

Growth-inflation dynamics turn unfavourable

Headline CPI inflation witnessed a sequential uptick for the second month in a row, rising to a four-month high of 5.5% in Mar'21 from 5.0% in the previous month—a tad higher than the Consensus estimate of 5.4% (Source: Reuters). Amidst an unfavourable base, food and fuel inflation led the rebound. The surge was primarily led by higher food and fuel prices as well as a steady increase in core inflation. Within the food basket, acceleration in prices of certain items like meat & fish, pulses, fruits and fats & oils as well as lower deflation in vegetable prices contributed to the rise in food inflation. Core inflation (headline inflation ex food and fuel), continued to inch higher and rose to a 29-month high of 5.7% YoY, primarily led by higher auto fuel prices that pushed transport & communication services inflation to the highest level in the series, partly offset by decline in gold/silver prices.

Industrial recovery remains in fits and starts, with Industrial Production (IIP) recording an YoY contraction for the second month in a row, albeit off a high base. Following an upwardly revised drop of **0.9% in Jan'21**, IIP fell by a sequentially steeper **3.6%YoY in Feb'21**, negative surprising market expectations (Consensus: -3.0%; source: Reuters). The plunge was yet again led by Manufacturing and Mining even as Electricity continued to remain in the positive territory despite an unfavourable base. The use-based classification shows continued weakness in investment activity as reflected from sustained contraction in production of capital and infra/construction goods, even as consumption demand has remained steady.

Notwithstanding a favourable base, renewed COVID-led supply-side bottlenecks, coupled with cost-push pressures emanating from higher commodity prices and logistics costs, are likely to keep inflation trajectory elevated in the near future. Economic recovery—that had already been showing signs of faltering—now faces significant downside risks amidst re-imposition of lockdown restrictions in several states in the wake of COVID resurgence. Additionally, a prolonged slowdown in pace of inoculations—witnessed since the beginning of Phase 3 (April 1st) due to supply shortage—can further derail the recovery process. While an elevated inflation trajectory rules out any rate cut possibility in the foreseeable future, increasing COVID-led uncertainty on growth outlook would ensure sustenance of an accommodative stance at least through **the current financial year. The RBI's focus** is likely to remain on ensuring ample liquidity in the system to support the economy and ensure smooth execution of the Government's borrowing programme without hurting financial stability.

- **Retail inflation rebounds to a four-month high in March...:** Headline retail inflation witnessed a sequential uptick for the second month in a row, rising to a four-month high of 5.5% in Mar'21. This was a tad higher than the Consensus estimate of 5.4%. The pick-up is largely attributable to further increase in food & beverages inflation, higher crude oil/fuel prices and modest increase in core inflation. Headline CPI inflation has averaged at 6.2% in FY21 vs. 4.8% in FY20.
- **...primarily led by higher food and fuel prices...:** The uptick in headline inflation was primarily led by a further surge in food inflation, that rose to a four-month high of 5.2% YoY in Mar'21. Within the food basket, acceleration in prices of certain items like meat and fish (+15.1% vs. +11.5% in Feb), pulses (+13.3% vs. +12.6% in Feb), fruits (+7.9% vs. +6% in Feb), fats & oils (+24.9% vs. +20.9% in Feb) and non-alcoholic beverages (+14.4% vs. +14% in Feb) as well as lower deflation in vegetable prices (-4.8% vs. -6.3% in Feb) contributed to the rise in food inflation. This was partly offset by moderation in prices of other food items including cereals, eggs, milk & milk products and spices. In fact, broadly all categories within food including saw an uptick in inflation in March. This trend is in sync with firming global food prices. Fuel & light inflation also rose to a 12-month high of 4.5% in March'21.
- **...and continued steady increase in core inflation:** Core inflation (headline inflation ex food and fuel), continued to inch higher and rose to a 29-month high of 5.7% YoY in Mar'21, primarily led by higher auto fuel prices that pushed transport & communication services inflation to 12.6%—the highest in the series. Except for

Headline retail inflation rose for the second month in a row to a four-month high of 5.5% in Mar'21.

personal care & effects and health, all other categories witnessed a spike in inflation in March. Core inflation has averaged at 5.3% in FY21 vs. 4% in FY20.

