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Macro Review

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Industrial production rises and inflation eases on a favourable base

Headline CPI inflation expectedly declined to a three-**month low of 4.3% in April'21 from 5.5% in the previous** month—broadly in line with the Consensus estimate of 4.2% (Source: Reuters). This was primarily on the back of **a favourable base (7.2% in Apr'20) even as inflation inched up on a sequential** basis in a broad-based manner for the third month in a row, signalling build-up of inflationary pressures. On a YoY basis, the drop in headline inflation trajectory was primarily led by lower food inflation, thanks to deflation in vegetables, cereals, sugar and milk & milk products, partly offset by a spike in prices for some food items including fruits, meat & fish, oils & fats and non-alcoholic beverages as well as higher fuel inflation. Core inflation (headline inflation ex food and fuel) also eased from a 29-month high of 5.7% in March to 5.2% in April, albeit off a high base, led by lower inflation in household goods & services, clothing & footwear, recreation & amusement, and education.

Industrial recovery gained slight momentum in March, with Industrial Production (IIP) rising by a strong 22.4% YoY, positively surprising market expectations (Consensus: +17.6%; Source: Reuters). While a part of this is attributed to a supportive base (**-18.7% YoY in Mar'20), a robust 10.6% growth on a sequential basis (MoM), albeit** seasonal, points to an improvement in growth momentum. While Manufacturing and Electricity registered a strong 25.8% and 22.5% YoY growth respectively, Mining sector growth came in at a muted 6.1%, signalling continued weakness in mining activity. The use-based classification also showed a broad-based rebound in growth but off a steep contraction last year. Industrial output fell by 8.7% in FY21 on top of a 0.8% drop in FY20.

Notwithstanding a favorable 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. A sharp spike in recent WPI inflation readings is a testament of rising cost pressures **that may eventually feed into retail inflation. That said, CPI inflation should remain within the RBI's target band** this year, with an expected normal monsoon providing an added support. Nascent economic recovery that was underway, however, faces significant overhang particularly in contact-intensive services, if the second wave fails to peak out this month resulting in sustained lockdowns imposed by several states. In the wake of rising uncertainty, we expect the RBI to remain focused on limiting disruptions to growth trajectory and helping stressed segments of the economy by ensuring adequate liquidity support. At the same time, an elevated inflation trajectory may force the RBI to stay put on policy rates.

Headline retail inflation eased to a three-month low of 4.3% in Apr'21.

- Retail inflation eases to a three-month low in April**...:** Headline retail inflation expectedly declined to a three-month low of 4.3% in Apr'21 from 5.5% in the previous month, broadly in line with the Consensus estimate of 4.2%. This was primarily led by lower food and core inflation, partly offset by higher fuel prices. Headline inflation, however, inched up on a sequential (MoM) basis for the third month in a row, signalling build-up of inflationary pressures owing to higher commodity and fuel prices. The sequential increase in inflation momentum was fairly broad-based, primarily led by fruits (+7.1% MoM), oils & fats (+3.8% MoM), meat & fish (+3.0% MoM), pulses (+1.2% MoM), personal care & effects (+1.0%) and housing (+0.9% MoM), partly offset by lower vegetable prices (-3.2% MoM).
- **...primarily led by lower food inflation...:** The drop in retail inflation on a YoY basis was primarily led lower food inflation, thanks to deflation in vegetables (-14.2% YoY), cereals (-3.0% YoY), sugar (-6% YoY) and milk & milk products (-0.1% YoY). This was partly offset by a spike in prices for some food items such as fruits (+9.8% YoY), meat & fish (+16.7% YoY), oils & fats (+25.9% YoY) and non-alcoholic beverages (+15.2% YoY). Fuel & light inflation jumped for the second month in a row to a 30-month high of 7.9%, primarily led by higher kerosene and coal prices.
- **...and** softening core inflation: Core inflation (headline inflation ex food and fuel) also softened from a 29-month high of 5.7% in Mar'21 to a 10-month low of 5.2% in Apr'21. This was on account of lower inflation in clothing & footwear, household goods & services, recreation & amusement, education, and personal care & effects.

While a part of this is attributed to favourable base effects, moderation in consumption demand amid lockdown restrictions may have also contributed to the drop. This is evident from a sharp spike in WPI inflation last month with seem to have not fed into final consumer prices yet, signalling propensity of companies to absorb costs in a weak demand environment. Within the core basket, transport & communication inflation remained elevated at 11%, reflecting the impact of higher fuel prices and consequent passthrough to transport fares. The drop in core inflation trajectory was partly offset by a jump in health and housing inflation to a 20-month high of 7.8% and a 12-month high of 3.7% in Apr'21.

Industrial production growth rose by a higher-than-expected 22.4% in Mar'21 amid a favourable base.

