

CPI inflation surges to 40-month high; IIP contracts for the 3rd month in a row

India's retail inflation (CPI) shot up further to 40-month high of 5.5% in November, higher than market expectations (Refinitiv Datastream poll: 5.3%) and 90bps higher than the October's print. This was primarily on account of a sharp pick-up in food inflation, largely attributable to vegetables, pulses, milk and cereals, partly deflation in the fuel & light category for the fifth consecutive month. Excluding vegetables, headline inflation would come in at 3.5% in November, albeit still up 40bps MoM. Core inflation (excluding food and fuel), however, remained stable at 3.5%—near the lowest level since the start of the series, largely on account of a dip in recreation & amusement and education inflation, partly offset by an increase in fuel and personal care & effects inflation. Growth outlook, however, remains bleak, with industrial production contracting by 3.8% YoY, higher than market expectations (Refinitiv Datastream poll: -5.0%), reflecting a broad-based slowdown.

CPI inflation is expected to inch-up further over the next few months, overshooting the RBI's projections, thanks to an unfavourable base, persistence of higher vegetable prices and implementation of telecom tariff hikes. However, core inflation is expected to remain benign amid weak demand environment, as also evident in continued contraction in industrial production. Having said that, an elevated inflation trajectory and consequent rise in household inflationary expectations is likely to keep the RBI on pause in the near-term. However, expectations of headline inflation falling back to near-4% by Q1FY21 is likely to keep the room open for further monetary easing; we expect another 25-50bps cut in policy rates in the current easing cycle, *ceteris paribus*.

- **Spike in food prices causes retail inflation to jump to 40-month high:** Retail inflation (CPI) rose sharply from 4.6% in October to 5.5% in November—the highest in 40 months, and higher than the Consensus estimate of 5.3%. This has translated into average monthly inflation rate for the second half of the fiscal thus far already reaching the higher end of the RBI's projected band of 5.1% (4.7-5.1% for H2FY20). This was largely on account of higher vegetable, pulses and cereals inflation, which increased to 71-month, 38-month and 27-month high to 36.0%, 13.9% and 3.7% respectively. While a part of the reason for the surge in food inflation was a very low base (vegetables and pulses were in deflation in the year ago period), crop damage on account of an excessive and prolonged monsoon have led to a spike in vegetable prices, particularly onion, garlic and tomato. Excluding vegetables, headline inflation actually inched up by 40bps MoM to 3.5% in November. High food inflation was partly offset by continued deflation in fuel & light (LPG, diesel, coal) which came in at -1.9%.
- **Steady core inflation points to weak domestic demand:** Core inflation (ex-food ex-fuel) remained stable at near the series lows at 3.5% in November. While an increase in conveyance expenses led to an rise in transportation inflation, a sustained increase in gold and silver prices led to a modest inch-up in personal care & effects inflation. Inflation in rest of the categories posted a decline, signalling a pervasive weakness in demand conditions. Housing inflation declined to 52-month low of 4.5% in November.
- **Industrial production continues to contract:** Industrial production growth remained negative at -3.8% in October—the second lowest print in the series—vs. -4.3% in September and Consensus estimate of -5.0%. This sharp plunge, albeit off an unfavourable base (+8.4% in October 2018), has been on account of a slowdown across the board. Manufacturing production declined by 2.1% YoY, marking the third consecutive month of contraction, with 18/23 sectors reporting negative growth (vs. 17 in the previous month) led by computer, electronic and optical products and motor vehicles. Electricity production registered a huge 12.2% YoY decline in September—the lowest print in the series. The slowdown in investment and consumption was visible in the lacklustre performance of capital goods, infra/construction goods and consumer durable goods that declined by 21.9%, 9.2% and 18.0% respectively in October, all of which were the lowest in the series.
- **Elevated inflation to keep RBI on pause in the near-term:** The recent spike in food inflation has resulted in a rise in inflationary expectations. Amid expectations of a persistence in the spike in vegetable prices and an unfavourable base, headline inflation is expected to remain elevated in the near-term and potentially overshoot the RBI's projected band of 4.7-5.1% in the second half. This is likely to keep the Central Bank on hold in the near-term. However, we see this as a temporary pause. With inflation expected to fall back to near-4% in Q1FY21, and growth recovery expected to be shallow and gradual, there is room available for further monetary easing. we expect another 25-50bps cut in policy rates in the current easing cycle, *ceteris paribus*.

