NSE

Macro Review

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Food inflation nears double-digits, IIP responds to Unlocks

Headline CPI inflation shot up to an eight-month high of 7.3% in September from 6.7% in the previous month, ahead of the market expectations of 6.9% (Source: Reuters). This marked the sixth consecutive month (and nine out of last 10 months) of a 6%+ print—the upper bound of the **RBI's target range.** Prices of vegetables rose by a fifth (20.7%) from levels in Sep**'19**, raising food inflation (~+150bps) to double-digits, posing questions on the supply-side response this year and contributing to most of the rise in the headline figures. Excluding vegetables, headline inflation has remained broadly steady over the last five months. Barring food and fuels, the core inflation print eased to eased to 5.35% (vs. 5.4% in August), a closer resemblance to weak demand conditions in the economy. Every major category in the inflation basket saw moderation in prices.

Industrial production (IIP) in August continued to recover, down 8% YoY, albeit off a low base, vs. -10.8% in July, as easing of lockdown restrictions helped activity get back on track. Manufacturing (-8.6%) and Mining (-9.8%) dragged on the index, while Electricity provided some respite (-1.8%). In the use-based classification, Consumer non-durables faltered after two consecutive months of growth (-3.3%), reflecting the general economic conditions following the post-lockdown surge. For the Apr-Aug period, industrial activity is down 25% YoY. The nascent recovery in Electricity apart, Manufacturing over five months remains down by a *third* vis-à-vis last year.

It is relevant to note that a) vegetable prices continue to remain elevated in October, and b) the MPC meeting earlier this month accounts for both the September inflation print and its expected trajectory. Despite this, the dovish tone of policy and the commitment to maintain an accommodative stance through the current and the following financial year are a nod to prevailing economic conditions; the RBI expects FY21 growth at -9.5% (Our est. at -10.5%, detailed note here), with risks tilted to the downside. We continue to maintain rate cuts are off the table for this fiscal, while space remains for an incremental 25-50bps drop in the repo in the current rate cycle, which began in 2015. Active Coronavirus cases have been on a downward trajectory for several days now, but the impending festive season remains a cause for worry.

- Retail inflation at an eight-month high in September: CPI inflation continued to remain elevated, printing at an eight-month high of 7.3% in September, following an uncomfortable 6.7% in August. Barring Mar'20's 5.8%, consumer inflation has remained above the MPC's 4+/-2% band for nine months now. Headline inflation has averaged 6.7% this fiscal vs. 3.2% over the same period last year. In this context, any base effect should only kick in by December (Dec'19 at 7.35%).

Retail inflation rose further to 7.3%, marking two full quarters of 6+% prints.

- Food inflation rears up again, nears double-digits: An extended rainy season and delay in supply chains getting back on track led to food inflation rising again in September after the marginal respite in August. Perishables were affected the most (Vegetables +20.7%, Meat and fish +17.6%, Eggs +15%), while cereals eased (+4.7%). Excluding vegetables, headline inflation has remained broadly steady over the last five months. In fact, tomato and potato (~1.6% of the inflation basket) has contributed nearly 50 of the 65bps sequential jump in inflation in September. Prices in October remain elevated and are likely to drive the print for this month as well. Other items in the food basket didn't rise as much as Perishables but have remained high through this fiscal. Across the rest of the categories in the inflation basket, rising fuel costs helped keep Transportation inflation high (+11.5%, FYTD average of 8.9% vs. 1.3% last year), and expensive bullion added to Personal Care & Effects inflation (+12.5% vs 4.5% last year). It is noteworthy that the categories are seeing the highest increase in at least eight years.

Perishables continue to remain elevated, and likely to be so this month as well. Transportation costs and Personal Care categories seeing highest levels since 2012.

- Core inflation shows some respite: Even as perishables made up the bulk of the price rise in September, the rest of the basket reflected weak economic conditions somewhat better. Core inflation remained high (+5.35%) but has been at these levels for three months now, and that too driven by Transportation and Personal Care, as discussed above. At 5.1%, it remains higher this fiscal (Apr-Sep) vs. what we saw last year (4.2%), but the gap is significantly lower than in food prices (+8.8% in Apr-Sep'20 vs 2.6% last year), where the impact of the lockdown has been clearly disproportionate.

- Industrial Production continues to improve...: At -8% YoY, the August IIP print appears unflattering, but is an improvement from an downwardly revised -10.8% in the previous month and YTD drop of -25%. Industrial activity has increased in line with the easing of lockdown restrictions, and should improve further in September's Unlock 5.0. A favorable base should provide an added support over the next two months. It is crucial for the rebound to hold post-restrictions, and in this context, some high-frequency indicators have shown a promising up-tick, e.g., E-way bills, Manufacturing PMIs, and Petrol Consumption among others.

Industrial production improved further in August (-8% YoY), albeit off a low base, in-line with the easing of lockdown restrictions.

- **...in fits and starts**: All three broad sectors of the IIP basket performed better YoY vs. MoM. Manufacturing dropped less in August (-8.6%) vs. July (-11.6%, revised down by ~50bps), led by base metals, motor vehicles, trailers & semi-trailers and other transport equipment. Notably, Pharmaceuticals registered a modest YoY decline in September following an expansion over the previous three months. Importantly, 7/23 manufacturing sub-sectors still recorded a 20%+ YoY contraction in August, led by paper & paper products (-41.3%), wood & wood products (-32.5%), other manufacturing (-29.2%) and wearing apparel (-24%). At -9.8% YoY in September, the improvement in mining activity from Apr-May levels has been relatively weak, possibly reflecting the impact of incessant rainfall during the month of August and continued labour shortages. Electricity production, however, is now almost back to pre-COVID-levels, declining by a mere 1.8% YoY in August as demand from industrial and commercial establishments is slowly coming back on track with continued easing of restrictions.