- **IIP growth plunges in February...:** Industrial production fell by a higher-than-expected 3.6% YoY in **Feb'21** following an upwardly revised 0.9% YoY contraction in the previous month. This reflects an uneven recovery in industrial activity which is likely to be weighed down further by the recent spike in COVID cases and renewed lockdown restrictions, even as a favorable base may keep the growth figures look optically strong. The average IIP growth during **Apr-Feb'21 stood at -11.3%** vs. a modest 1% growth during the same period in the previous fiscal year.
- **...Led by weakness in Mining and Manufacturing activity:** Manufacturing sector fell by 3.7% YoY drop in **Feb'21**—the steepest YoY decline in six months, partly off a high base (+3.8% YoY in **Feb'20**). **The weakness was fairly broad-based**, with 17/23 sub-sectors recording a YoY contraction, led by recorded media (-28.3%), furniture (-19.0%), wearing apparel (-14.2%), beverages (-13.1%), paper & paper products (-10.3%), and coke & refined petroleum products (-9.5%). This was partly offset by strong 21.1% YoY growth in computer, electronic and optical products, and modest 3-5% growth in motor vehicles, trailers & semi-trailers and other transport equipment as well as electrical equipment. Mining activity remained lacklustre for yet another month, falling by a six-month high of 5.5% YoY—marking the fifth month and 11/12 months to witness a YoY contraction. On the positive side, Electricity sector continued to show a steady performance, registering a modest 0.1% YoY growth despite an unfavourable base (+11.5% YoY in **Feb'20**).
- Use-based classification shows continued weakness in investment activity: In the use-based classification, while investment-led sectors witnessed a contraction for yet another month, consumption-led sectors remained broadly steady despite a spike in COVID cases beginning mid-February. On a YoY basis, Primary, Intermediate and Infra/Construction Goods declined by 5.1%, 5.6% and 4.6% respectively. Capital Goods production also slumped by 4.2% YoY, following a steep 9.0% YoY drop in the previous month, indicating continued weakness in investment activity. Consumption activity has remained broadly steady—reflected in a modest 0.2% YoY growth in overall Consumer Goods production, primarily led by **Consumer Durables which recorded a strong 6.3% YoY growth in Feb'21**, albeit off a low base (-6.2% in **Feb'20**), even as Consumer Non-durables fell by 3.8% YoY.
- Expect sustenance of accommodative stance and continued liquidity support from RBI: Notwithstanding a supportive base, renewed COVID-led supply-side bottlenecks, along with cost-push pressures arising from higher commodity prices and logistics costs, are likely to keep inflation trajectory elevated in the near future. Economic recovery—that had already been showing signs of faltering—visible from a sequentially slower growth in some high-frequency indicators (auto sales, freight traffic, petrol consumption)—faces significant downside risks amidst re-imposition of lockdown restrictions in several states due to COVID resurgence. Additionally, a prolonged slowdown in pace of inoculations—witnessed since the beginning of Phase 3 (April 1st) due to supply shortage, can further derail the recovery process. While an elevated inflation trajectory rules out any rate cut possibility in the foreseeable future, increasing COVID-led uncertainty on growth outlook would ensure sustenance of an accommodative stance at least through the current financial year. **The RBI's focus is likely to remain on ensuring ample liquidity in the system to support the economy and ensure smooth execution of the Govt.'s borrowing programme without hurting financial stability.**

Industrial production growth fell deeper into the contraction zone, falling by 3.6% YoY in Feb'21.

Expect RBI to maintain an accommodative stance all through FY21 and support growth by ensuring adequate liquidity in the system.

Figure 1: Consumer price inflation in March 2021 (%YoY)

%YoY	Weight (%)	Mar-21	Feb-21	Mar-20	FY21TD	FY20TD
CPI		5.5	5.0	5.8	6.2	4.8
Food & Beverages	45.9	5.2	4.3	7.8	7.3	6.0
Pan, Tobacco & Intoxicants ²	2.4	9.8	10.7	4.7	9.9	4.2
Clothing & Footwear ²	6.5	4.4	4.2	2.1	3.4	1.6
Housing	10.1	3.5	3.2	3.7	3.3	4.5
Fuel & Light	6.8	4.5	3.5	6.6	2.7	1.3
Miscellaneous ²	28.3	6.9	6.8	4.4	6.6	4.4
Core CPI inflation ^{1,2}	44.9	5.7	5.6	3.9	5.3	4.0