Figure 1: Consumer price inflation in November 2019 (%YoY)

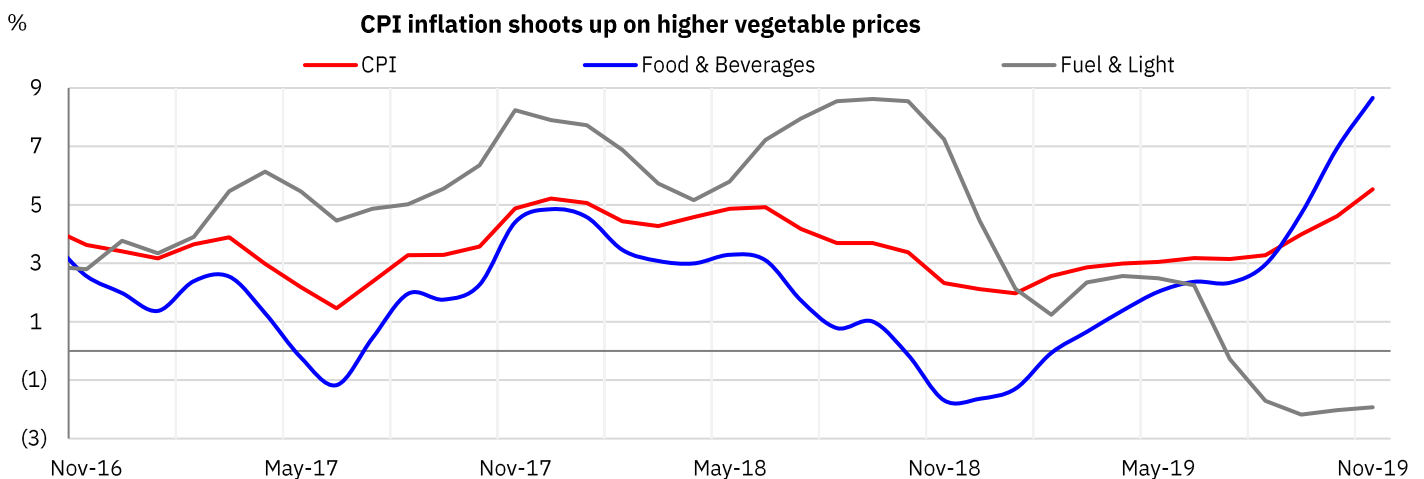
	Weight (%)	Nov-19	Oct-19	Nov-18	FY20TD	FY19TD
CPI		5.5	4.6	2.3	3.7	3.9
Food & Beverages	45.9	8.7	6.9	(1.7)	3.9	1.4
Pan, Tobacco & Intoxicants	2.4	3.3	3.9	6.1	4.2	6.7
Clothing & Footwear	6.5	1.3	1.6	3.5	1.5	4.7
Housing	10.1	4.5	4.6	6.0	4.7	7.6
Fuel & Light	6.8	(1.9)	(2.0)	7.2	(0.1)	7.4
Miscellaneous	28.3	3.7	3.4	6.2	4.4	5.7

