

## Retail inflation rebounds; IIP slumps

Headline CPI inflation bounced back again and surged to a three-month high of 5.0% in February 2021, snapping its downward trend and negatively surprising market expectations (Consensus: 4.8%; Source: Reuters). Food and fuel inflation led the rebound. Within food, acceleration in prices of certain items like fruits and fats & oils as well as lower deflation in vegetable prices, particularly onions, weighed in on the rise. Core inflation (headline inflation ex food and fuel), inched higher and rose to a 26-month high of 5.6% YoY—a reflection of steady consumption demand and higher commodity prices.

Industrial recovery in India remains uneven with Industrial Production (IIP) falling back into the contraction zone, recording a 1.6% YoY decline in January 2021 following an upwardly revised expansion of 1.6% in December 2020. This is much lower than the Consensus estimate of +0.9% YoY and even lower than the minimum market expectation of -1.4%. The plunge was led by Manufacturing and Mining even as Electricity continued to show decent growth. The use-based classification shows weakness in consumption as well as investment activity as reflected from a five-month high YoY fall in Consumer and Capital Goods production.

We expect the headline inflation to remain elevated for another month before the base effect starts kicking in as benefits from lower food prices are likely to be outweighed by demand-side pressures and rising crude and commodity prices. Notwithstanding a supportive base, inflation is expected to remain north of the RBI's 4% target in the foreseeable future. Economic recovery seems to have faltered after the festive season—visible from a sequentially slower growth in some high frequency indicators (auto sales, freight traffic, petrol consumption), with the resurgence of COVID-19 cases and rising commodity prices posing further downside risks. That said, the increasing pace of inoculations should translate into continued normalisation of activities, particularly in the contact-based services sector. We expect the RBI to remain 'accommodative' in 2021 given the nascent economic recovery but see no change in policy rates. The RBI's focus would remain on maintaining adequate liquidity in the system to support the ongoing recovery and ensure effective execution of the Govt's borrowing programme.

- **Retail inflation rebounds to a three-month high in February...:** Headline retail inflation snapped the downward trend and came in at 5% in February 2021—the highest print in last three months. The rebound is largely attributable to higher food and beverage prices coupled with the surge in fuel and other commodity prices. Headline CPI inflation has averaged 6.2% in FY21 thus far (April 2020–February 2021) as compared to 4.7% during the same period in FY20.
- **...Led by higher food inflation:** The higher-than-expected uptick in headline inflation was primarily led by a surge in food inflation to a three-month high of 4.3 YoY in Feb'21 from an 18-month low of 2.7% in Jan'21. Within the food basket, acceleration in prices of certain items like fruits (+6.3% vs. 5% in Jan), fats & oils (+20.8% vs. +19.8% in Jan) and non-alcoholic beverages (+13.9% vs. +13.2% in Jan) as well as lower deflation in vegetable prices (-6.3% vs. -15.8% in Jan) have contributed to the rise in food inflation. Within vegetables, significant increase in prices of onions (+2.5% vs. -36.2% in Jan) and tomatoes (+4.4% vs. -3.7% in Jan) pushed prices higher. This was partly offset by moderation in prices of other food items including cereals, meat & fish, eggs, milk & milk products, pulses, sugar and spices. In fact, all categories within food, barring fruits, fats and oils, vegetables, non-alcoholic beverages and prepared meals, saw a drop in inflation in February.
- **Core inflation inched higher:** Core inflation (headline inflation excluding food and fuel) rose to a 26-month high of 5.6% YoY—a reflection of steady consumption demand and higher fuel and commodity prices. Except for personal care & effects where inflation fell from 10.7% to a 11-month low of 8.6% because of significant moderation in gold prices and education where inflation remained steady at 2.1%, all other categories witnessed a spike in inflation in February. The increase has

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*Headline retail inflation snapped the downward trend and came in at a three-month high of 5% in February 2021.*

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been particularly steep in transportation and communication services where inflation surged to a five-month high of 11.4% YoY in February from 9.4% YoY in the previous month. Core inflation has averaged 5.3% over the April-Feb period of FY21 as compared to 4% over the same period of FY20.