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

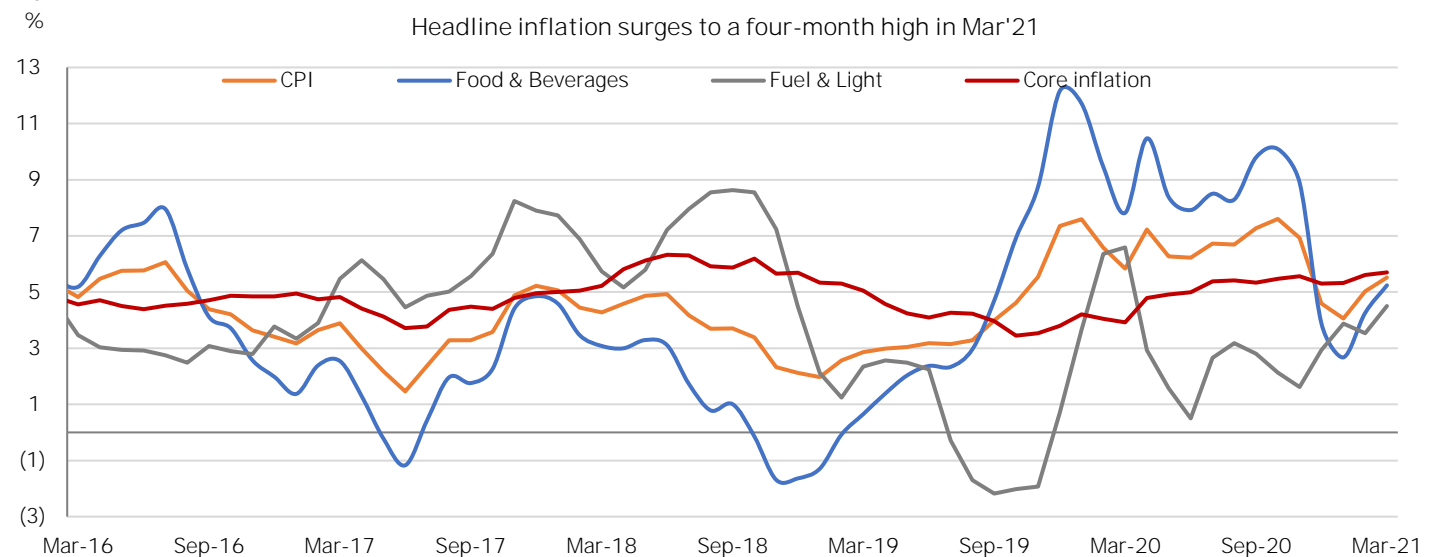


Figure 3: Real interest rates have remained negative for quite some time now

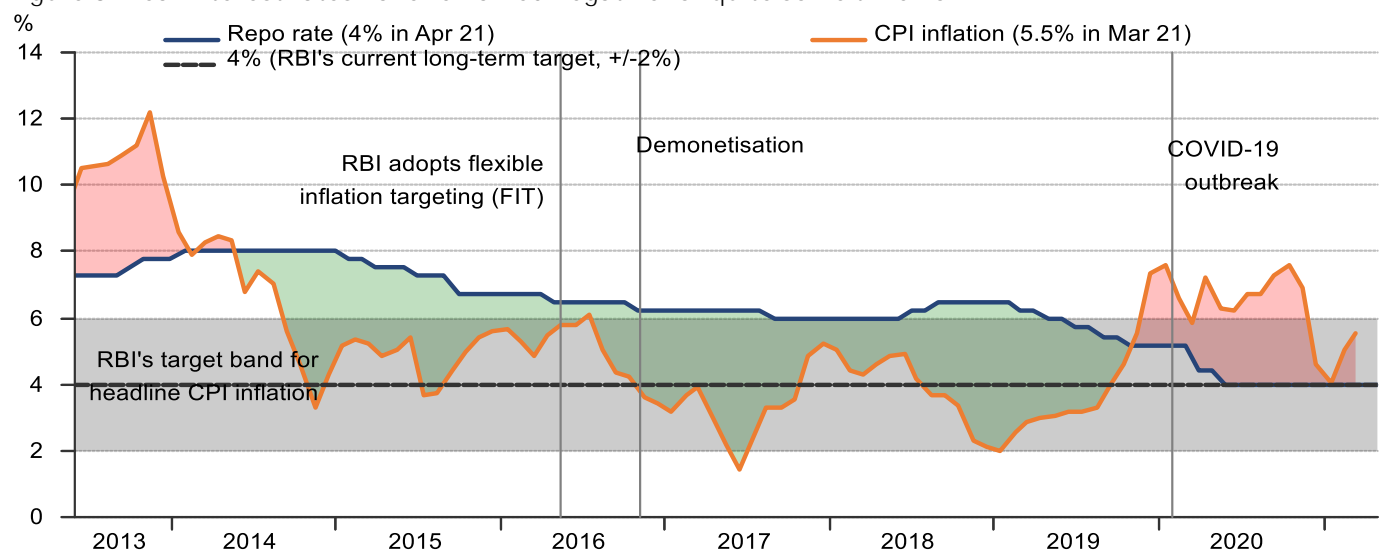
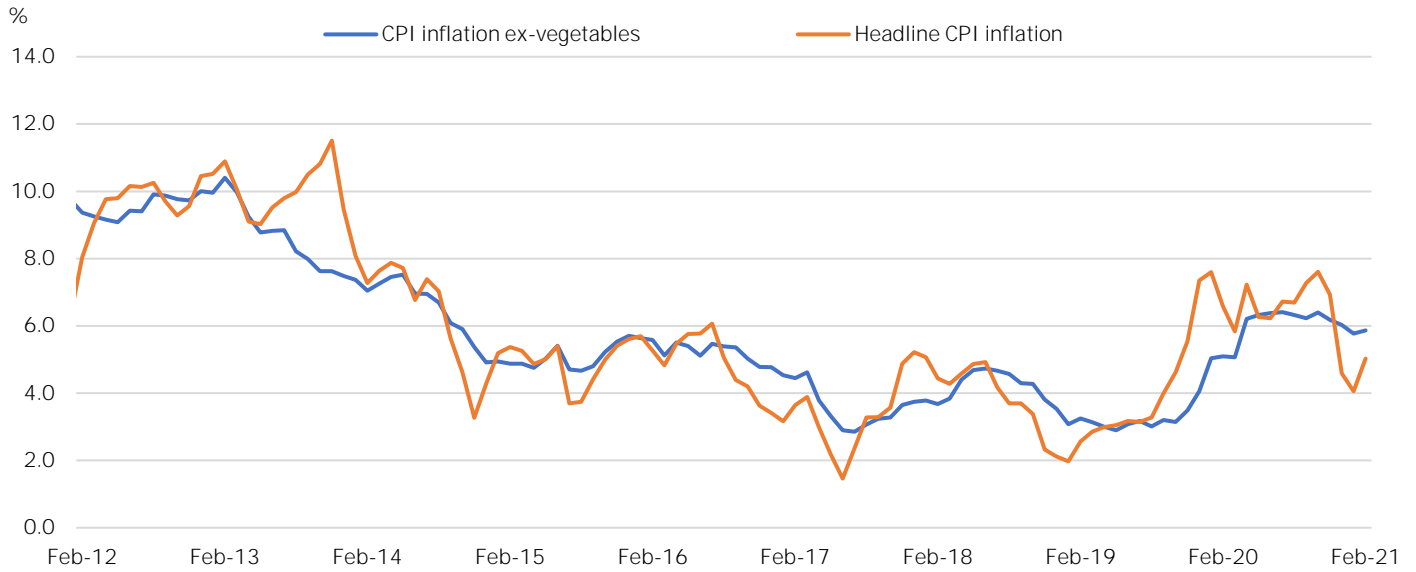