- IIP growth shoots up in March on a favorable base: Industrial production rose by a higher-than-expected 22.4% YoY in Mar'21, reversing the contraction trend witnessed over the previous two months. While a part of this is attributed to a supportive base (-18.7% YoY in Mar'20), a robust 10.6% growth on a sequential basis (MoM), albeit seasonal, points to an improvement in growth momentum. The average IIP growth in FY21 stood at -8.7% on top of a 0.8% contraction in FY20.
- Manufacturing and Electricity register strong growth: Manufacturing sector grew by a strong 25.8% YoY but off a very low base (-22.8% YoY in Mar'20). Except for tobacco products, recorded media, and coke & refined petroleum products that registered YoY drop in low single-digits and furniture that grew by a modest 3.1% YoY, all other sectors displayed a strong growth, thanks to supportive bases. This was led by motor vehicles (+77.7% YoY), computer, electronic & optical products (+74.7%), electrical equipment (+50.3%), rubber & plastic products (+46.7% YoY) and wood products (+45.4%). Manufacturing production fell by 9.8% in FY21 with all sectors, except pharmaceuticals, recording a contraction. Sectors leading the drop in FY21 primarily include discretionary categories such as wearing apparel (-29.8%), recorded media (-28.2%), furniture (-27.8%), beverages (-26.1%), paper products (-23.2%) and textiles (-21.6%). Essential categories such as food products, chemical & chemical products and base metals fell by low single digits.

  Electricity production also witnessed a strong 22.5% YoY growth. Even as part of this is attributed to a low base (-8.2% in Mar'20), a YoY expansion over the previous five months point to strong recovery in the electricity sector—reflected in a modest 0.5% contraction in FY21. Mining sector growth came in at a muted 6.1%, signalling continued weakness in mining activity. In FY21, mining output fell by 7.8%.
- Use-based classification shows a broad-based rebound: In the use-based classification, the rebound was expectedly led by Capital Goods and Consumer Durables given the steep drop witnessed by these two in the year ago period. While Capital Goods production surged by 41.9% YoY in March, Consumer Durables production grew by an even higher 54.9%. The sequential recovery, however, has been relatively benign considering the seasonality aspect, with Capital Goods and Consumer Durables production growing by 9.9% and 3.0% MoM respectively. These two sectors have been the worst performing in FY21, registering a drop of 19.2% and 15.2% respectively. Among other sectors, while primarily goods—considered an essential category—grew by a modest 7.7% (-7.0% in FY21), intermediate goods registered a strong 21.2% growth (-9.7% in FY21). Infra / Construction goods, however, grew by a tad lower 12.3% despite a more favourable base effect. Consumer non-durables, that grew by 27.5% YoY in Mar'21, emerged as the best performing sector in FY21 (-2.3%) and understandably so as it primarily comprises of essential segments that were allowed to operate during the nation-wide lockdown last year.

- Expect RBI to remain focused on growth: 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. A sharp spike in recent WPI inflation readings is a testament of rising cost pressures that may eventually feed into retail inflation. That said, CPI inflation should remain within the RBI's target band this year, with an expected normal monsoon providing an added support. Nascent economic recovery that was underway, however, faces significant overhang, particularly in contact-intensive services, if the second wave fails to peak out this month, resulting in sustained lockdowns imposed by several states. This has already started reflecting in some of the high frequency indicators including auto sales, e-Way bills, mobility data, power demand, railway freight traffic, among others. In the wake of rising uncertainty, we expect the RBI to remain focused on limiting disruptions to growth trajectory and helping stressed segments of the economy by ensuring adequate liquidity support. At the same time, an elevated inflation trajectory may force the RBI to stay put on policy rates.

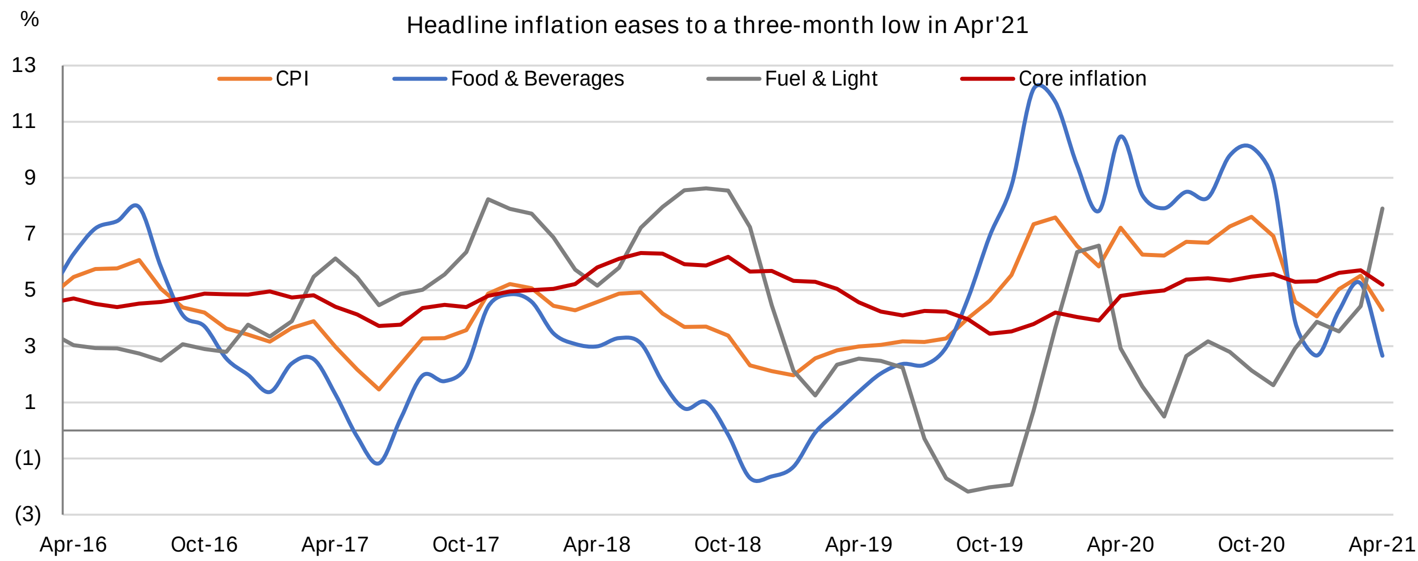
Expect RBI to maintain an accommodative stance all through FY21 and support growth by ensuring adequate liquidity in the system.