All three broad sectors of the IIP basket performed better YoY vs. MoM.

- Relatively steeper drop in consumer durables and capital goods persists: Use-based classification also show an improvement across the board, but off a low base in some categories. Capital goods production fell by 15.4% YoY in September vs. a 22.8% YoY drop in August but has come on top of a 20.9% contraction in Sep'19, reflecting a much slower recovery in investment activity. Contraction in Primary Goods, however, widened on an YoY basis to 11.1% in September from 10.8% in the previous month owing to a weak mining activity. Production of intermediate and infra/construction goods fell by 6.8% and 2.3% YoY respectively. At -10.3%, contraction in Consumer durables on an YoY basis halved in September but off a similar drop in the same period last year. Consumer non-durables, however, faltered (-3.3%) after two consecutive months of growth despite a low base, reflecting the general economic conditions following the post-lockdown surge.

Contraction in capital goods production remained steep at 15.4% YoY in September despite a low base, reflecting a much slower recovery in investment activity.

- Liquidity support over rate cuts for now: It is relevant to note that a) vegetable prices continue to remain elevated in October, and b) the MPC meeting earlier this month accounts for both the September inflation print and its expected trajectory. Despite this, the dovish tone of policy and the commitment to maintain an accommodative stance through the current and the following financial year are a nod to prevailing economic conditions; the RBI expects FY21 growth at -9.5% (Our est. -10.5%), with risks tilted to the downside. We continue to maintain rate cuts are off the table for this fiscal, while space remains for an incremental 25-50bps drop in the repo in the current rate cycle, which began in 2015. Beyond rate cuts, the policy focus is likely to remain on liquidity infusion and ensuring effective monetary transmission to support growth for now.

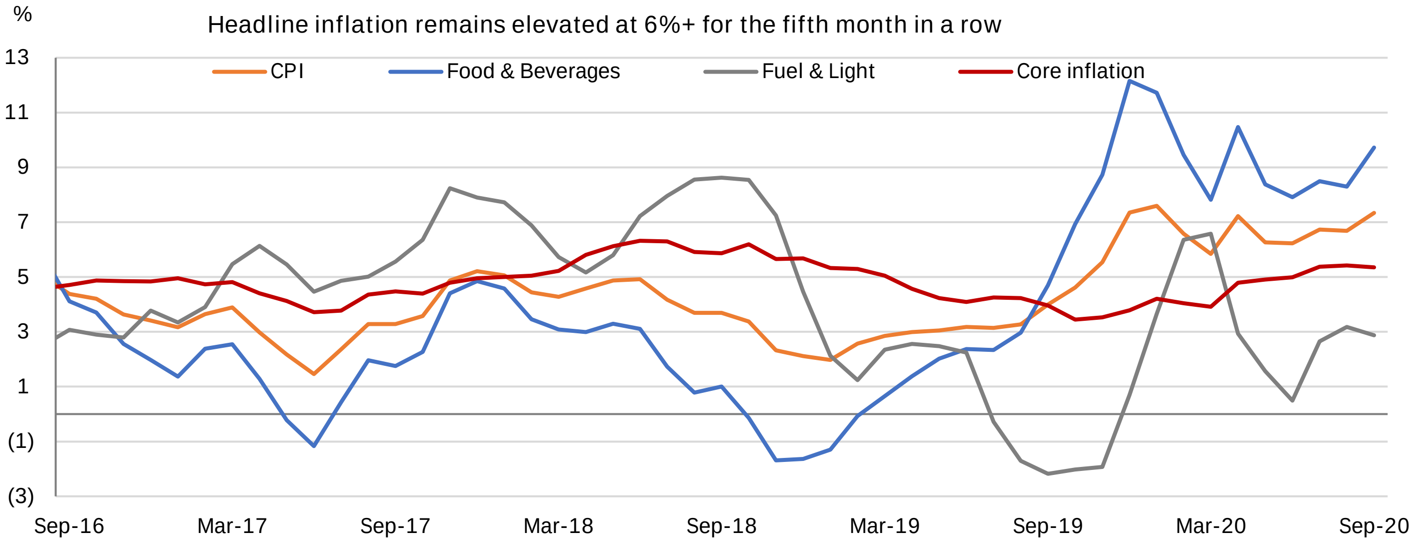
The RBI is expected to continue to focus on liquidity infusion and monetary transmission than rate cuts to support growth for now.