- **IIP growth slumps in January...:** Industrial production fell by 1.6% YoY in Jan'21 following an upwardly revised 1.6% YoY growth in Dec'20, pointing to an uneven economic recovery, significantly falling short of market expectations (+0.9%). Growth in the previous months seem to have been supported by normalisation of business activities and inventory build-up to cater to festive/pent-up demand. The average IIP growth in the current fiscal year (Apr-Jan'21) is -12.2% as opposed to +0.6% growth during the same period in the previous fiscal year.
- **...Led by weakness in Mining and Manufacturing activity:** Manufacturing sector registered a 2.0% YoY drop in January—the steepest decline in five months, partly off a high base (+1.8% YoY in Jan'20). The weakness was fairly broad-based, with 18/23 sub-sectors recording a YoY contraction, led by wearing apparel (-20.2%), recorded media (-18.3%), furniture (-18%), paper & paper products (-12.5%), pharmaceuticals, medicinal chemical & botanical products (-11.5%) and tobacco products (-10.8%). This was partly offset by strong growth in rubber & plastic products (+6.3%), base metals (+4.2%) other transport equipment (+4.7%) and chemical & chemical products (+3.1%). Mining activity remained lacklustre for yet another month, down 3.7% YoY—marking the fourth month and 10/11 months to witness a YoY contraction, even as it improved on a sequential basis. On the positive side, Electricity sector continued to show healthy performance, growing by 5.5% YoY despite an unfavourable base (+3.1% YoY in Jan'20).
- **Use-based classification shows weakness in consumption and investment activity:** In the use-based classification, except for Primary Goods that registered a sequential improvement in January 2021, all other sectors witnessed a drop from the previous month's levels. On a YoY basis, Primary, Intermediate and Infra/Construction Goods grew by 0.2%, 0.5% and 0.3% respectively. Capital Goods production slumped by 9.6% YoY—the steepest drop in five months, indicating continued weakness in investment activity. Consumption activity also seem to have faltered, with Consumer Non-durables production falling by an eight-month high of 6.8% YoY, while Consumer Durables declined by a modest 0.2% YoY.
- **Expect sustenance of accommodative stance and adequate liquidity from RBI:** We expect the headline inflation to remain elevated for another month before the base effect starts kicking in as benefits from lower food prices is likely to be outweighed by demand-side pressures and rising crude and commodity prices. Notwithstanding a favourable base, inflation is expected to remain north of the RBI's 4% target in the foreseeable future. Economic recovery seems to have faltered after the festive season—visible from a sequentially slower growth in some high frequency indicators (auto sales, freight traffic, petrol consumption), with the resurgence of COVID-19 cases and rising commodity prices posing further downside risks. That said, increasing pace of inoculations should translate into continued normalisation of activities, particularly in the contact-based services sector. We expect the RBI to remain 'accommodative' in 2021 given the nascent economic recovery but see no change in policy rates. The RBI's focus would remain on maintaining adequate liquidity in the system to support the ongoing recovery and ensure effective execution of the Government's borrowing programme.

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*Industrial production growth fell back into contraction zone, falling by 1.6% YoY in Jan'21.*

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

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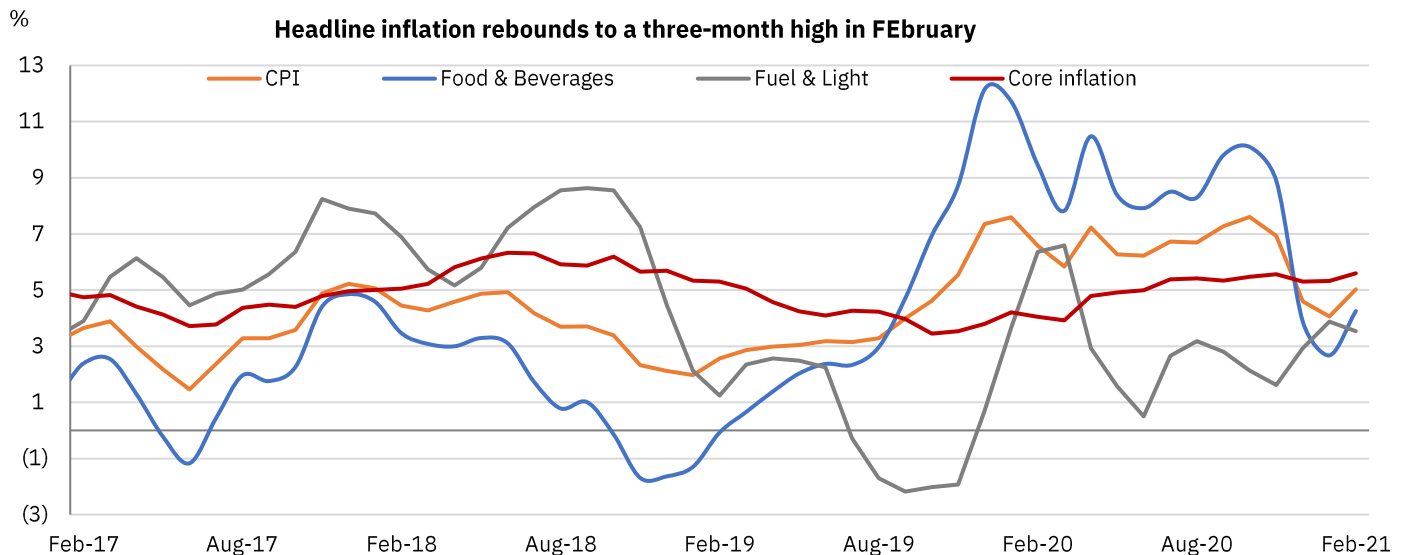
**Figure 1: Consumer price inflation in February 2021 (%YoY)**

| %YoY                                    | Weight (%) | Feb-21 | Jan-21 | Feb-20 | FY21TD | FY20TD |
|---|------------|--------|--------|--------|--------|--------|
| <b>CPI</b>                              |            | 5.0    | 4.1    | 6.6    | 6.2    | 4.7    |
| Food & Beverages                        | 45.9       | 4.3    | 2.7    | 9.5    | 7.5    | 5.9    |
| Pan, Tobacco & Intoxicants <sup>2</sup> | 2.4        | 10.7   | 10.9   | 4.1    | 9.9    | 4.1    |
| Clothing & Footwear <sup>2</sup>        | 6.5        | 4.2    | 3.8    | 2.0    | 3.3    | 1.6    |
| Housing                                 | 10.1       | 3.2    | 3.2    | 4.2    | 3.3    | 4.6    |
| Fuel & Light                            | 6.8        | 3.5    | 3.9    | 6.4    | 2.5    | 0.9    |
| Miscellaneous <sup>2</sup>              | 28.3       | 6.8    | 6.5    | 4.5    | 6.5    | 4.4    |
| <b>Core CPI inflation<sup>1,2</sup></b> | 44.9       | 5.6    | 5.3    | 4.0    | 5.3    | 4.0    |

