the trajectory, the moderation in core inflation is likely to keep the headline under check. Further, the latest change in MPC's policy stance to accommodative augurs well for an incremental 50bps rate cut this year, including a 25bps cut in the August policy meet. The MPC, however, would keep a watchful eye on the unfolding of the southwest monsoons and Budget reforms before taking any policy action, while the transmission of past rate cuts would be essential to ensure a steady growth revival in the medium to long term.

Figure 1: Consumer price inflation (%YoY)

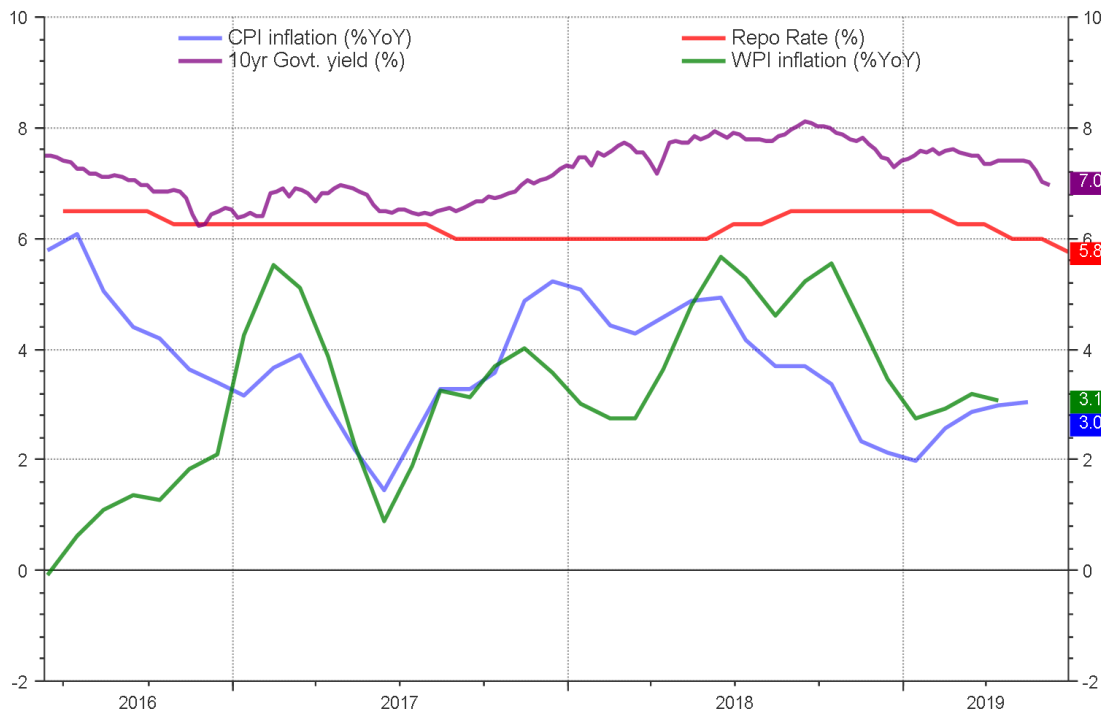
	Weight (%)	May-18	Apr-19	May-19	Apr-May'19
CPI		4.9	3.0	3.0	3.0
Food & Beverages	45.9	3.3	1.4	2.0	1.7
Pan, Tobacco & Intoxicants	2.4	8.0	4.3	3.9	4.1
Clothing & Footwear	6.5	5.5	2.0	1.8	1.9
Housing	10.1	8.4	4.8	4.8	4.8
Fuel & Light	6.8	5.8	2.6	2.5	2.5
Miscellaneous	28.3	5.4	5.1	4.6	4.9