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

	Weight (%)	Sep-20	Aug-20	Sep-19	FY21TD	FY20TD
CPI		7.3	6.7	4.0	6.7	3.3
Food & Beverages	45.9	9.7	8.3	4.7	8.9	2.6
Pan, Tobacco & Intoxicants[2]	2.4	10.8	11.2	4.6	9.3	4.5
Clothing & Footwear[2]	6.5	3.0	2.8	1.0	3.0	1.5
Housing	10.1	2.8	3.1	4.7	3.4	4.8
Fuel & Light	6.8	2.9	3.2	(2.2)	2.3	0.5
Miscellaneous[2]	28.3	6.9	7.0	4.5	6.3	4.7
Core CPI inflation[1, 2]	44.9	5.3	5.4	4.0	5.1	4.2

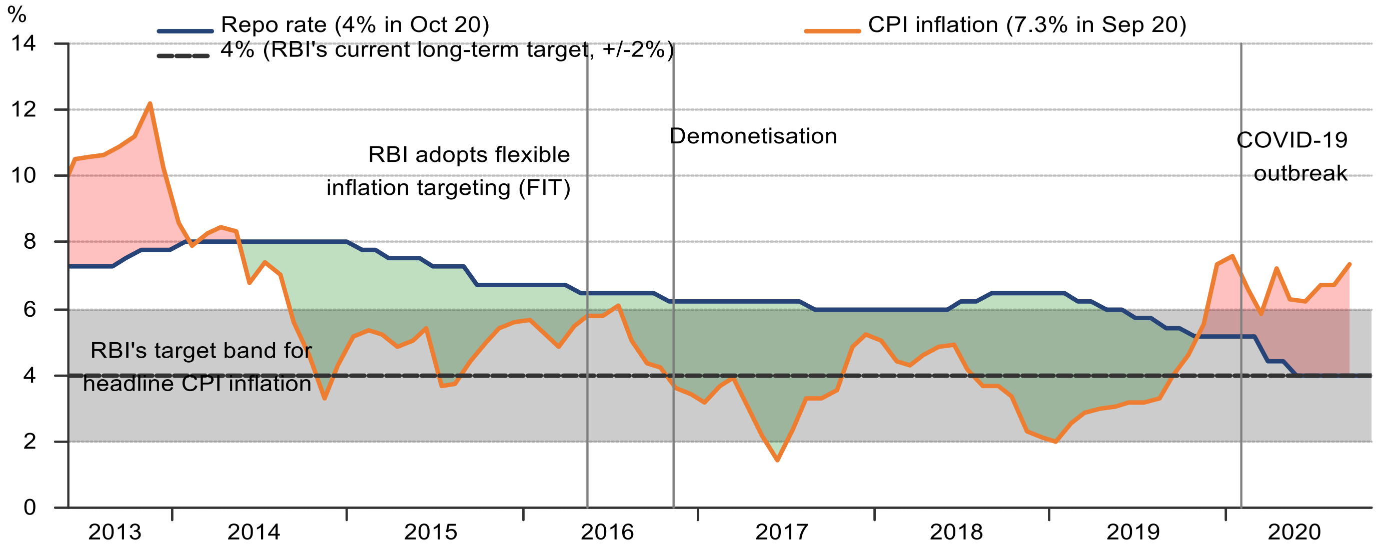
Source: CSO, NSE. NA = Not Available.
Note: [1] Headline inflation excluding food & beverages, pan, tobacco & intoxicants and fuel & light.
[2] Inflation data for these components for April and May 2020 are based on the imputed index calculated by MOSPI.