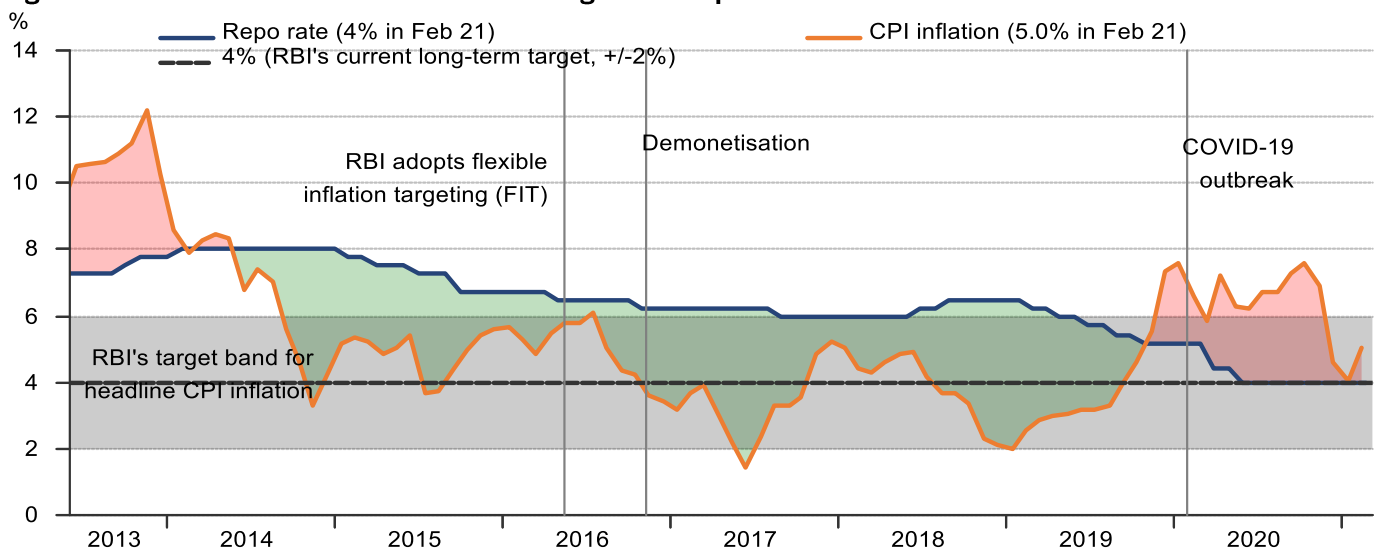
Source: CSO, NSE. NA = Not Available.

 Note: <sup>1</sup> Headline inflation excluding food & beverages, pan, tobacco & intoxicants and fuel & light.

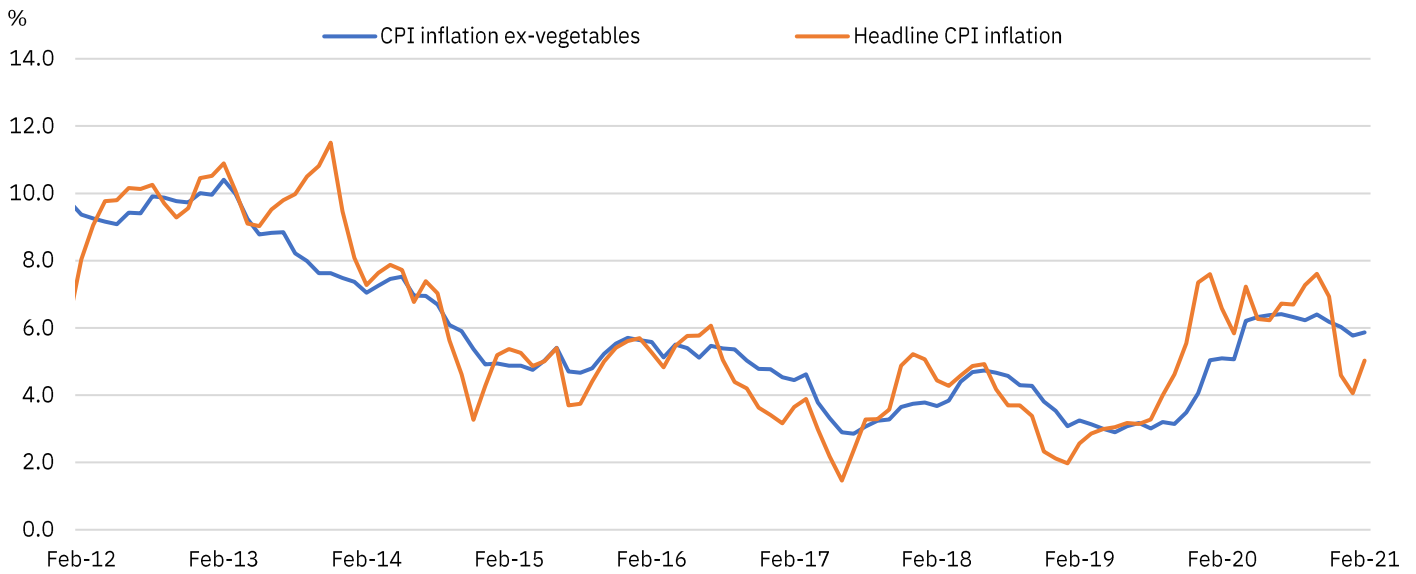
<sup>2</sup> Inflation data for these components for April and May 2020 are based on the imputed index calculated by MOSPI.