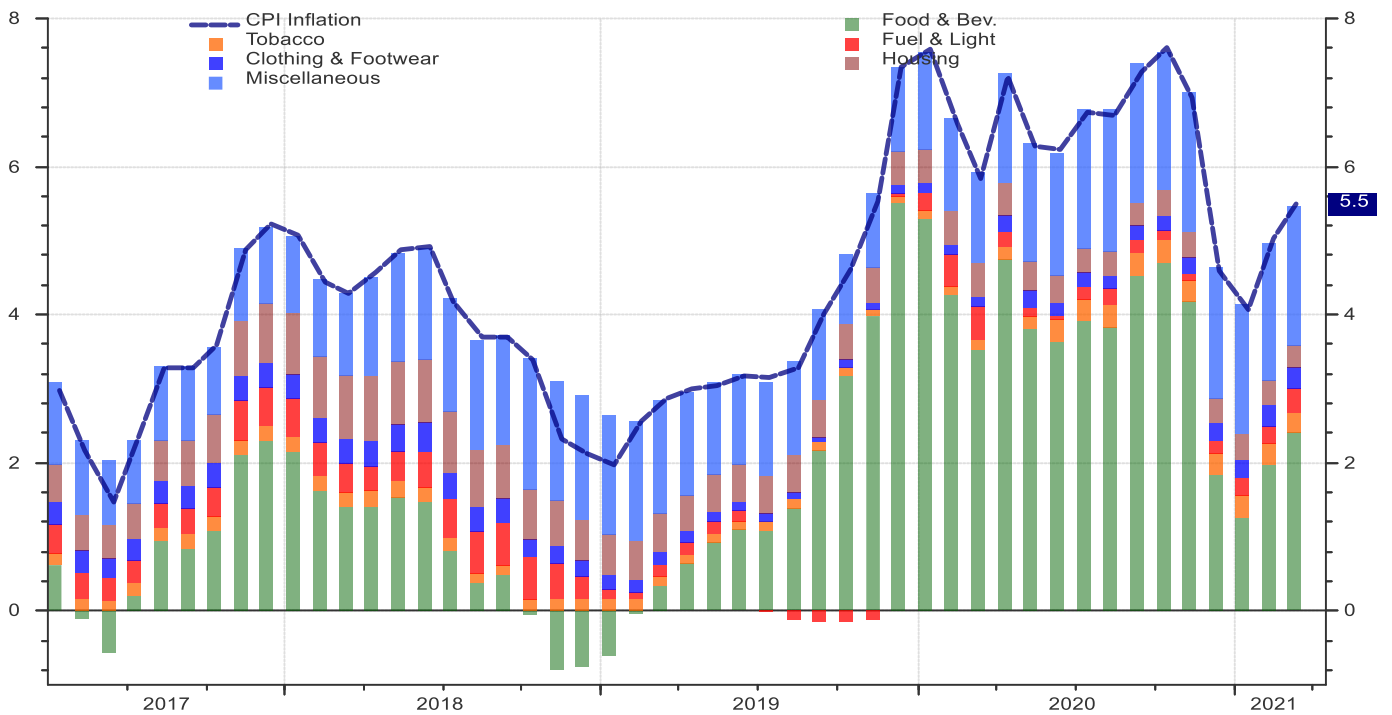
Figure 4: Fall in headline inflation primarily led by higher vegetable prices