Figure 2: Headline CPI inflation trend



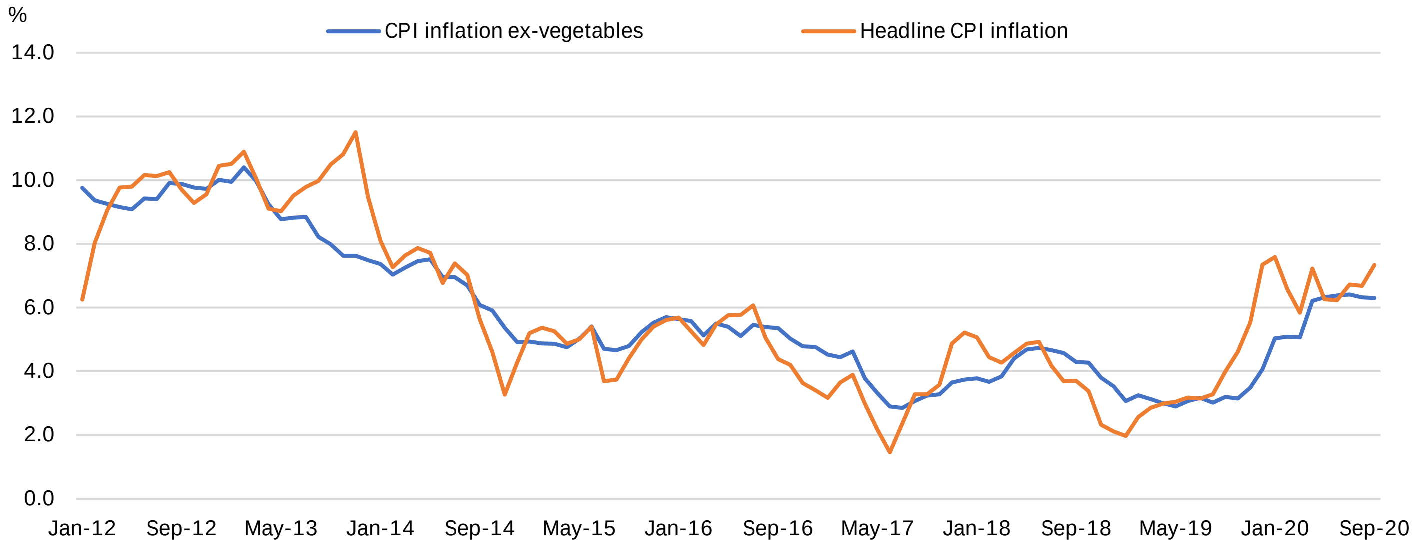
Source: CMIE Economic Outlook, NSE

Figure 3: Real interest rates have remained negative for quite some time now



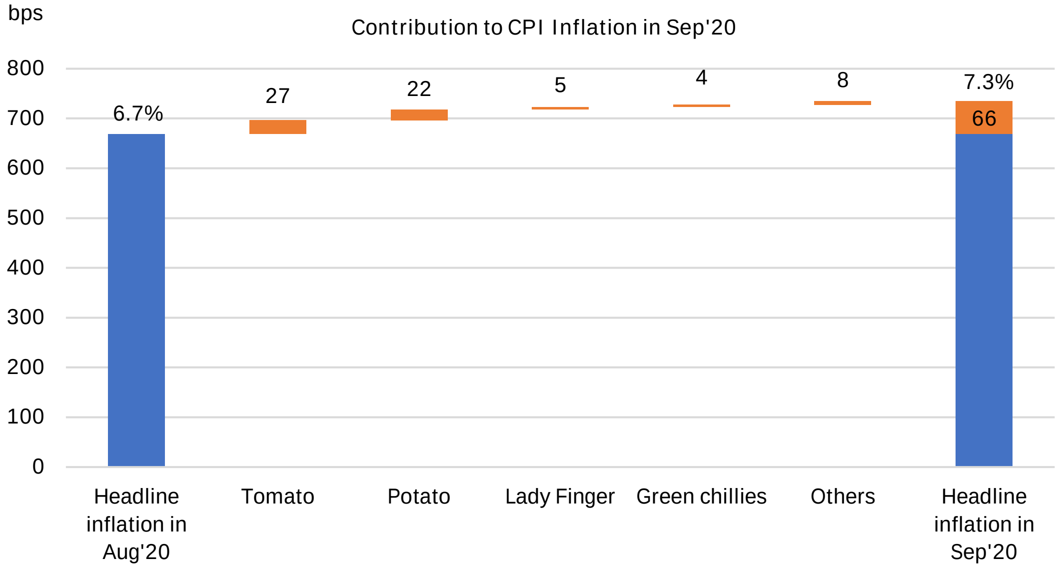
Source: CMIE Economic Outlook, NSE

Figure 4: Recent spike in headline inflation largely led by perishables



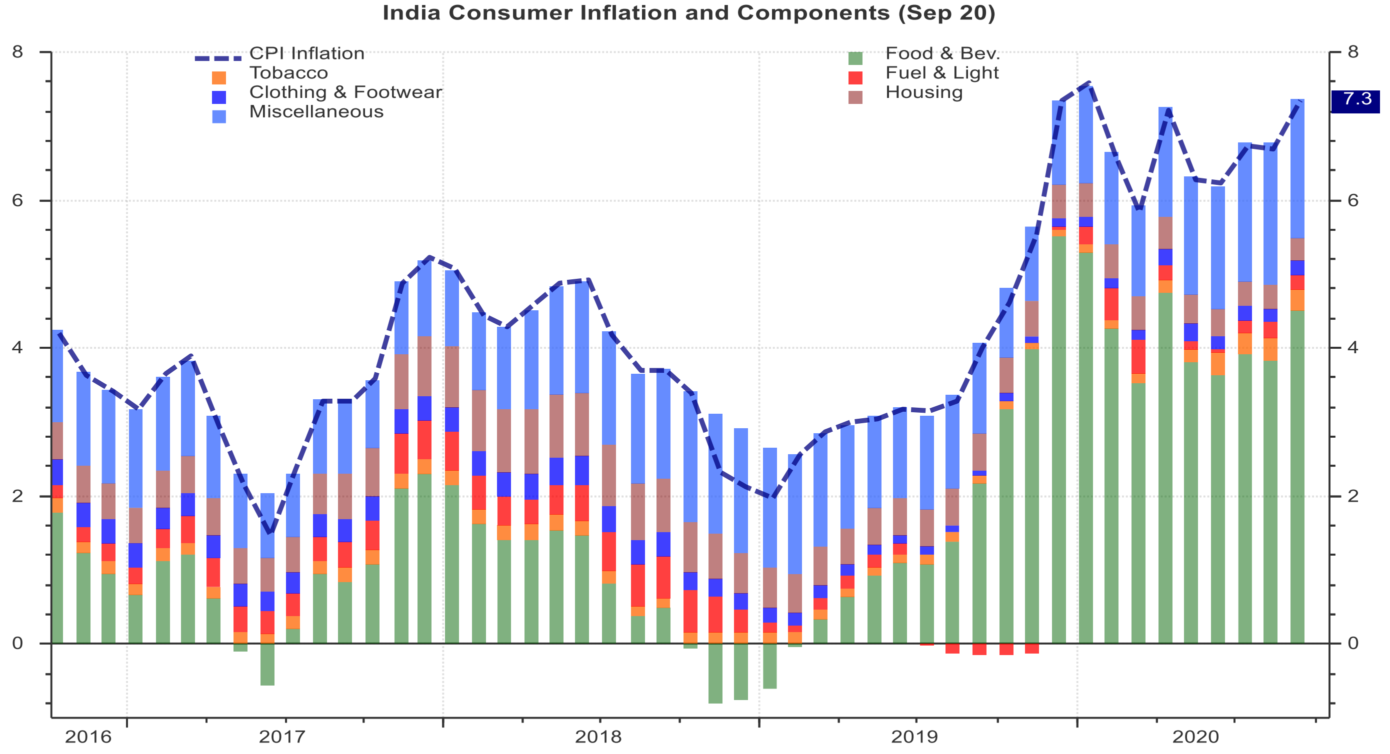
Source: CMIE Economic Outlook, NSE

Figure 5: Tomato and Potato together account for ~50bps of the 65bps spike in headline inflation in September