**Figure 2: Headline CPI inflation trend**


Source: CMIE Economic Outlook, NSE

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


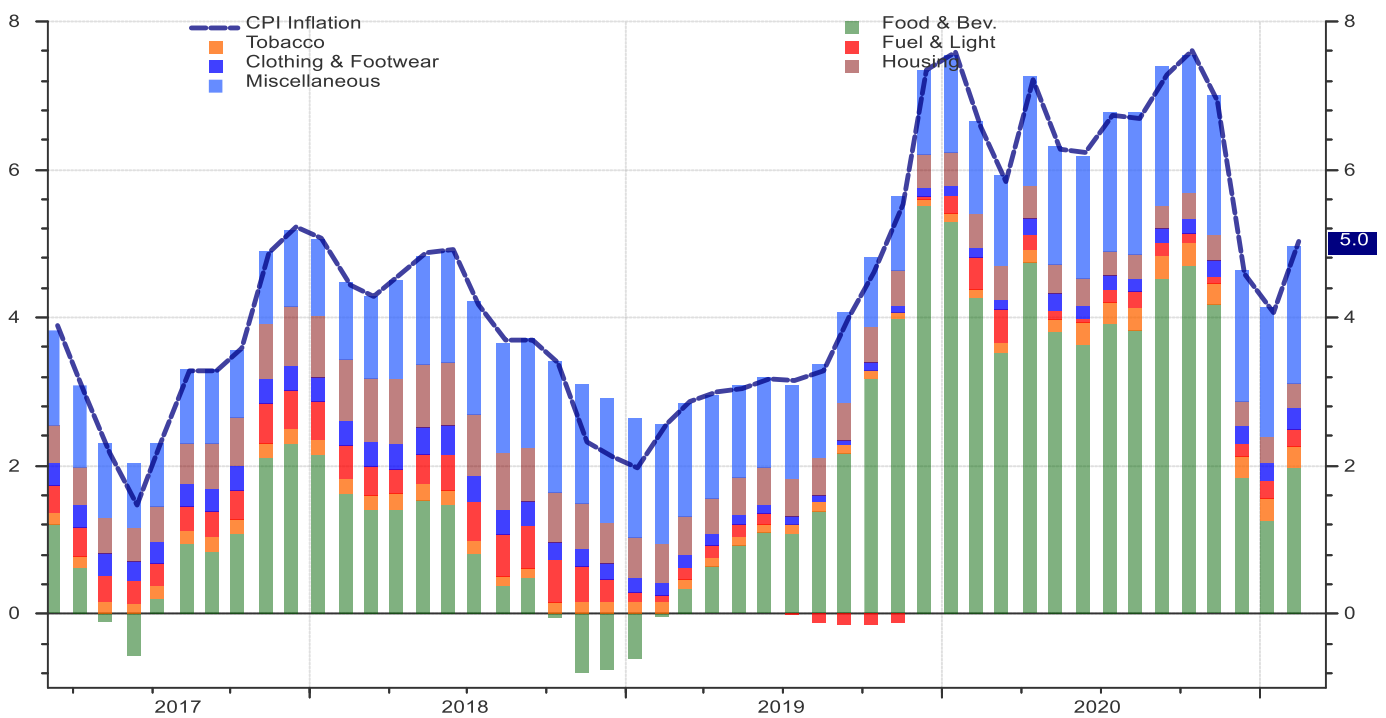
Source: CMIE Economic Outlook, NSE

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


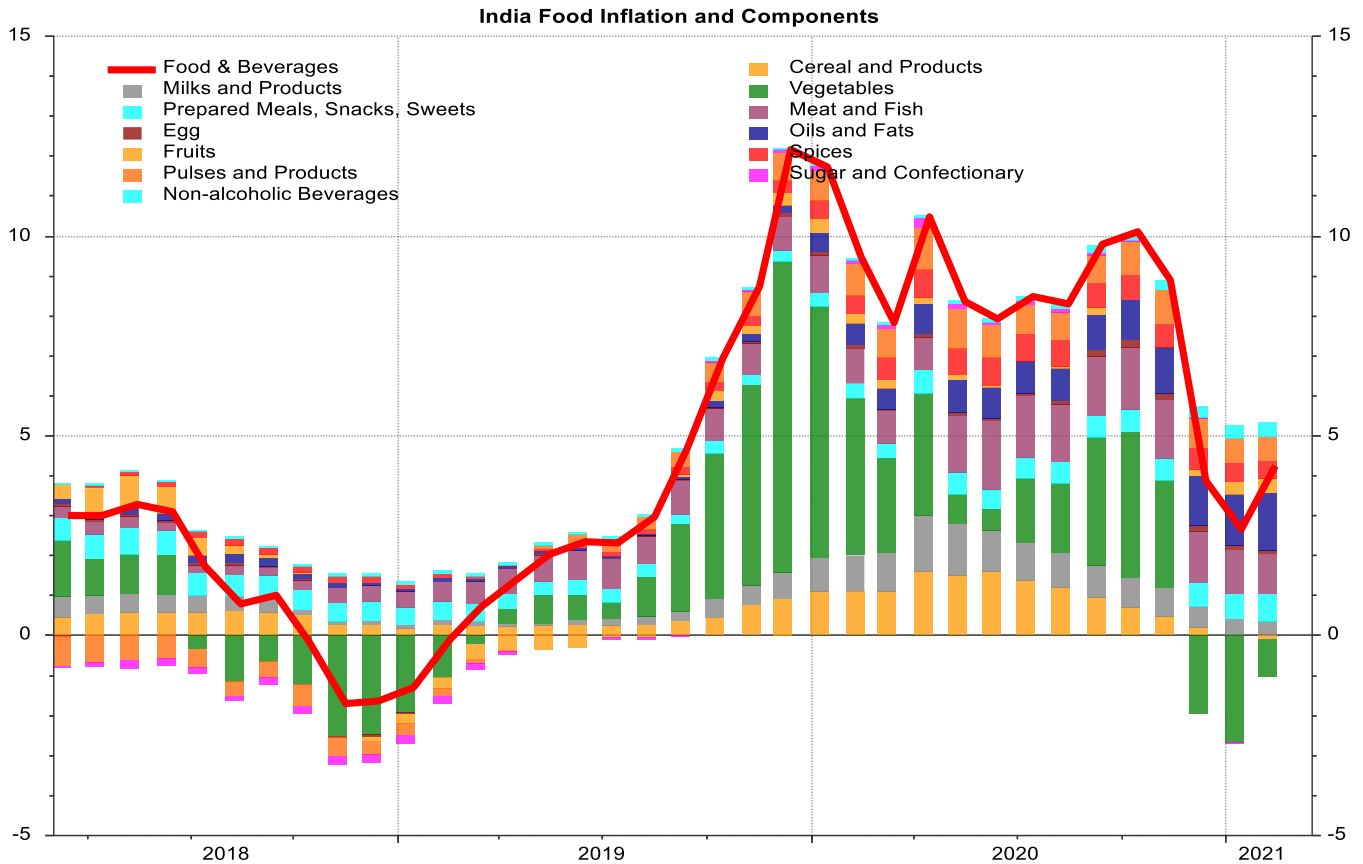