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

%YoY	Weight (%)	Apr-21	Mar-21	Apr-20	FY21	FY20
CPI		4.3	5.5	7.2	6.2	4.8
Food & Beverages	45.9	2.7	5.2	10.5	7.3	6.0
Pan, Tobacco & Intoxicants[2]	2.4	9.0	9.9	5.9	9.9	4.2
Clothing & Footwear[2]	6.5	3.5	4.4	3.5	3.4	1.6
Housing	10.1	3.7	3.5	3.9	3.3	4.5
Fuel & Light	6.8	7.9	4.4	2.9	2.7	1.3
Miscellaneous[2]	28.3	6.2	7.0	5.4	6.6	4.4
Core CPI inflation[1,2]	44.9	5.2	5.7	4.8	5.3	4.0

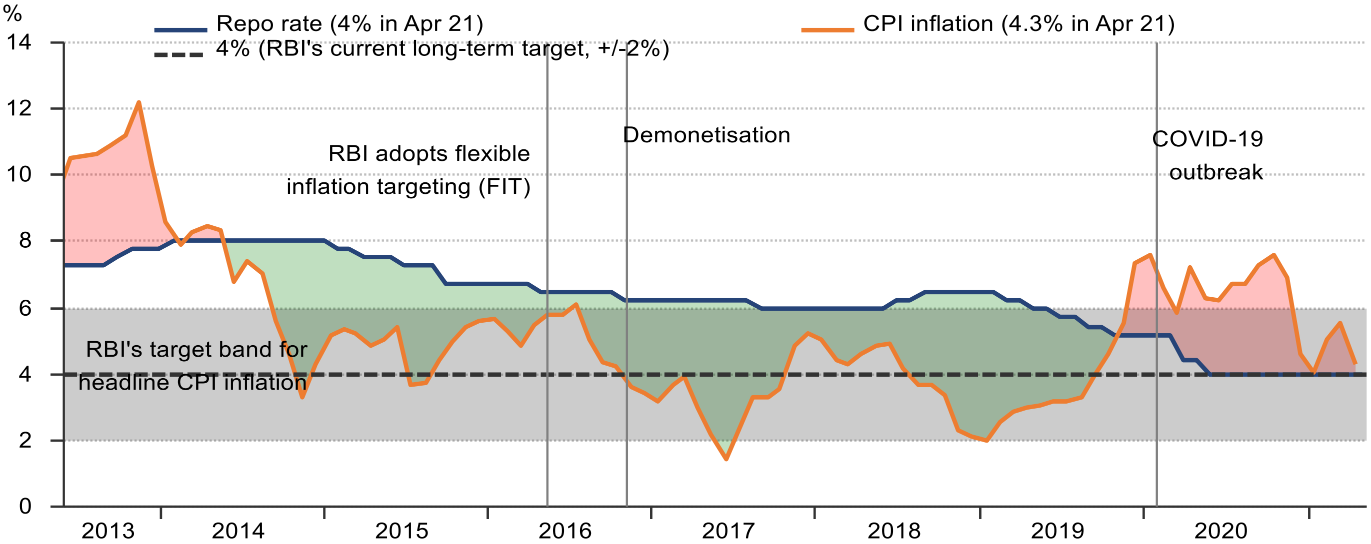
Source: CSO, NSE. NA = Not Available.
Note: [1] Headline inflation excluding food & beverages, pan, tobacco & intoxicants and fuel & light.
[2] Inflation data for these components for April and May 2020 are based on the imputed index calculated by MOSPI.