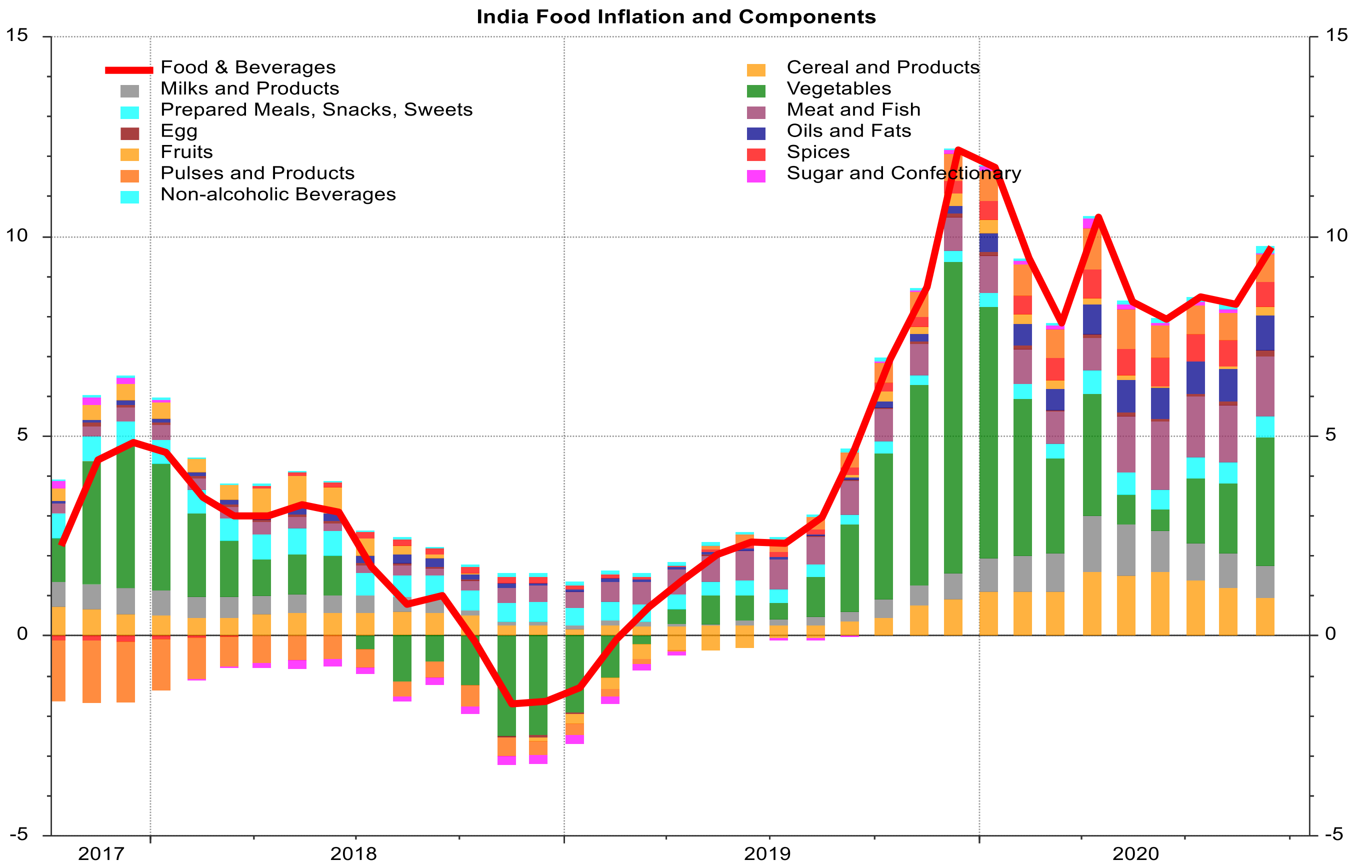
Source: CMIE Economic Outlook, NSE

Figure 6: Category-wise contribution to India consumer price inflation (CPI)



Source: Refinitiv Datastream, NSE.

Figure 7: Category-wise contribution to India Food and Beverages inflation (CPI)