Source: CSO, NSE

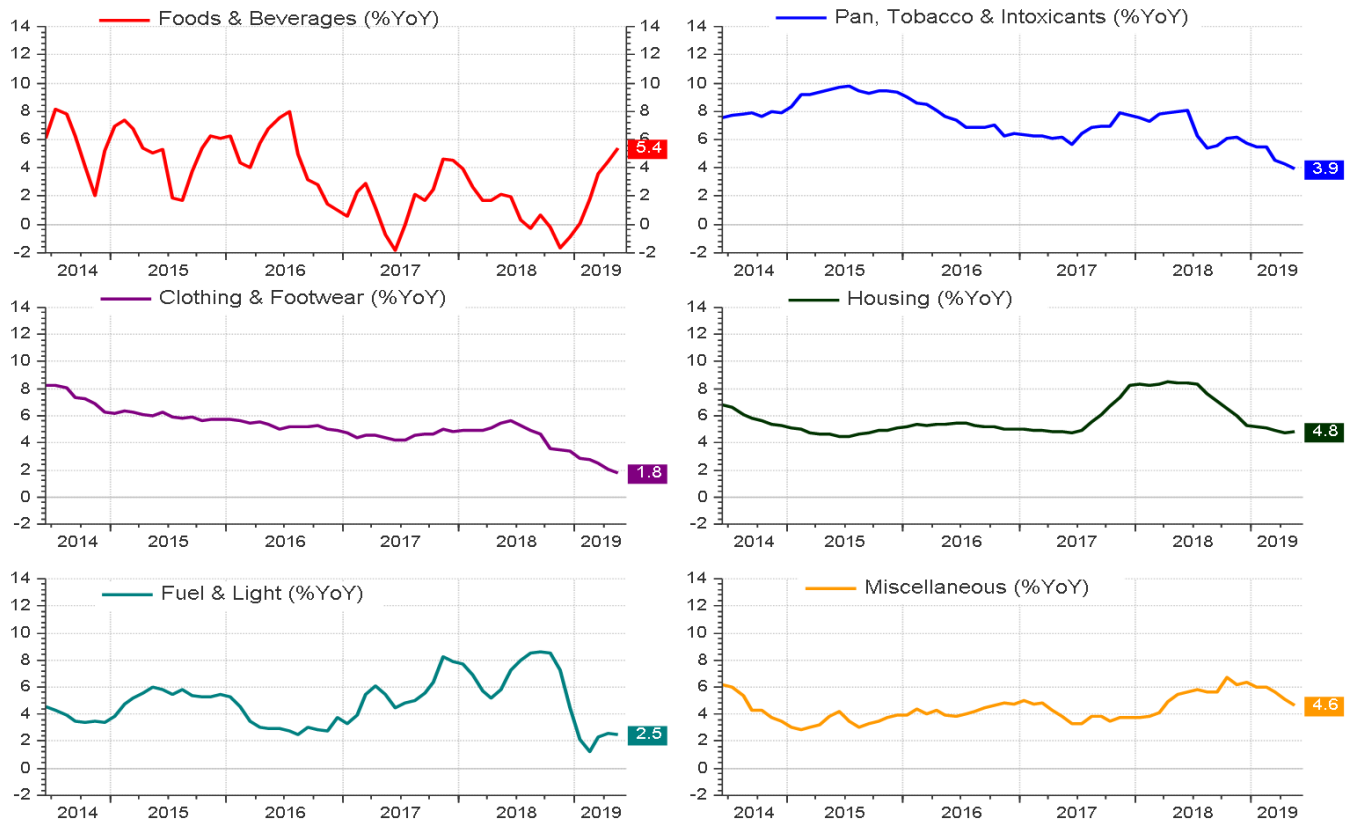
Figure 2: Industrial production (%YoY)

	Weight (%)	Mar-19	Apr-18	Apr-19
IIP		4.5	0.4	3.4
Sectoral indices				
Mining	14.4	3.8	0.8	5.1
Manufacturing	77.6	4.9	0.1	2.8
Electricity	8.0	2.1	2.2	6.0
Use-based Goods				
Primary Goods	34.0	2.7	2.6	5.2
Capital Goods	8.2	9.8	(8.4)	2.5
Intermediate Goods	17.2	0.4	(2.5)	1.0
Infra/Construction Goods	12.3	8.5	6.4	1.7
Consumer Goods	28.2	5.9	(0.8)	4.0
Consumer Durables	12.8	3.9	(3.1)	2.4
Consumer Non-durables	15.3	7.5	1.0	5.2