Figure 2: Headline CPI inflation trend



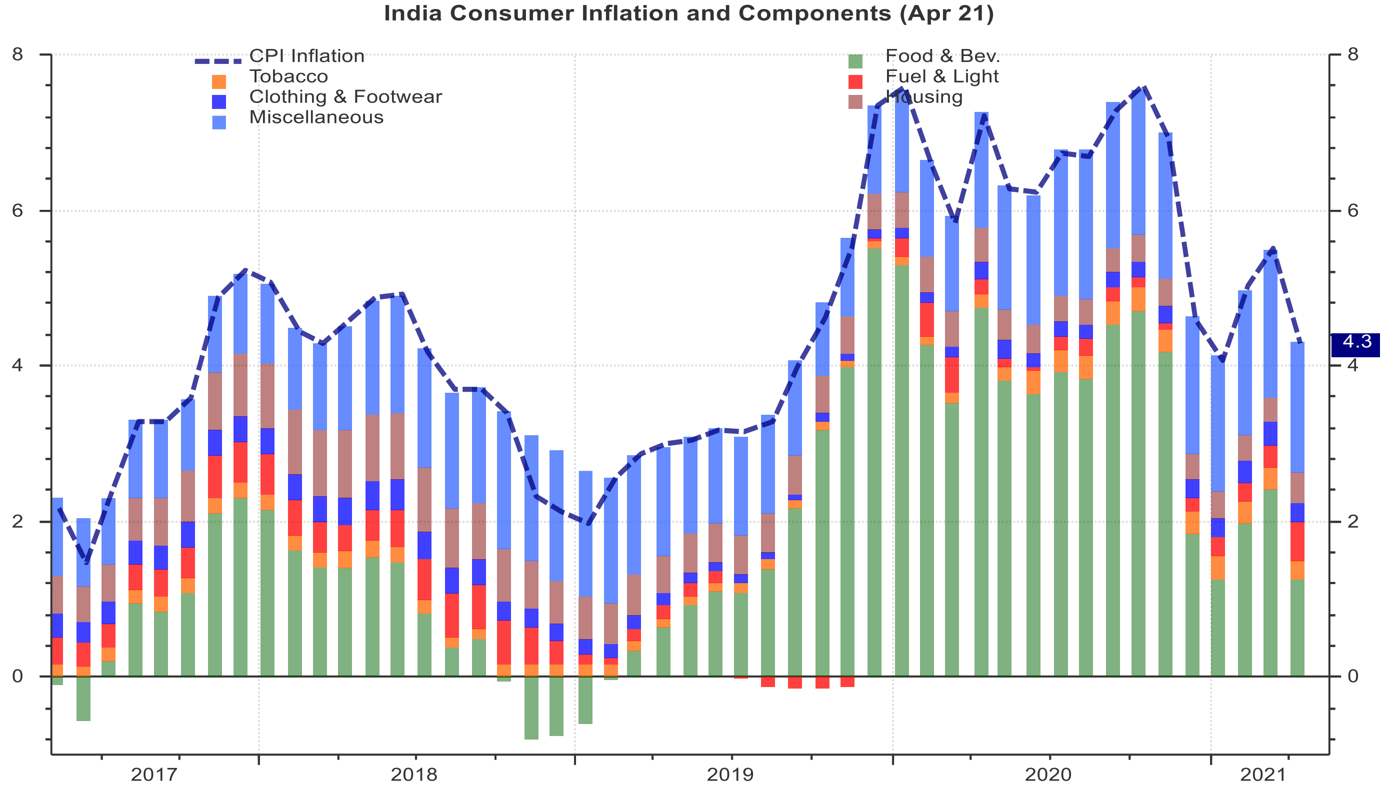
Source: CMIE Economic Outlook, NSE

Figure 3: Real interest rates have remained negative for more than a year now, albeit incrementally less so