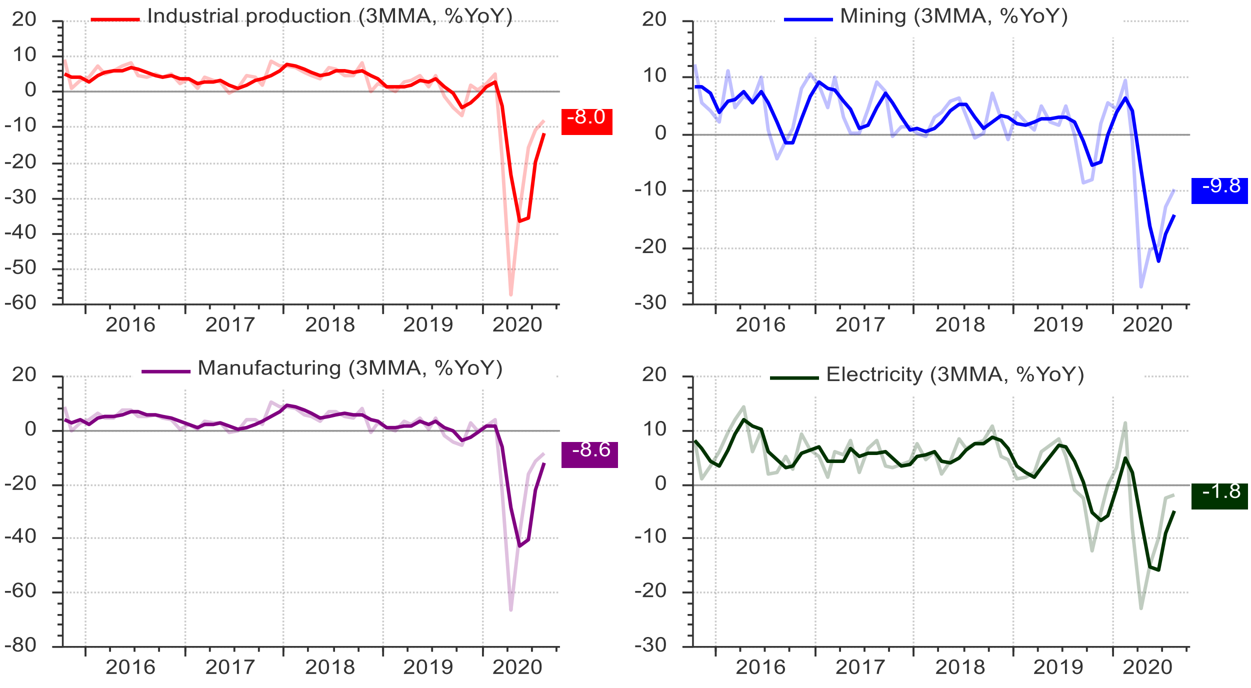
Source: Refinitiv Datastream, NSE.

Figure 8: India industrial production for August 2020 (%YoY)

		Weight (%)	Aug-20	Jul-20	Aug-19	FY21TD	FY20TD
	IIP		(8.0)	(10.8)	(1.4)	(25.0)	2.5
Sector-based indices	Mining	14.4	(9.8)	(12.8)	-	(18.2)	2.8
	Manufacturing	77.6	(8.6)	(11.6)	(1.7)	(28.0)	2.0
	Electricity	8.0	(1.8)	(2.5)	(0.9)	(10.4)	5.2
Use-based Goods	Primary Goods	34.0	(11.1)	(10.8)	1.0	(16.5)	2.5
	Capital Goods	8.2	(15.4)	(22.8)	(20.9)	(47.8)	(7.9)
	Intermediate Goods	17.2	(6.8)	(11.7)	7.3	(28.3)	10.1
	Infra/Construction Goods	12.3	(2.3)	(8.6)	(5.7)	(30.8)	(0.3)
	Consumer Goods	28.2	(6.2)	(8.8)	(2.6)	(25.2)	1.7
	Consumer Durables	12.8	(10.3)	(23.0)	(9.7)	(47.3)	(4.1)
	Consumer Non-durables	15.3	(3.3)	1.8	3.1	(8.9)	6.5

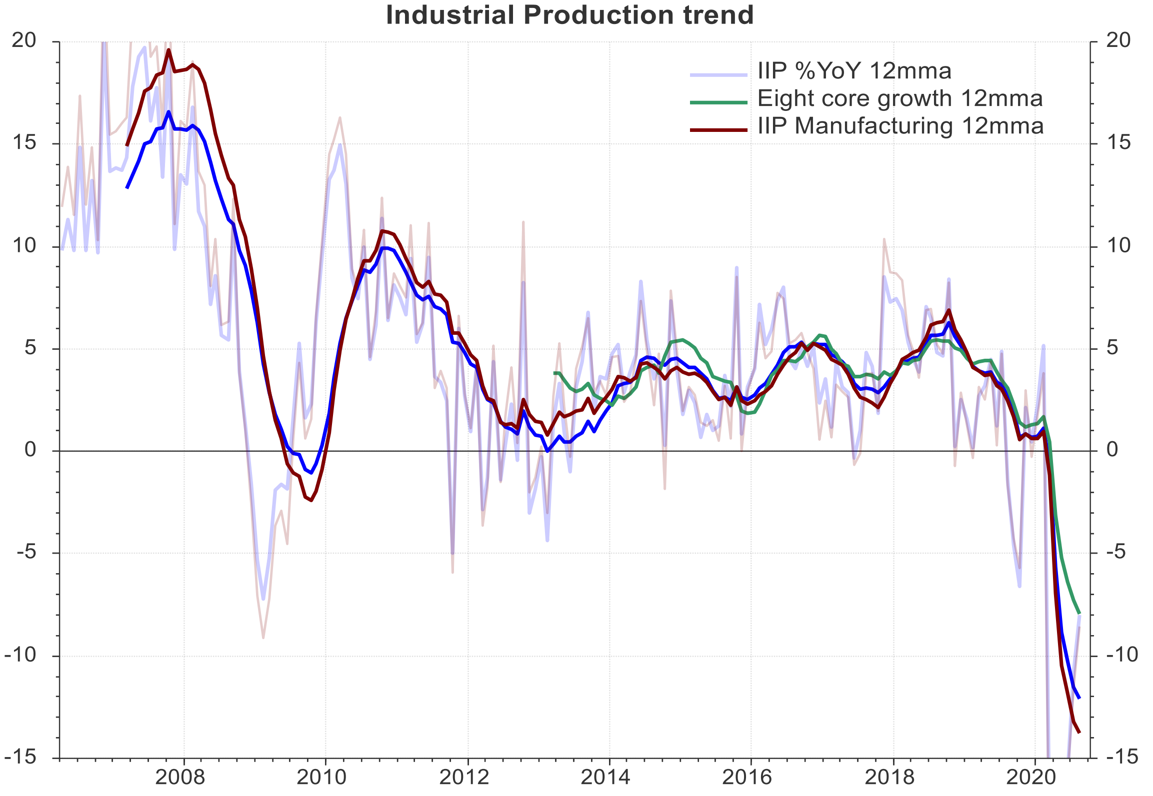
Source: CSO, NSE

Figure 9: India industrial production (3MMA)