Source: CMIE Economic Outlook, NSE

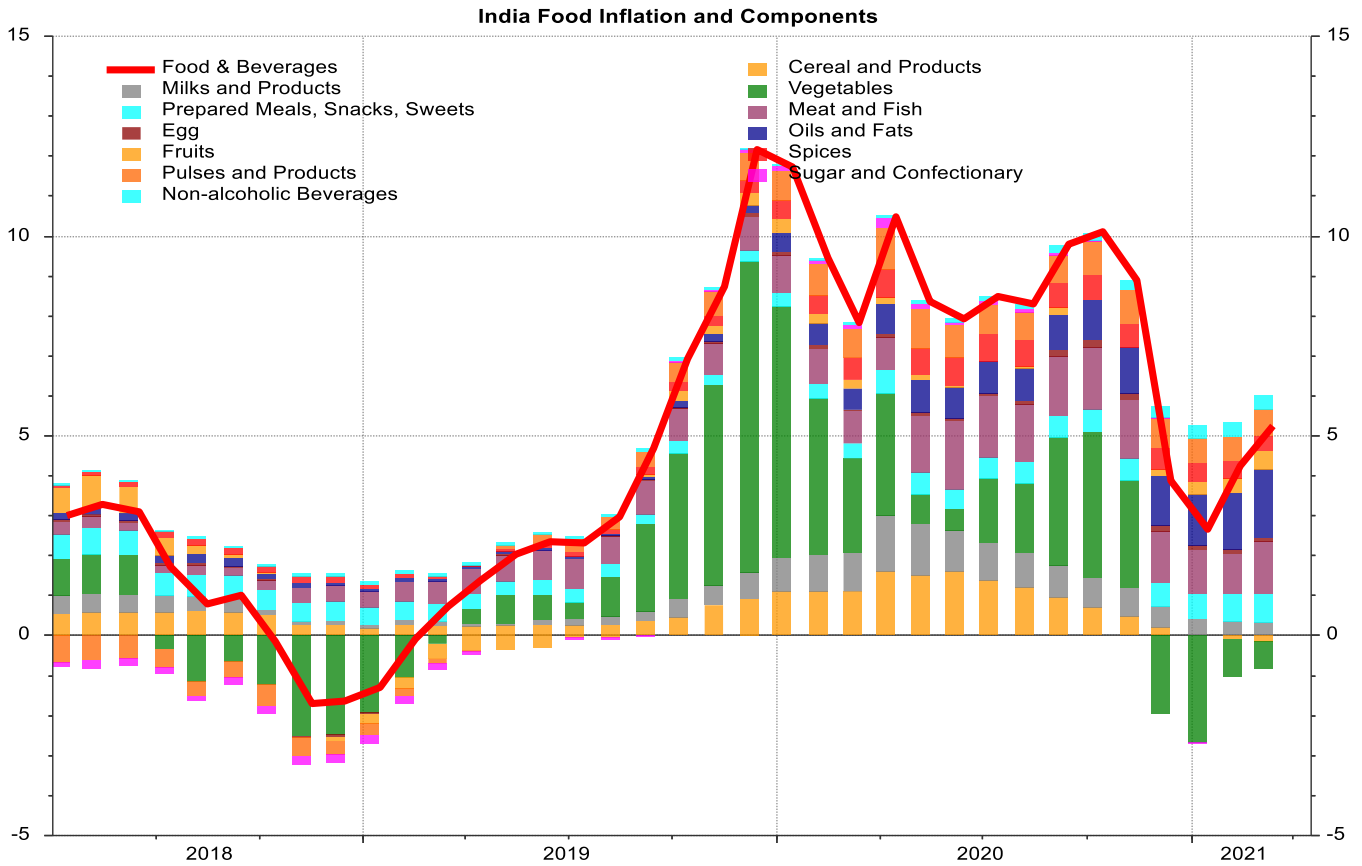
Figure 5: Category-wise contribution to India consumer price inflation (CPI)

India Consumer Inflation and Components (Mar 21)



Source: Refinitiv Datastream, NSE.

Figure 6: Category-wise contribution to India Food and Beverages inflation (CPI)



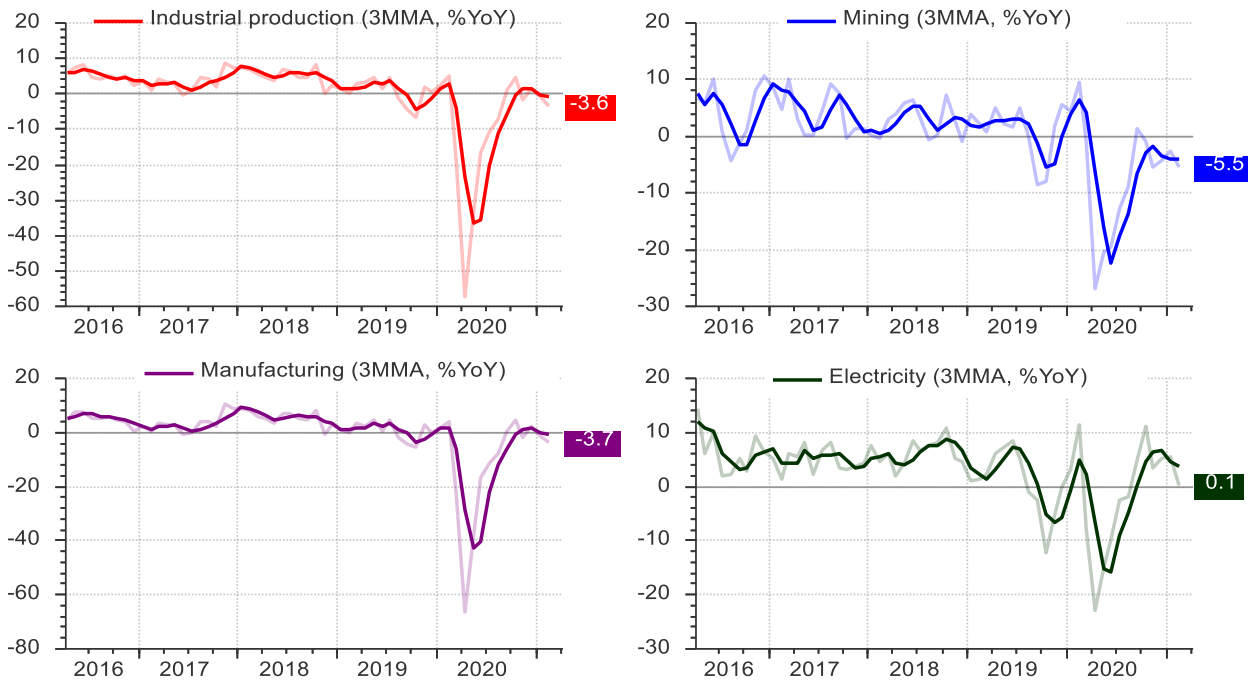
Source: Refinitiv Datastream, NSE.