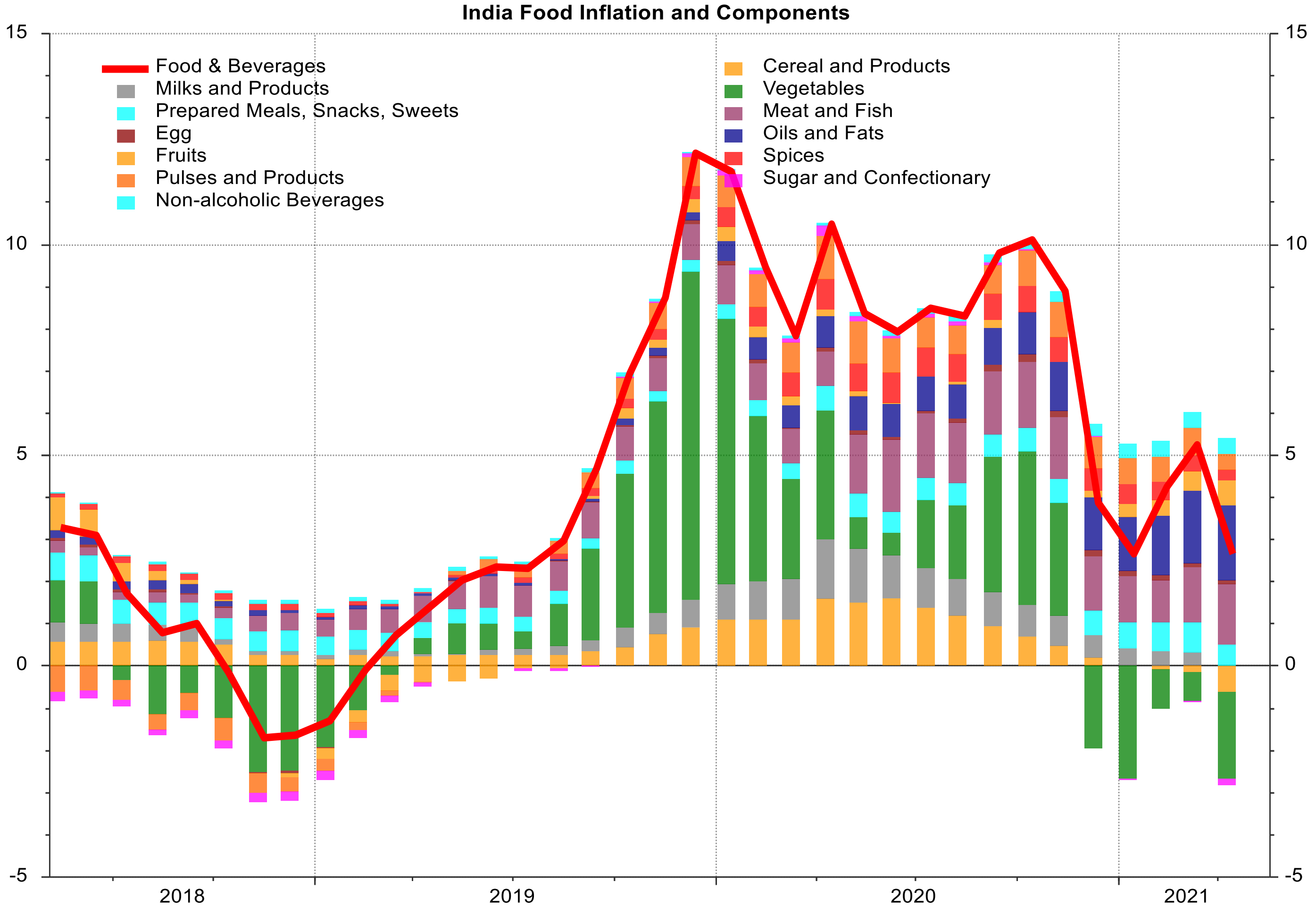
Source: CMIE Economic Outlook, NSE

Figure 4: Category-wise contribution to India consumer price inflation (CPI)



Source: Refinitiv Datastream, NSE.

Figure 5: Category-wise contribution to India Food and Beverages inflation (CPI)



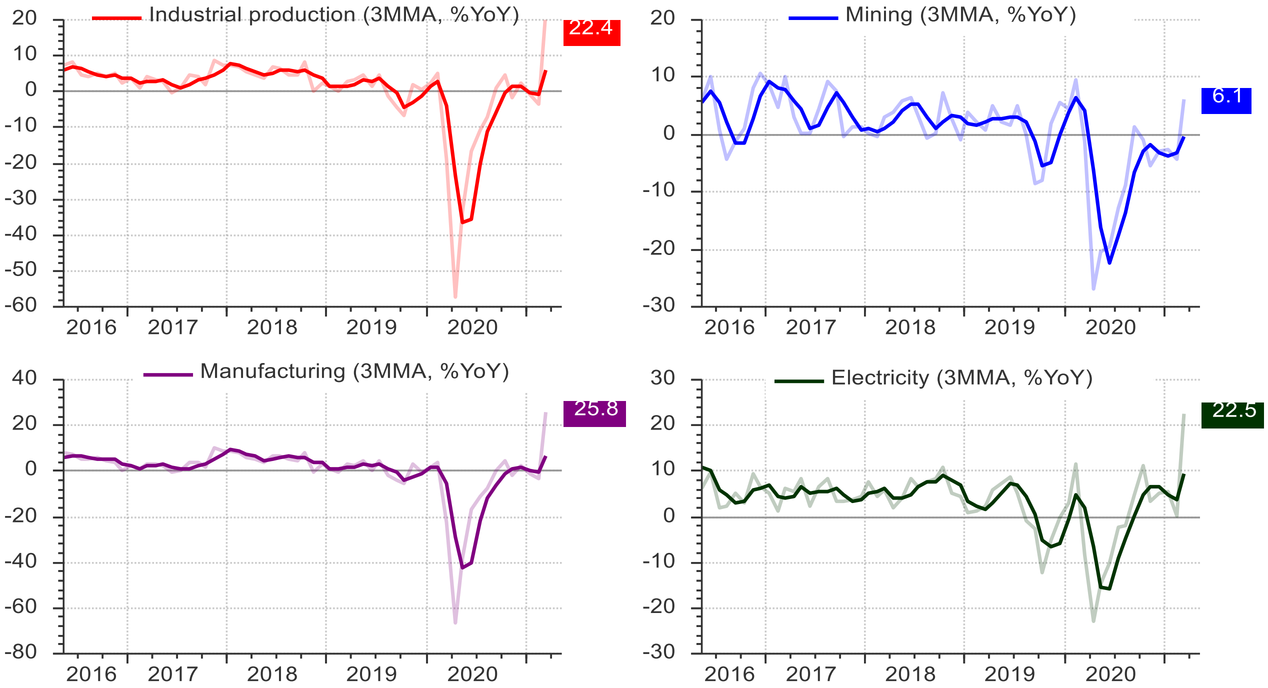
Source: Refinitiv Datastream, NSE.