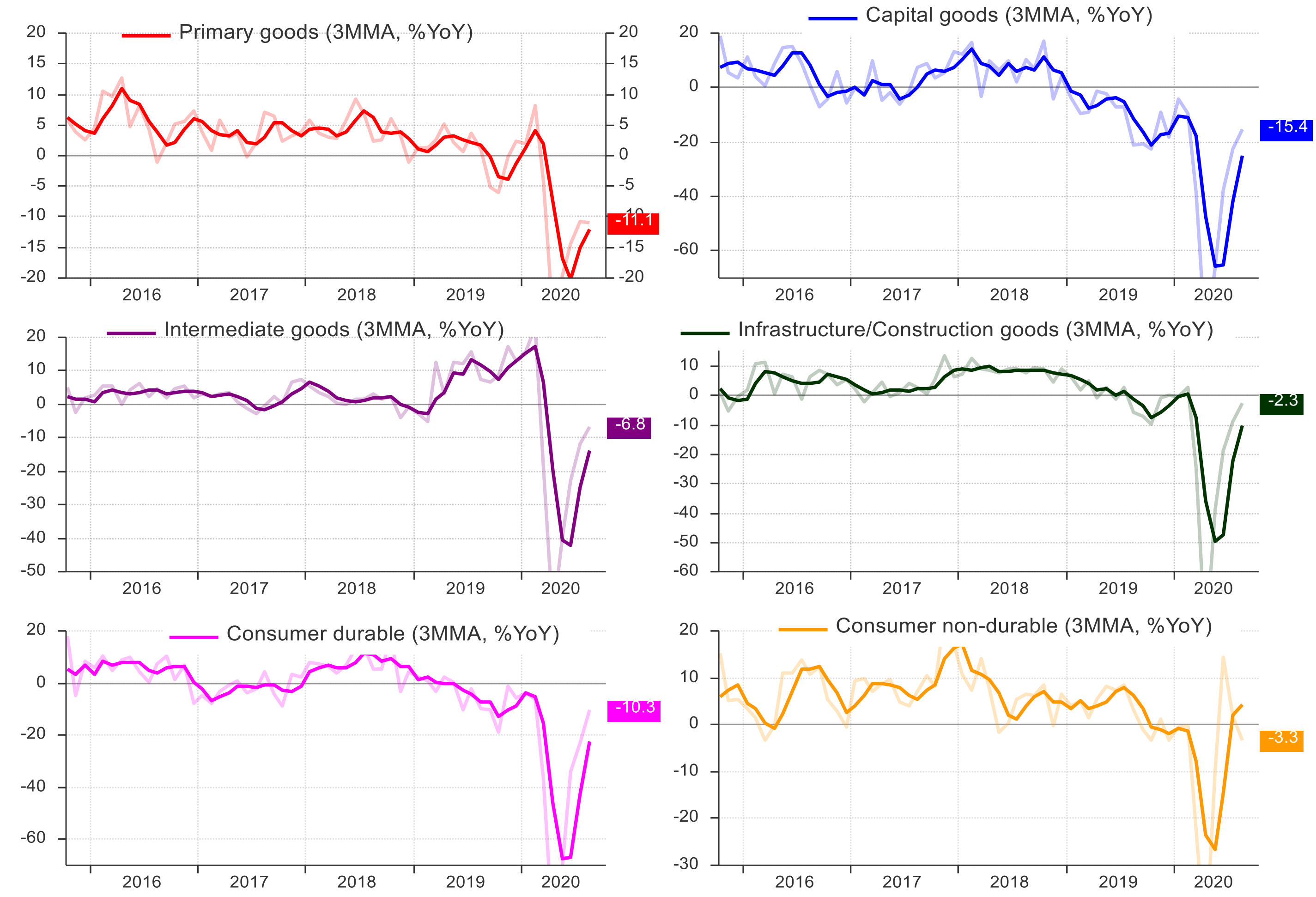
Source: Refinitiv Datastream, NSE

Figure 10: Long-term industrial production trend (12MMA)