Source: CSO, NSE

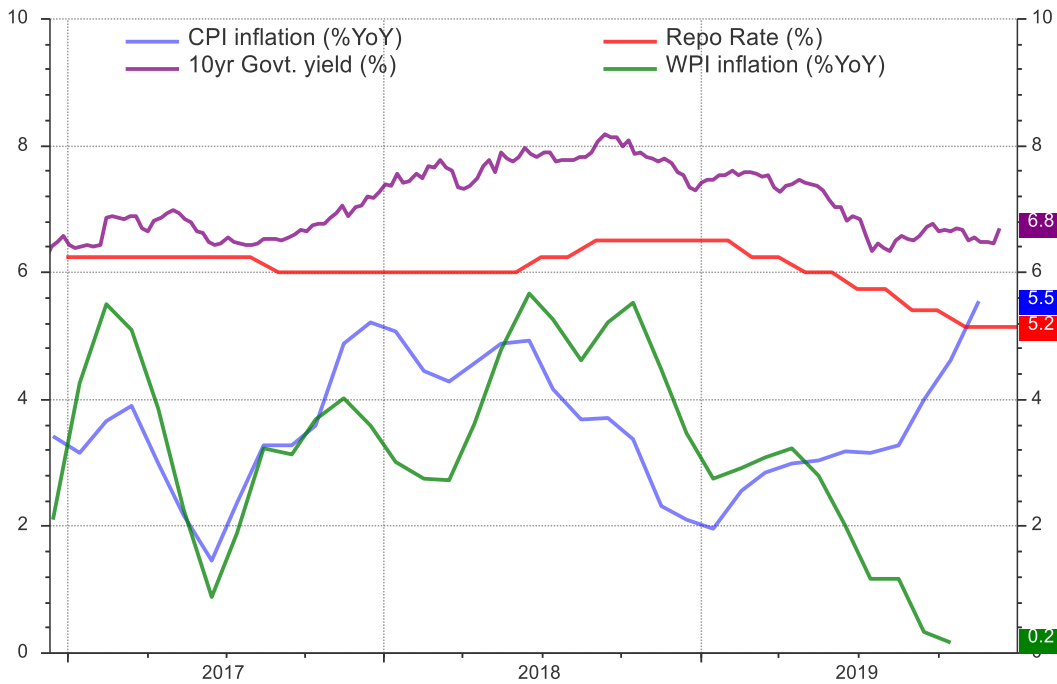
Figure 2: Industrial production in October 2019 (%YoY)

	Weight (%)	Oct-19	Sep-19	Oct-18	Apr-Oct'19	Apr-Oct'18
IIP		(3.8)	(4.3)	8.4	0.5	5.7
Sector-based indices						
Mining	14.4	(8.0)	(8.6)	7.3	(0.4)	3.8
Manufacturing	77.6	(2.1)	(4.0)	8.2	0.6	5.8
Electricity	8.0	(12.2)	(2.6)	10.8	1.6	6.8
Use-based Goods						
Primary Goods	34.0	(6.0)	(5.2)	6.1	1.2	4.9
Capital Goods	8.2	(21.9)	(20.3)	16.9	(10.2)	7.6
Intermediate Goods	17.2	22.2	7.0	2.4	9.5	1.3
Infra/Construction Goods	12.3	(9.2)	(6.8)	9.0	(1.3)	8.7
Consumer Goods	28.2	(8.7)	(4.6)	12.4	0.7	5.8
Consumer Durables	12.8	(18.0)	(9.9)	17.4	(5.0)	8.1
Consumer Non-durables	15.3	(1.1)	(0.4)	8.6	5.3	4.0