Figure 6: India industrial production for March 2021 (%YoY)

%YoY		Weight (%)	Mar-21	Feb-21	Mar-20	FY21	FY20
	IIP		22.4	(3.4)	(18.7)	(8.7)	(0.8)
Sector-based indices	Mining	14.4	6.1	(4.4)	(1.3)	(7.8)	1.6
	Manufacturing	77.6	25.8	(3.7)	(22.8)	(9.8)	(1.4)
	Electricity	8.0	22.5	0.1	(8.2)	(0.5)	0.9
Use-based Goods	Primary Goods	34.0	7.7	(4.7)	(4.0)	(7.0)	0.7
	Capital Goods	8.2	41.9	(3.8)	(38.8)	(19.2)	(14.0)
	Intermediate Goods	17.2	21.2	(5.6)	(18.6)	(9.7)	9.1
	Infra/Construction Goods	12.3	31.2	(4.0)	(24.3)	(9.0)	(3.6)
	Consumer Goods	28.2	37.4	(0.1)	(28.3)	(7.6)	(3.8)
	Consumer Durables	12.8	54.9	6.6	(36.8)	(15.2)	(8.8)
	Consumer Non-durables	15.3	27.5	(4.5)	(22.3)	(2.3)	(0.1)

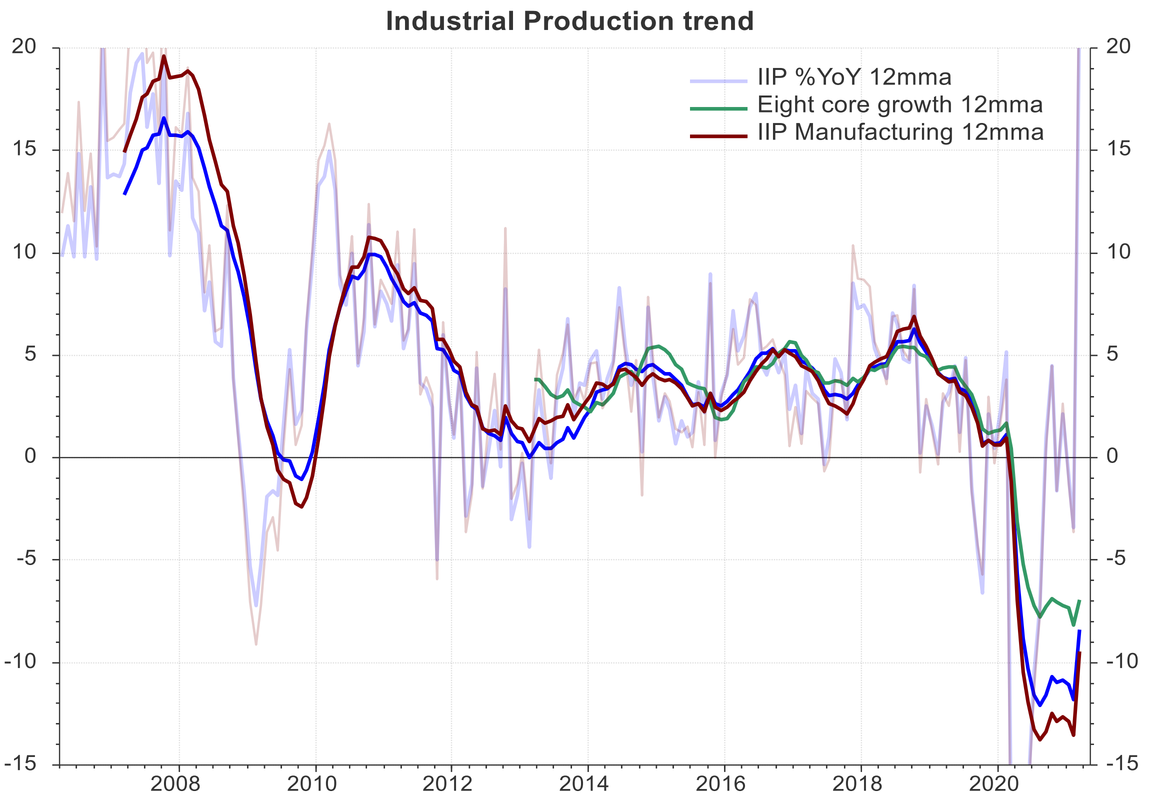
Source: CSO, NSE.