Source: CMIE Economic Outlook, NSE

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

India Consumer Inflation and Components (Feb 21)



Source: Refinitiv Datastream, NSE.

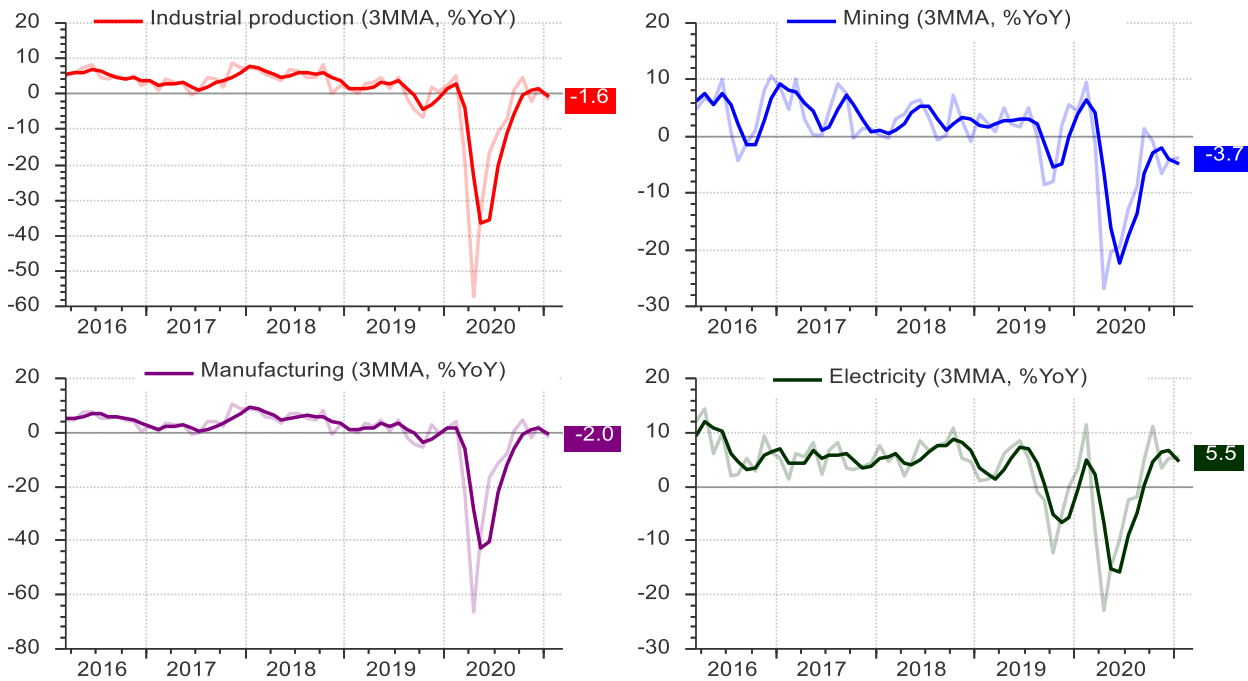
**Figure 6: Category-wise contribution to India Food and Beverages inflation (CPI)**


Source: Refinitiv Datastream, NSE.