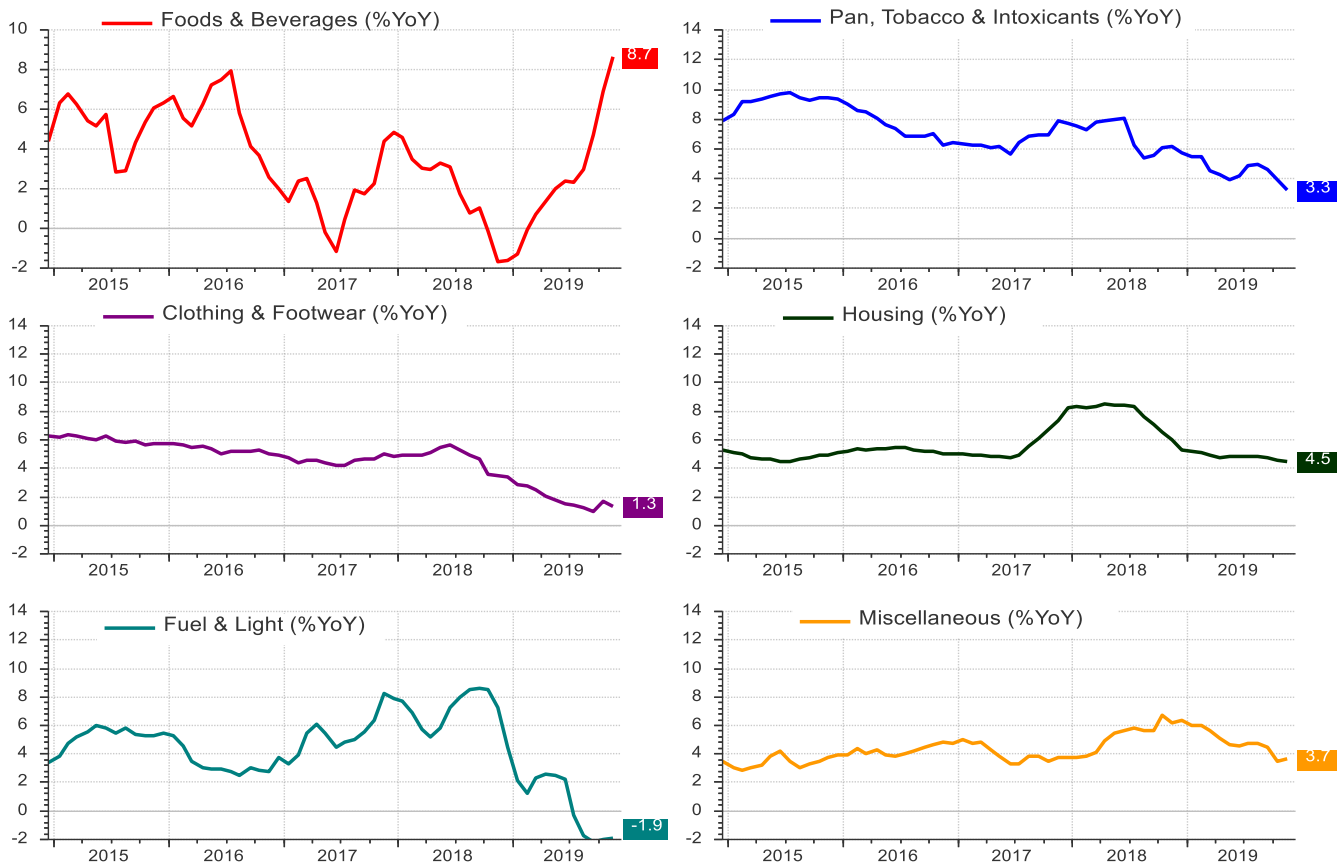
Source: CSO, NSE

Figure 3: CPI inflation accelerates further in November


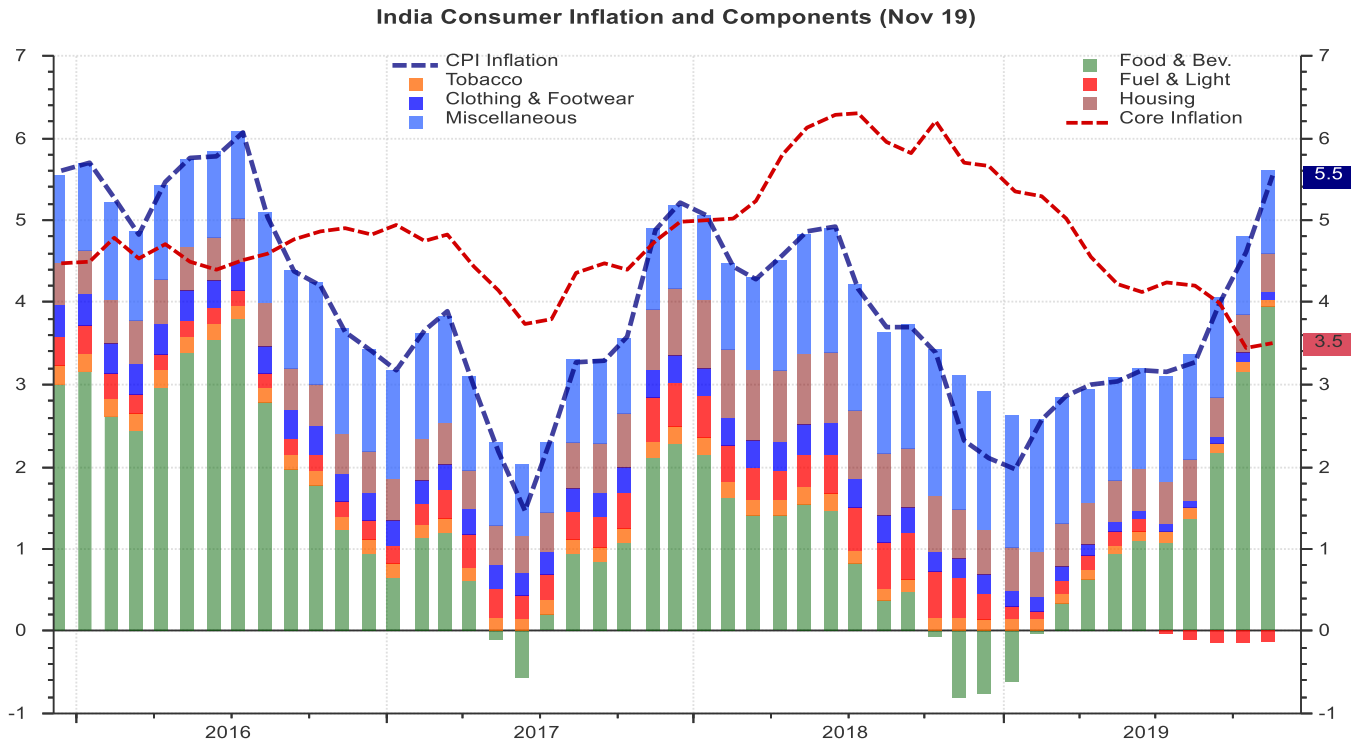