Figure 7: India industrial production for February 2021 (%YoY)

%YoY	Weight (%)	Feb-21	Jan-21	Feb-20	FY21TD	FY20TD	
IIP		(3.6)	(0.9)	5.2	(11.3)	1.0	
Sector-based indices	Mining	14.4	(5.5)	(2.5)	9.6	(10.1)	1.0
	Manufacturing	77.6	(3.7)	(1.3)	3.8	(13.5)	0.4
	Electricity	8.0	0.1	5.5	11.5	(2.7)	0.9
Use-based Goods	Primary Goods	34.0	(5.1)	0.7	8.2	(8.9)	0.5
	Capital Goods	8.2	(4.2)	(9.0)	(9.6)	(25.5)	(11.7)
	Intermediate Goods	17.2	(5.6)	0.9	23.0	(12.9)	11.2
	Infra/Construction Goods	12.3	(4.7)	1.8	2.8	(13.1)	(1.9)
	Consumer Goods	28.2	0.2	(3.4)	(2.7)	(11.9)	(1.4)
	Consumer Durables	12.8	6.3	(0.2)	(6.2)	(22.1)	(6.2)
	Consumer Non-durables	15.3	(3.8)	(5.4)	(0.3)	(4.7)	2.3

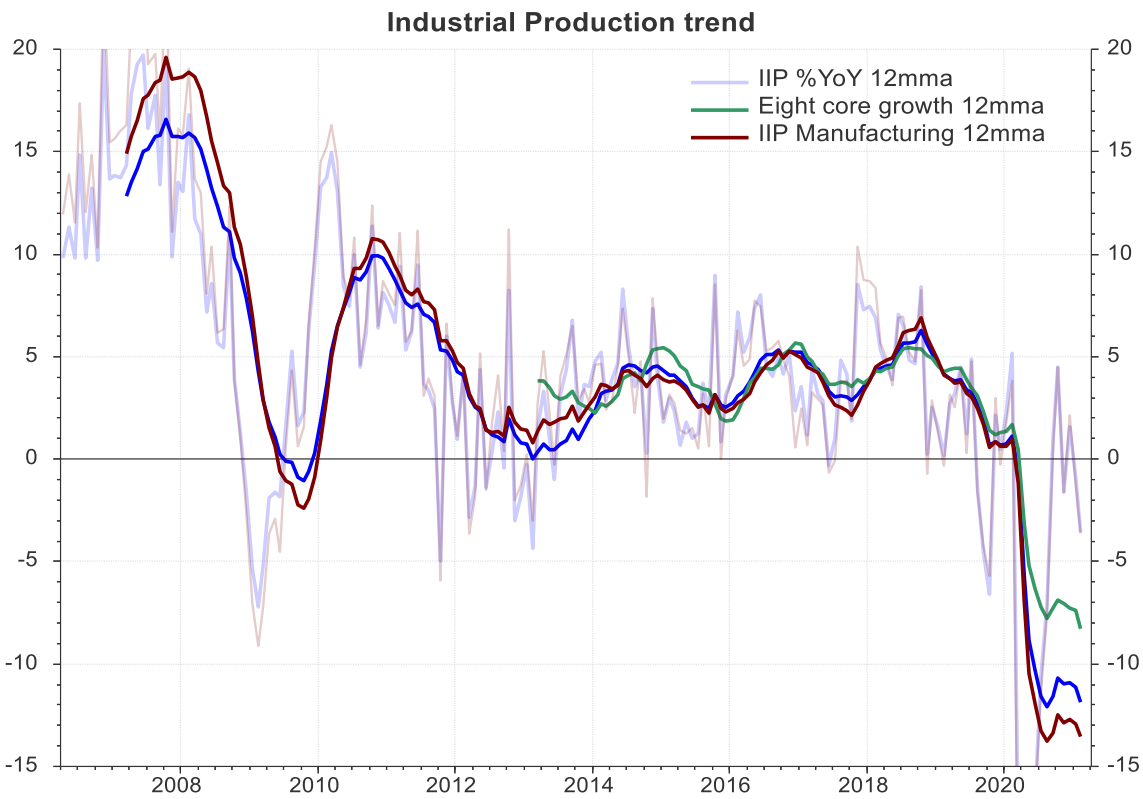
Source: CSO, NSE.