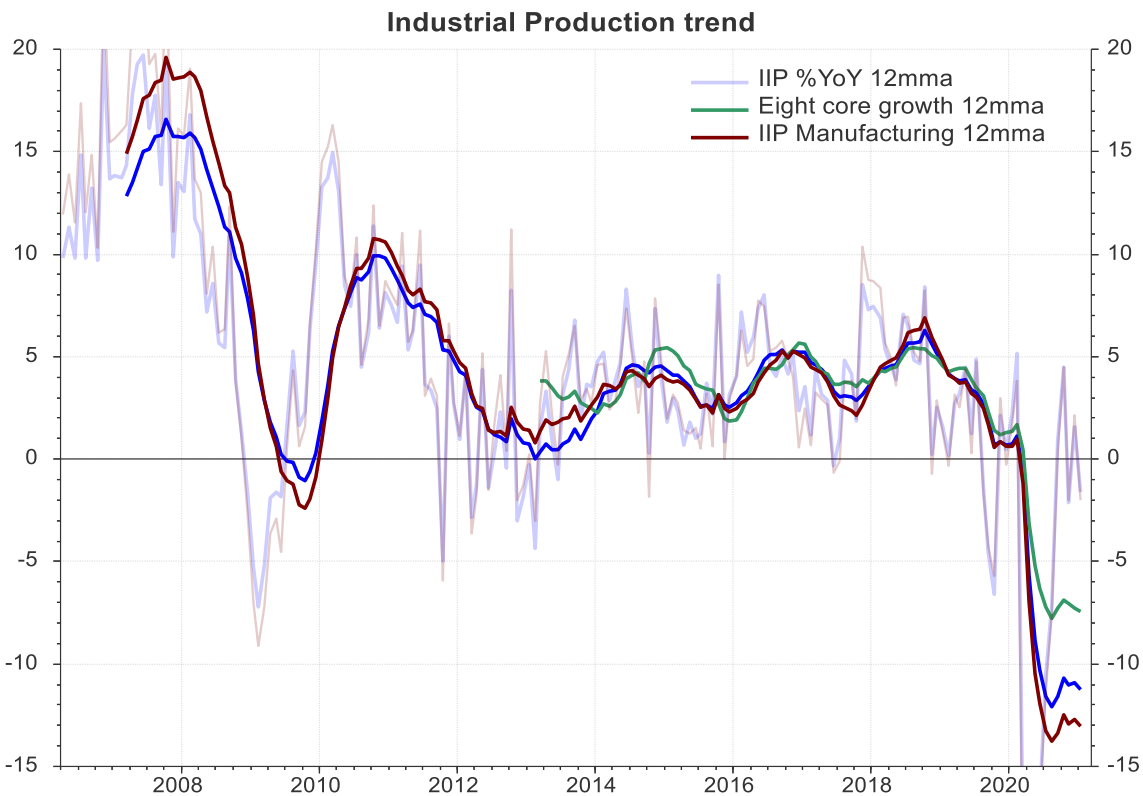
**Figure 7: India industrial production for January 2021 (%YoY)**

| %YoY                 |                          | Weight (%) | Jan-21       | Dec-20     | Jan-20     | FY21TD        | FY20TD     |
|----------------------|--------------------------|------------|--------------|------------|------------|---------------|------------|
|                      | <b>IIP</b>               |            | <b>(1.6)</b> | <b>1.6</b> | <b>2.2</b> | <b>(12.2)</b> | <b>0.6</b> |
| Sector-based indices | Mining                   | 14.4       | (3.7)        | (4.2)      | 4.4        | (10.4)        | 1.0        |
|                      | Manufacturing            | 77.6       | (2.0)        | 2.1        | 1.8        | (13.6)        | 0.4        |
|                      | Electricity              | 8.0        | 5.5          | 5.1        | 3.1        | (2.7)         | 0.9        |
| Use-based Goods      | Primary Goods            | 34.0       | 0.2          | (0.1)      | 1.8        | (9.0)         | 0.5        |
|                      | Capital Goods            | 8.2        | (9.6)        | 1.5        | (4.4)      | (25.6)        | (11.7)     |
|                      | Intermediate Goods       | 17.2       | 0.5          | 2.2        | 15.6       | (13.0)        | 11.2       |
|                      | Infra/Construction Goods | 12.3       | 0.3          | 2.7        | (0.3)      | (13.3)        | (1.9)      |
|                      | Consumer Goods           | 28.2       | (4.2)        | 2.5        | (1.8)      | (12.0)        | (1.4)      |
|                      | Consumer Durables        | 12.8       | (0.2)        | 5.7        | (3.7)      | (22.1)        | (6.2)      |
|                      | Consumer Non-durables    | 15.3       | (6.8)        | 0.5        | (0.6)      | (4.9)         | 2.3        |

Source: CSO, NSE.