Figure 7: India industrial production (3MMA)



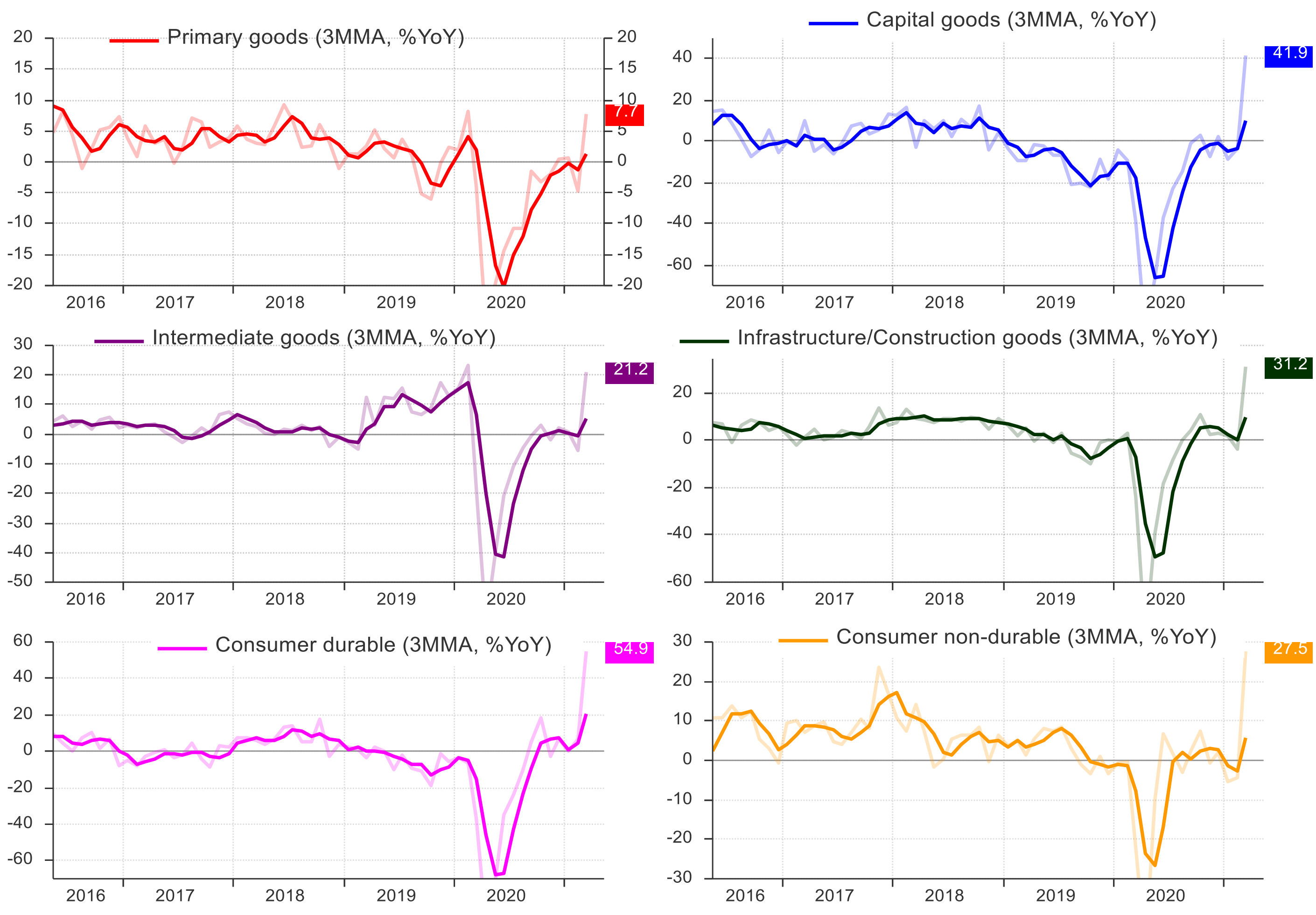
Source: Refinitiv Datastream, NSE

Figure 8: Long-term industrial production trend (12MMA)