Source: CSO, Ministry of Commerce, NSE

Figure 4: India inflation vs. interest rates


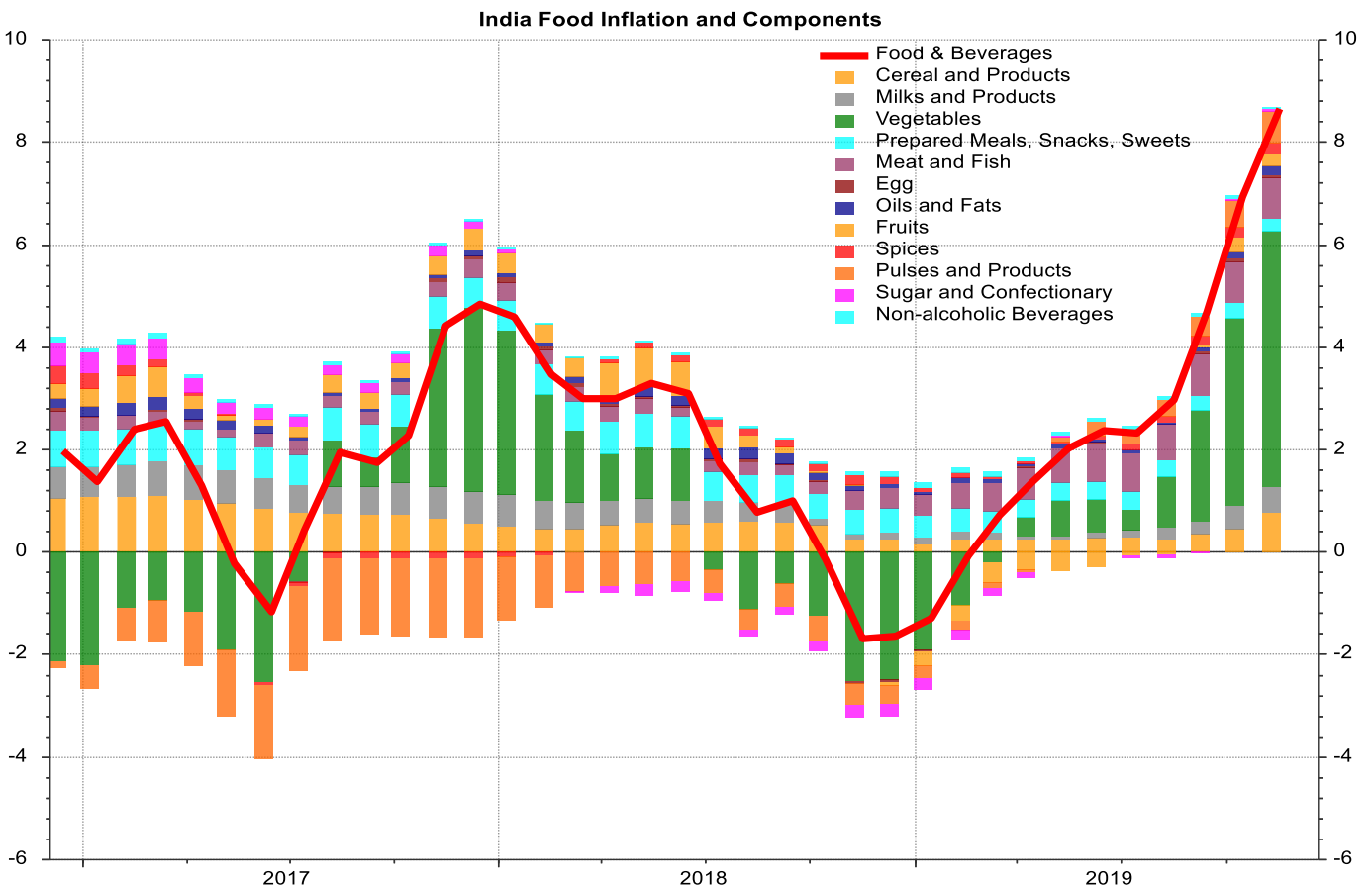
Source: Refinitiv Datastream, NSE