Figure 8: India industrial production (3MMA)



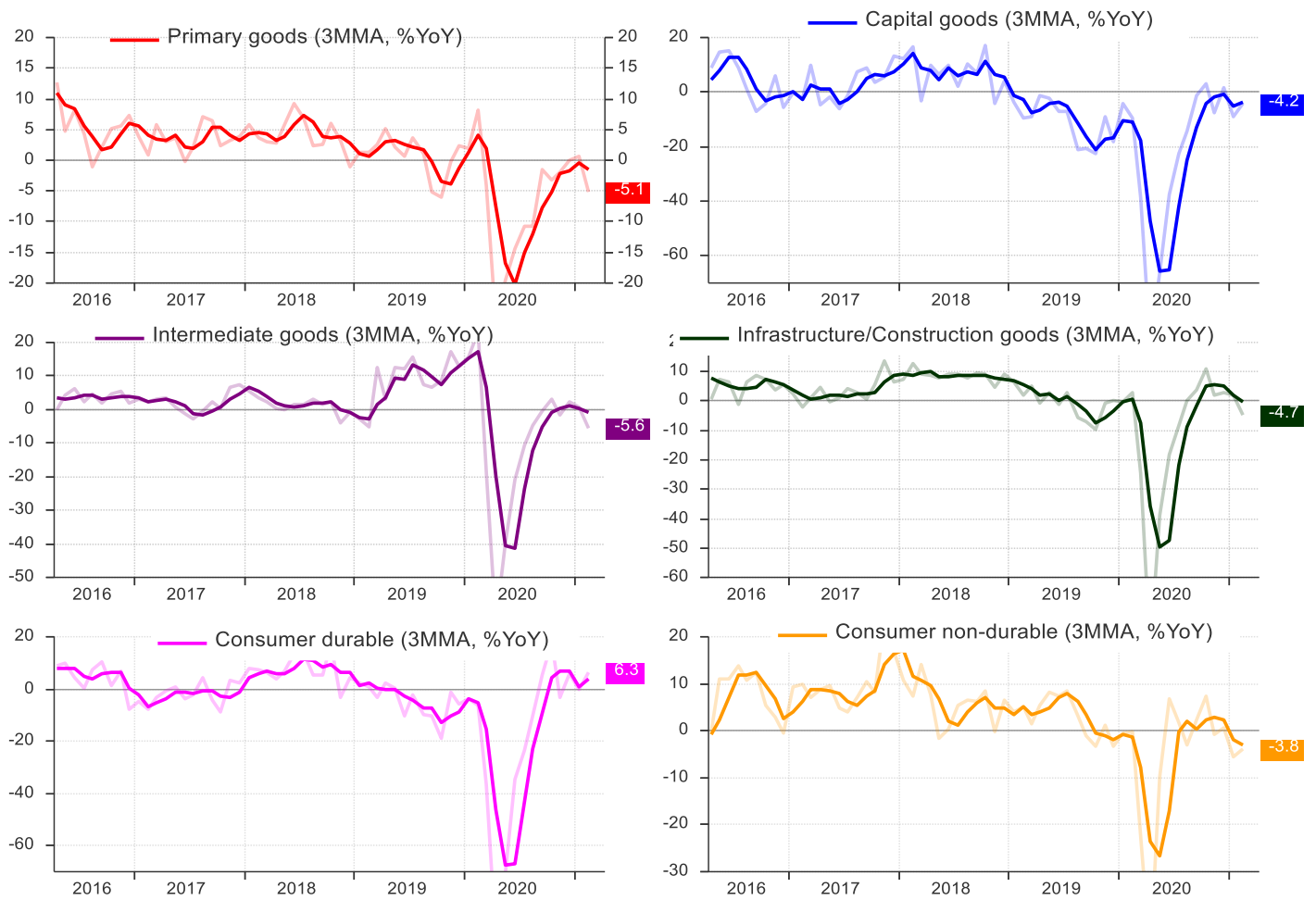
Source: Refinitiv Datastream, NSE

Figure 9: Long-term industrial production trend (12MMA)