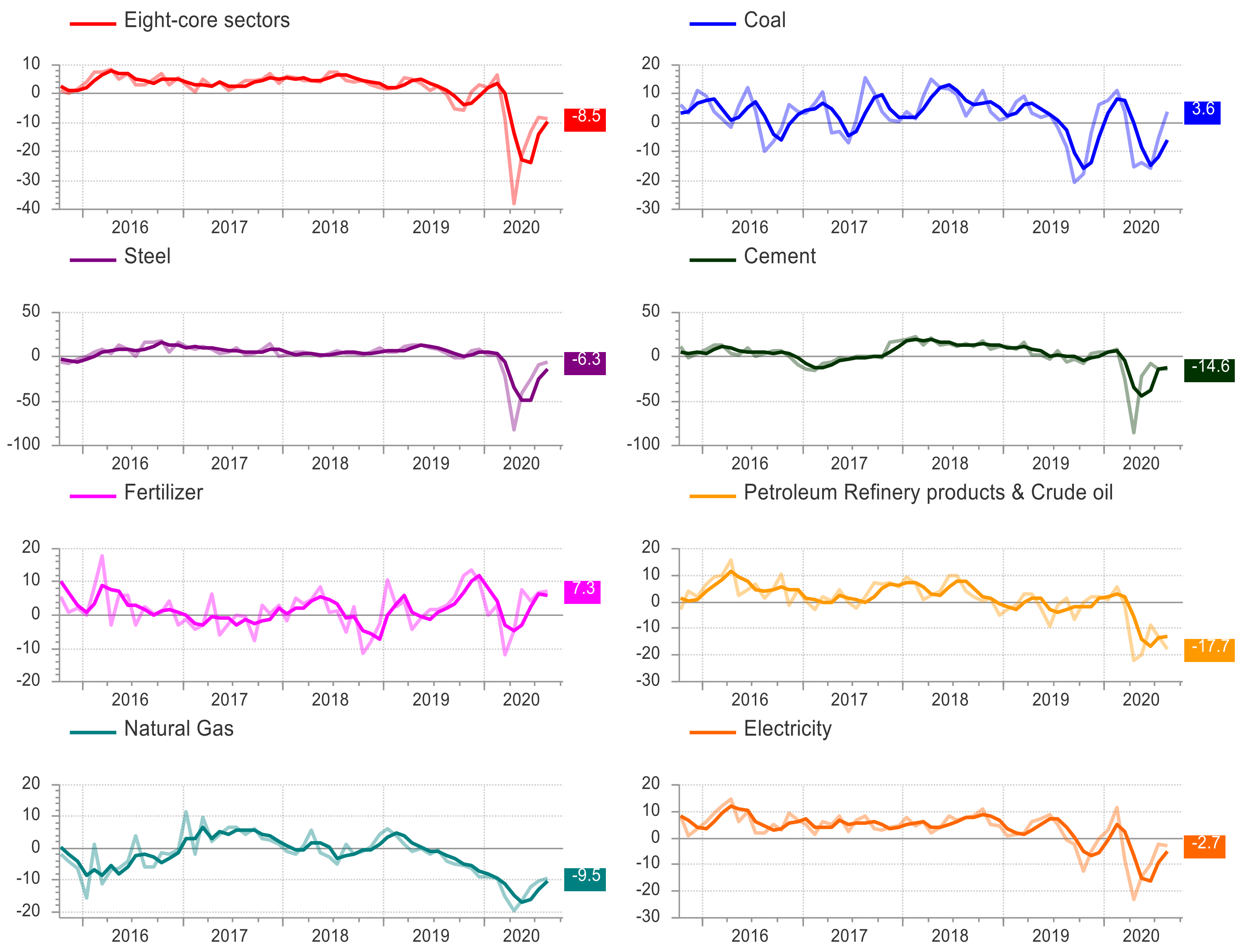
Source: Refinitiv Datastream, NSE

Figure 11: India industrial production use-based goods (3MMA)



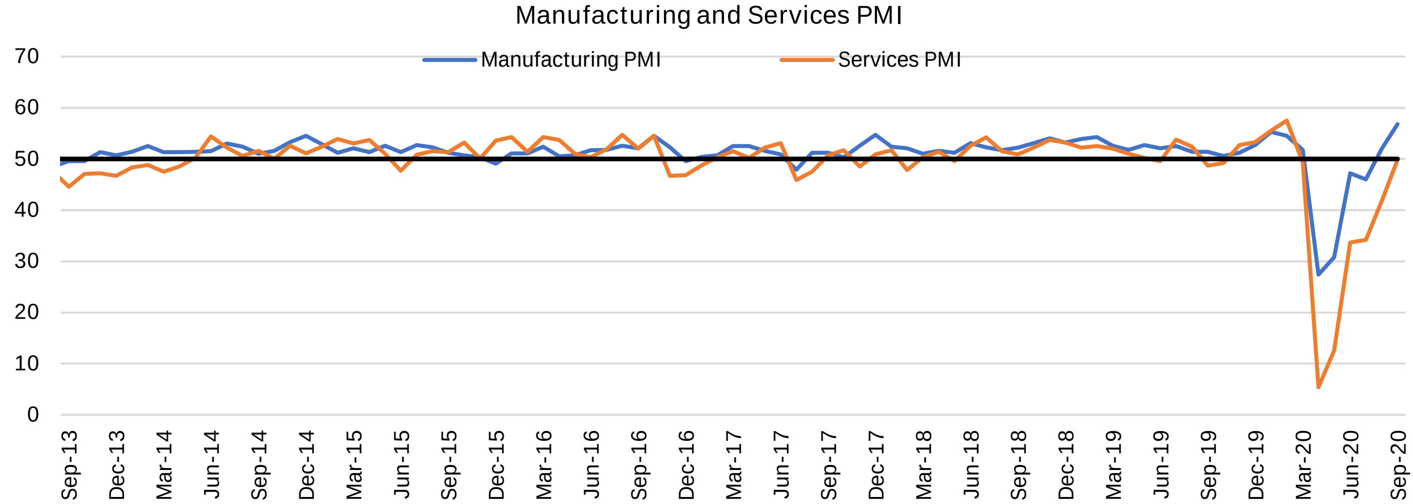
Source: Refinitiv Datastream, NSE

Figure 12: India eight-core sector growth (3MMA)



Source: Refinitiv Datastream, NSE

Figure 13: Manufacturing and Services PMI rebounds sharply in September



Source: CMIE Economic Outlook, NSE.

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