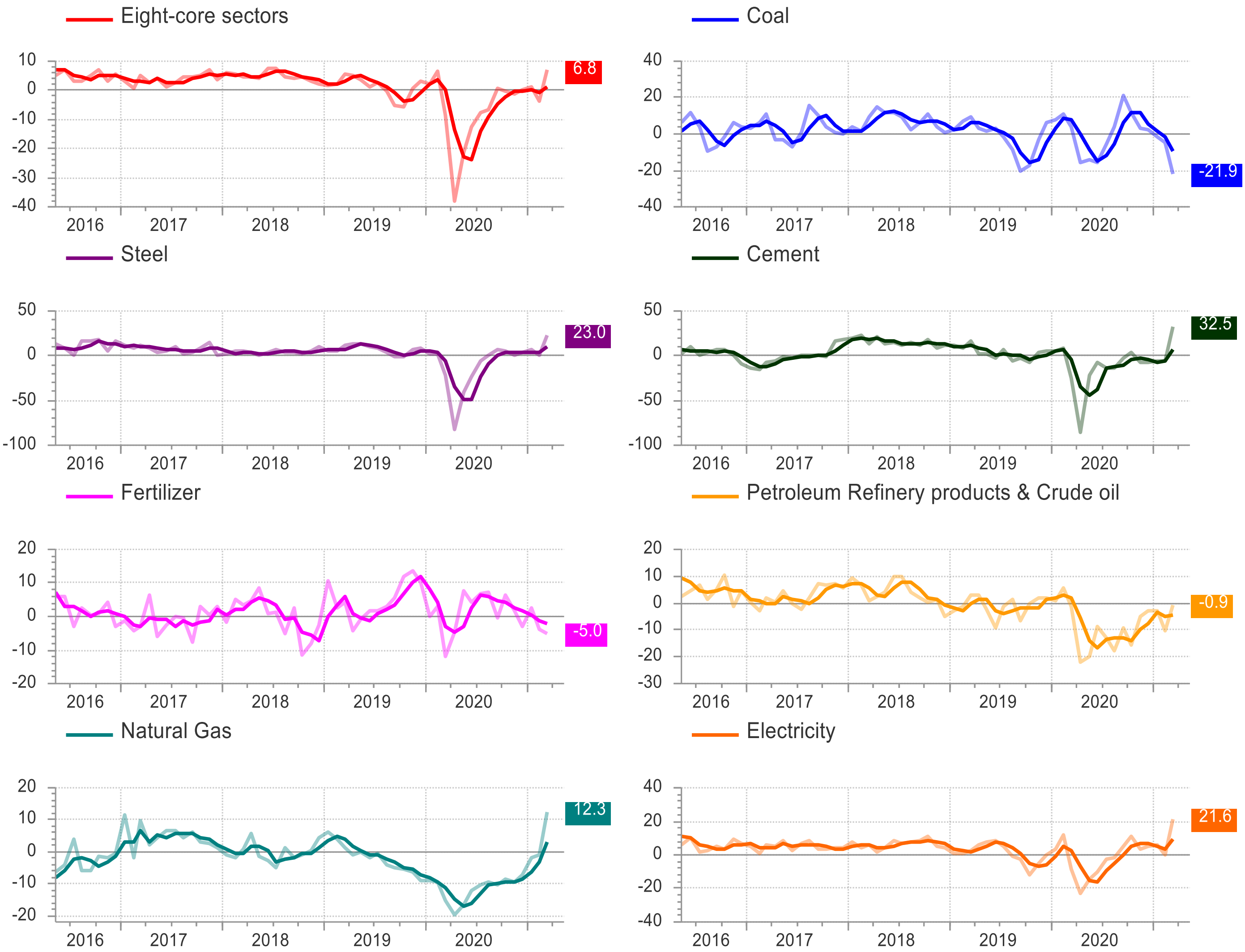
Source: Refinitiv Datastream, NSE

Figure 9: India industrial production use-based goods (3MMA)



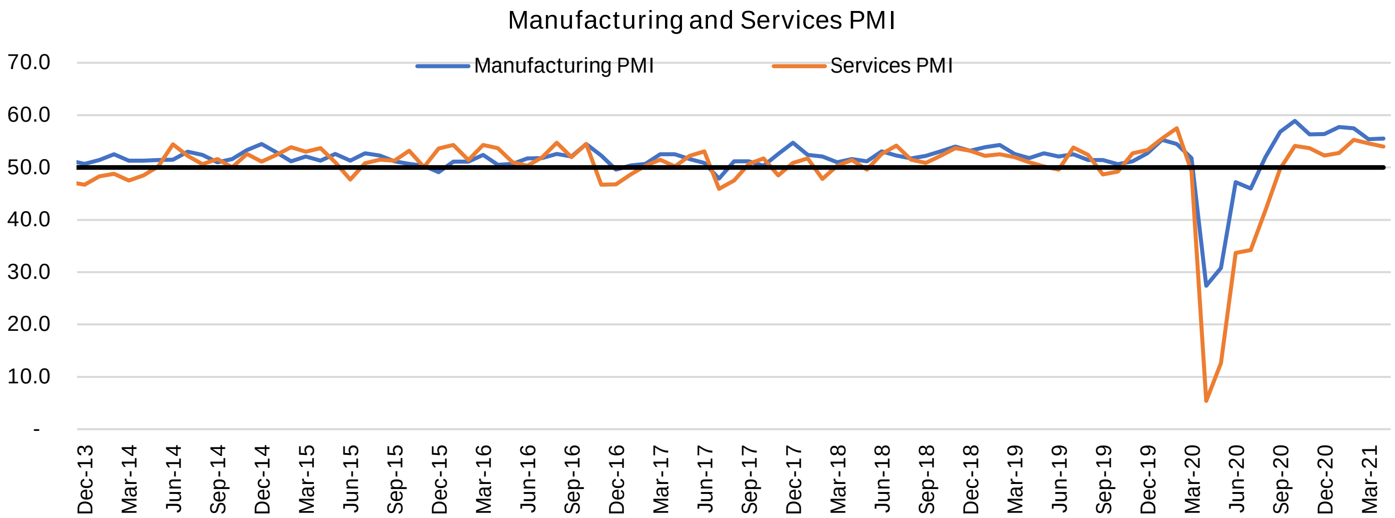
Source: Refinitiv Datastream, NSE

Figure 10: India eight-core sector growth (3MMA)



Source: Refinitiv Datastream, NSE

Figure 11: Manufacturing and Services PMI slows down amid rising COVID cases and attendant lockdowns



Source: CMIE Economic Outlook, NSE.

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