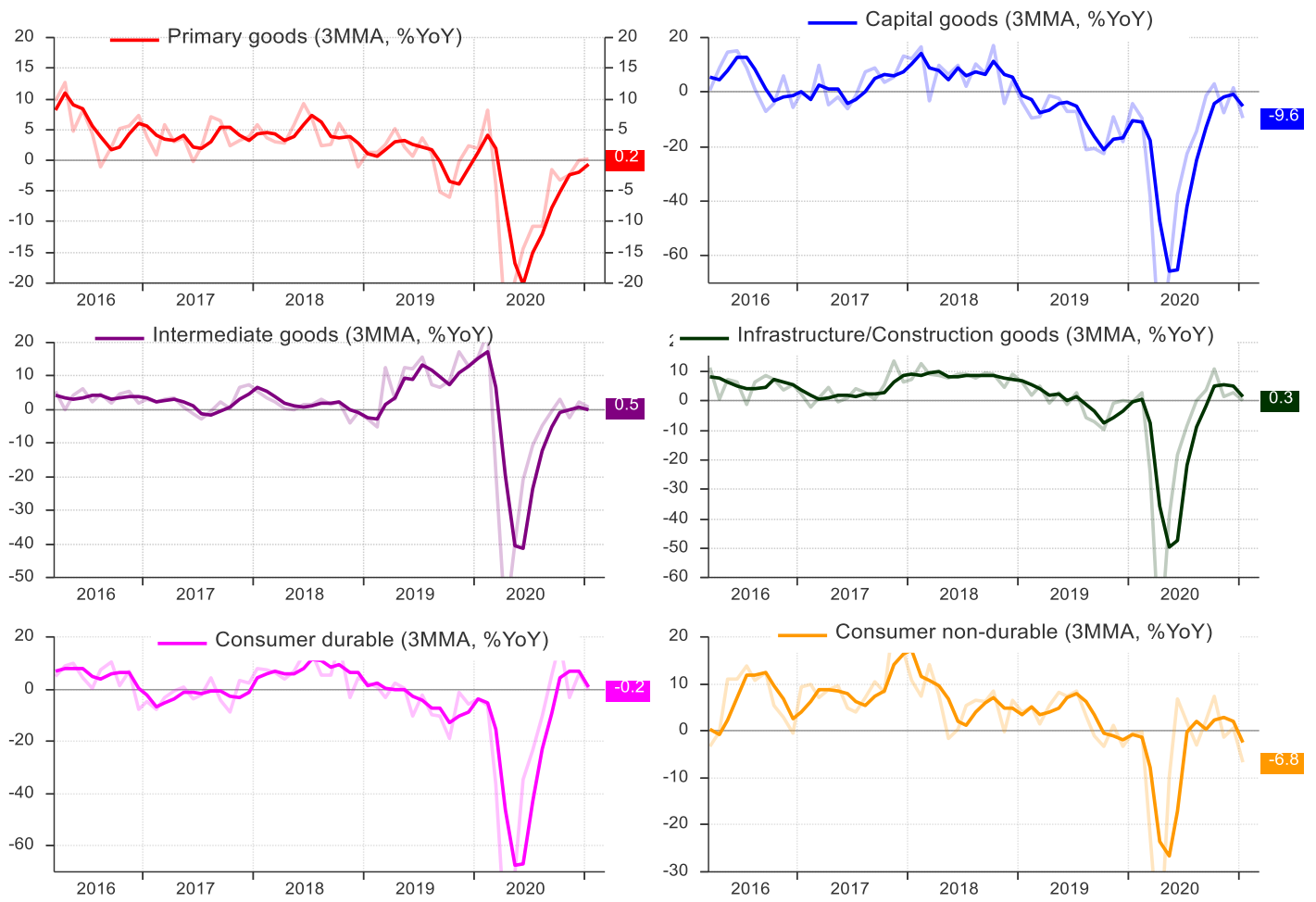
**Figure 8: India industrial production (3MMA)**