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


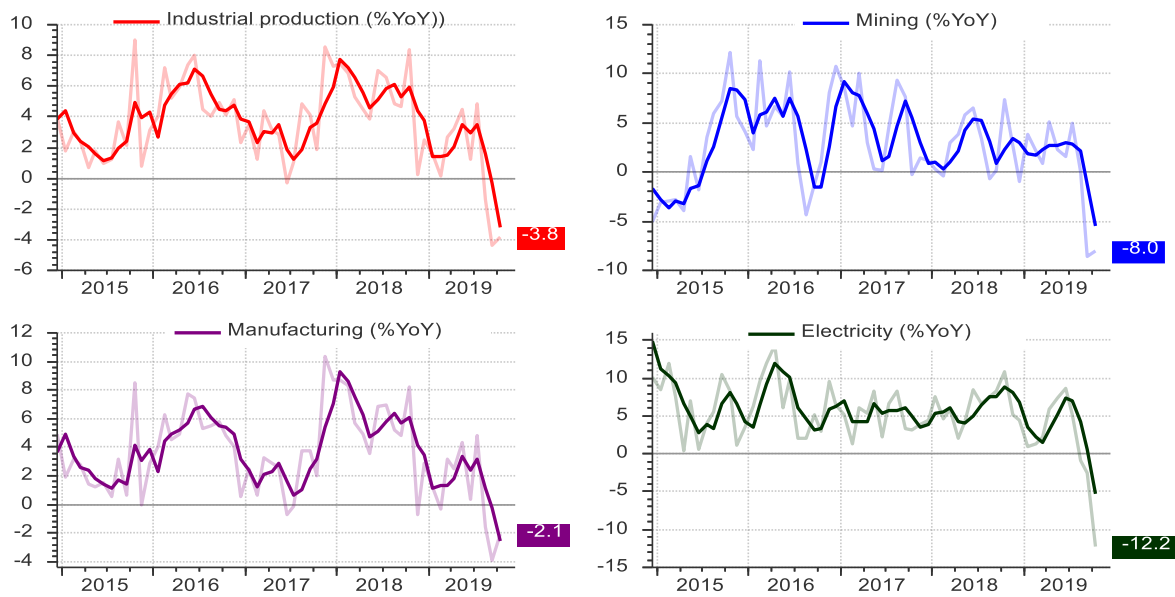
Source: Refinitiv Datastream, NSE

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