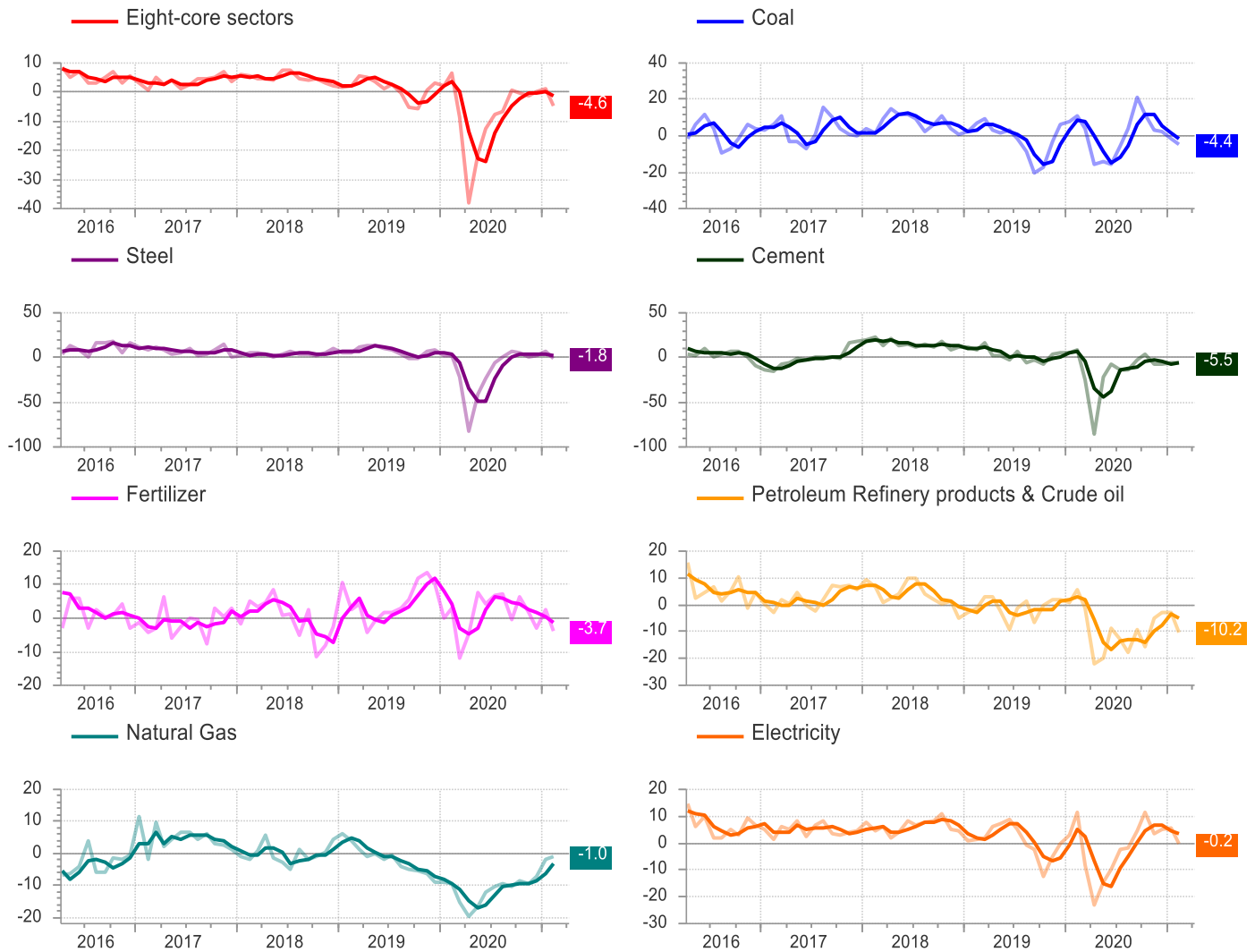
Source: Refinitiv Datastream, NSE

Figure 10: India industrial production use-based goods (3MMA)



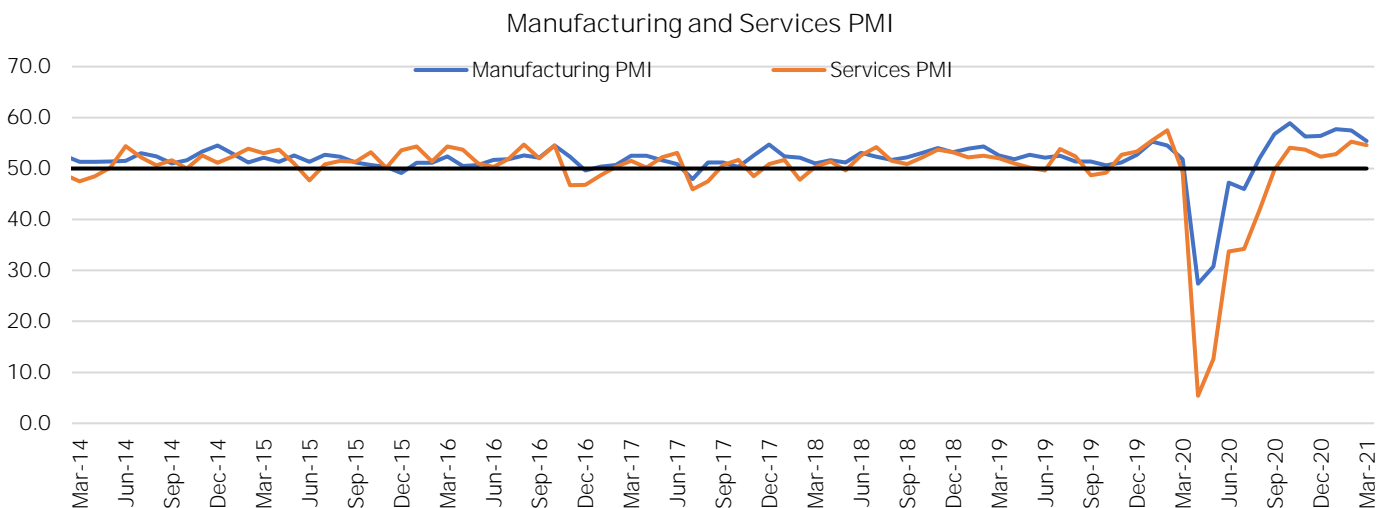
Source: Refinitiv Datastream, NSE

Figure 11: India eight-core sector growth (3MMA)



Source: Refinitiv Datastream, NSE

Figure 12: Manufacturing and Services PMI slows down in March amid rising COVID cases



Source: CMIE Economic Outlook, NSE.

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