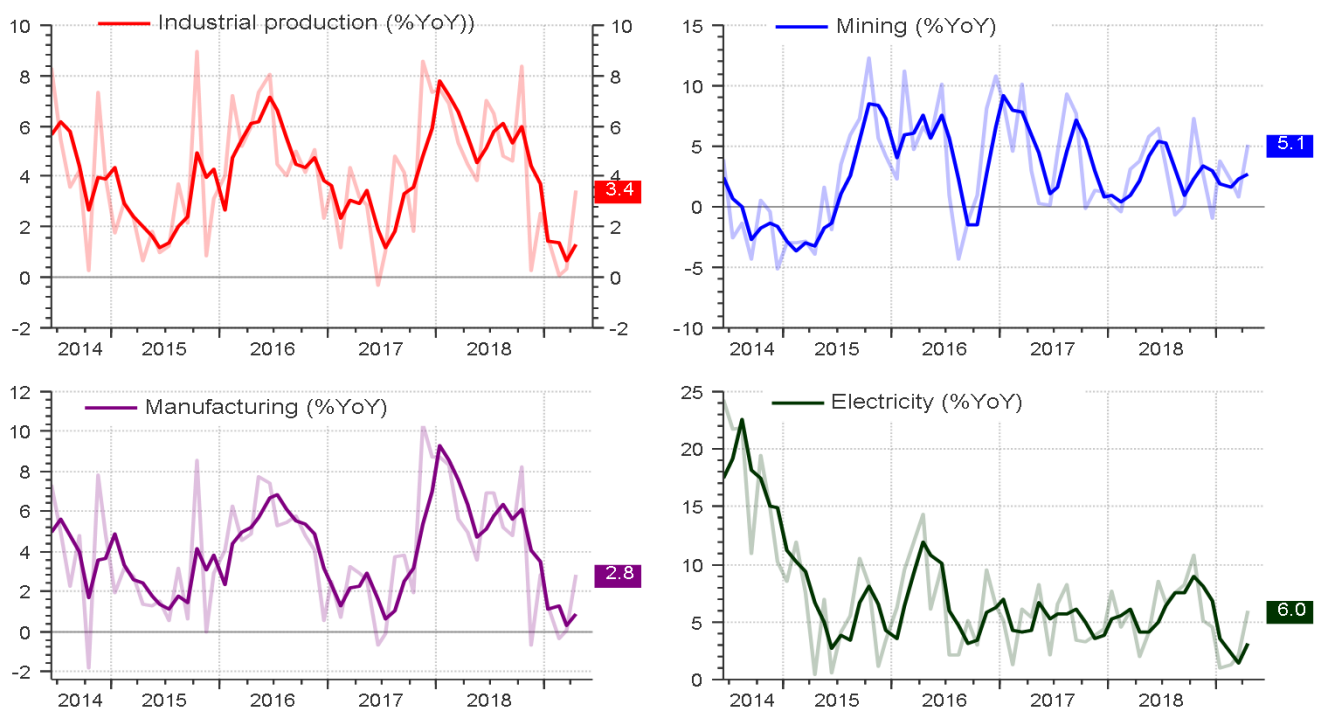
Source: CSO, NSE

Figure 3: India inflation vs. interest rates


Source: Thomson Reuters Datastream, NSE

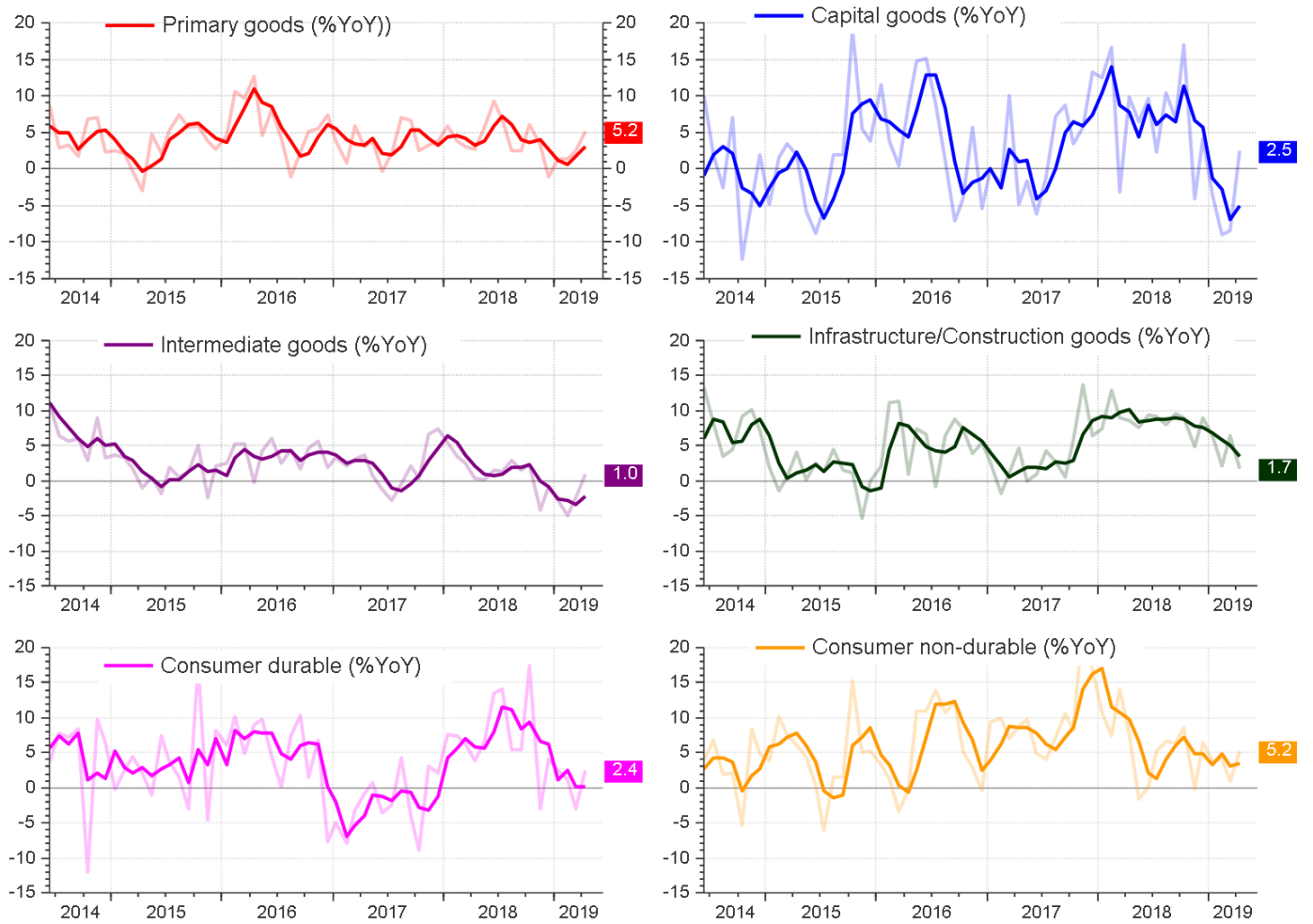
Figure 4: India consumer price inflation (CPI)


Source: Thomson Reuters Datastream, NSE

Figure 5: India industrial production (3MMA)


Source: Thomson Reuters Datastream, NSE

Figure 6: India industrial production use-based goods (3MMA)



Source: Thomson Reuters Datastream, NSE

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