Source: Refinitiv Datastream, NSE

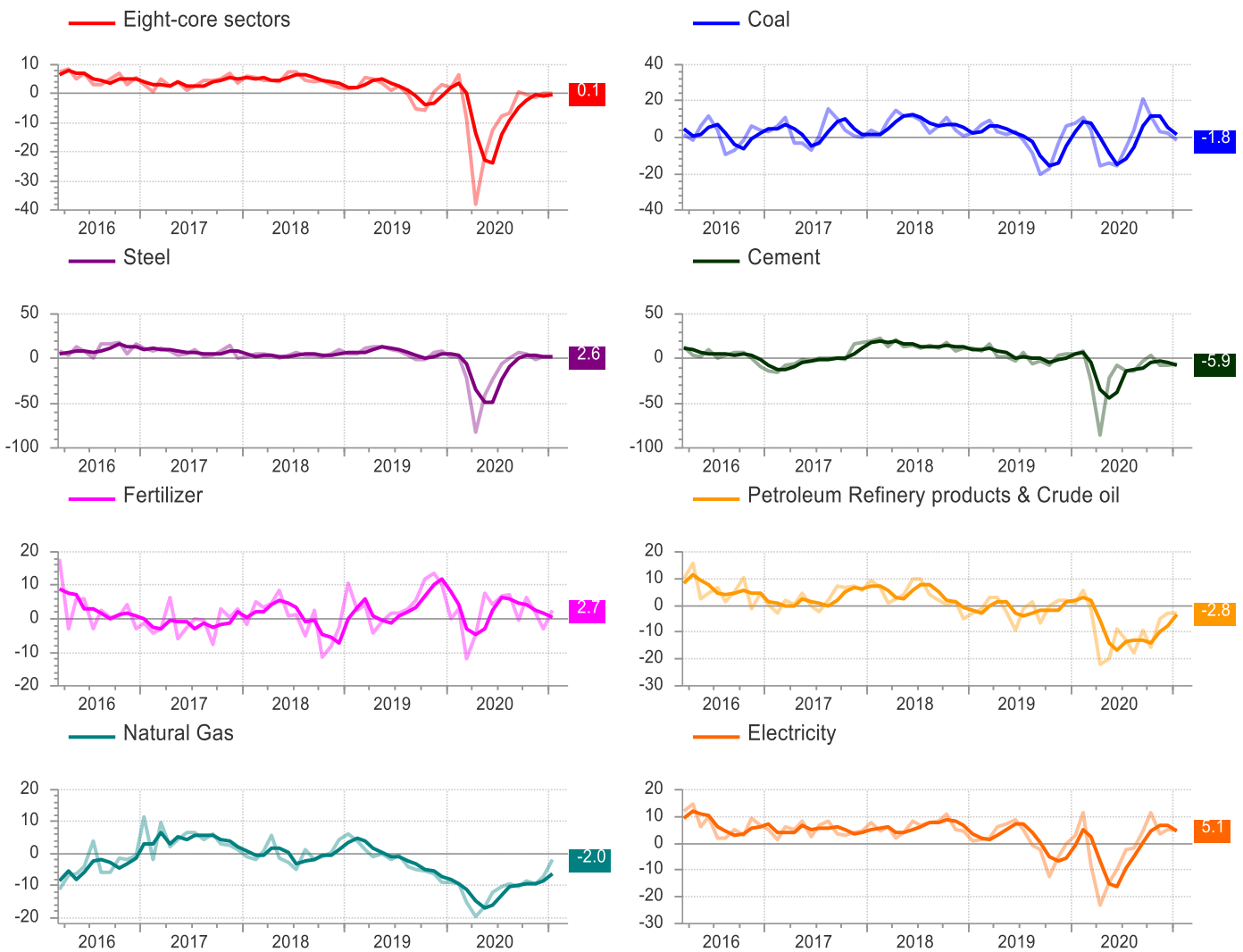
**Figure 9: Long-term industrial production trend (12MMA)**


Source: Refinitiv Datastream, NSE

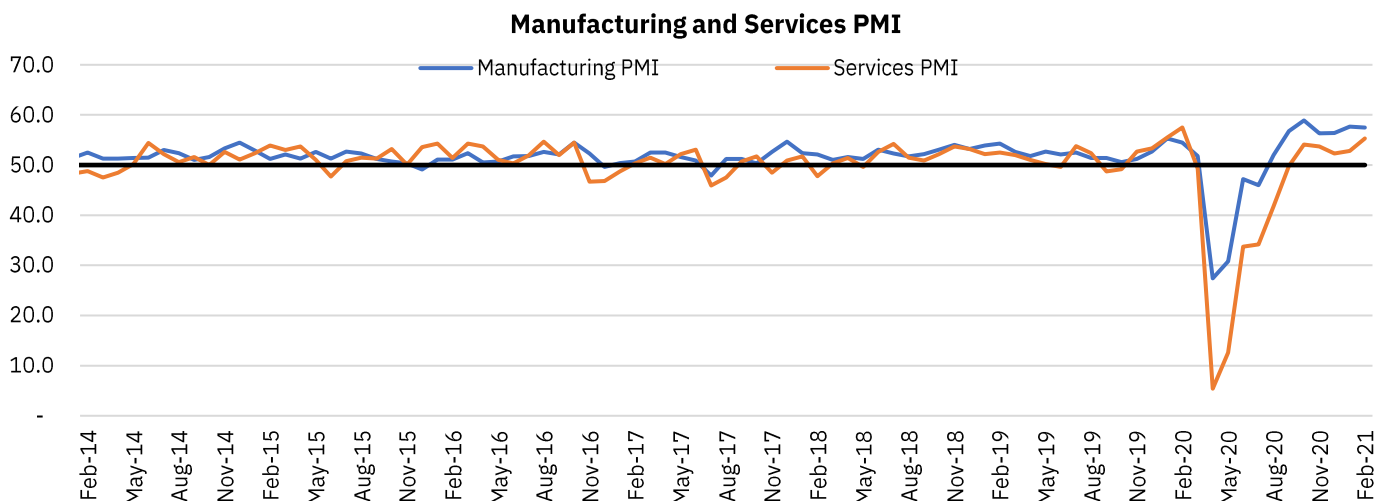
**Figure 10: India industrial production use-based goods (3MMA)**



Source: Refinitiv Datastream, NSE

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


Source: Refinitiv Datastream, NSE

**Figure 12: Manufacturing and Services PMI remained steady in February**


Source: CMIE Economic Outlook, NSE.



## Economic Policy & Research

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