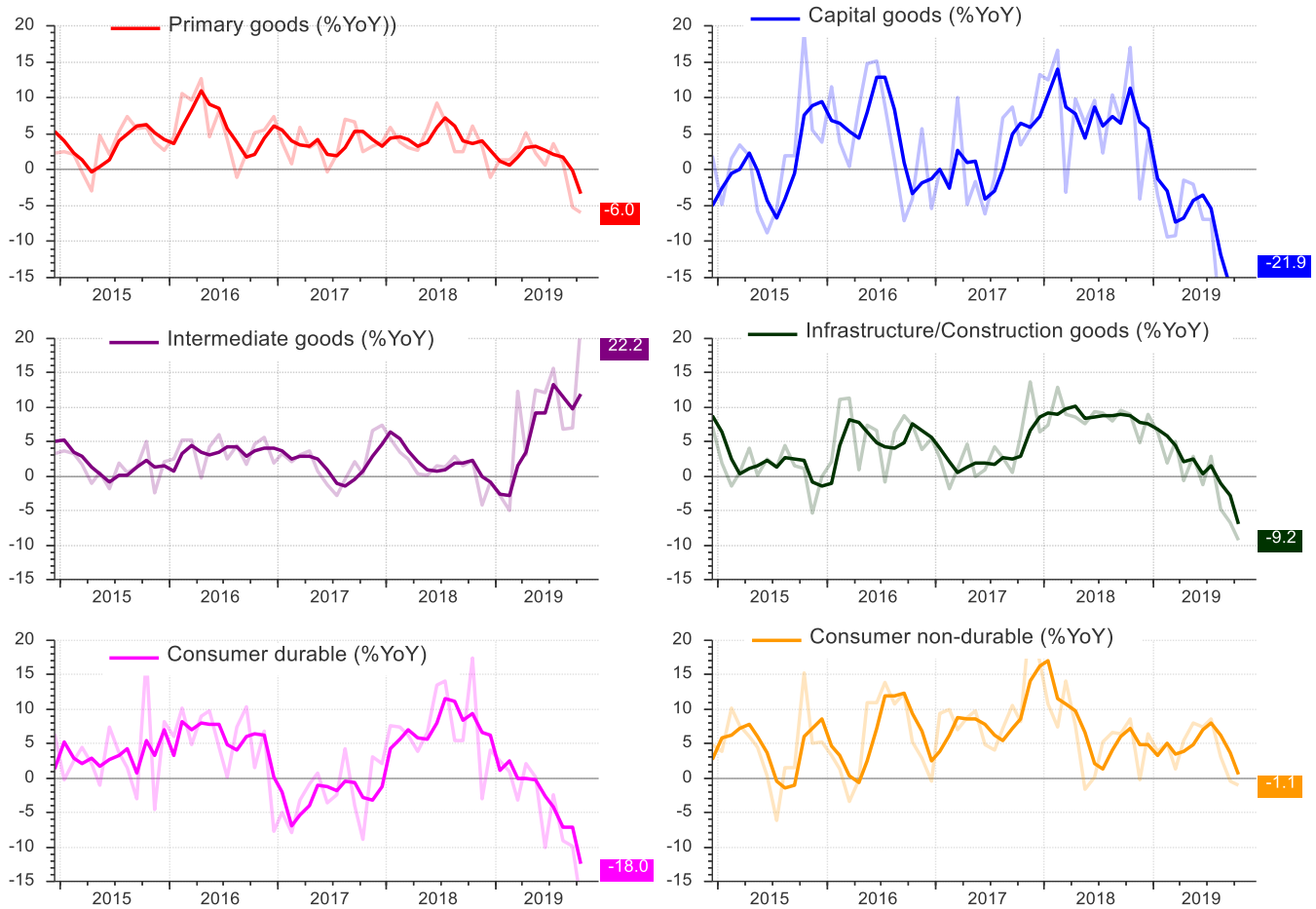
Source: Refinitiv Datastream, NSE

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


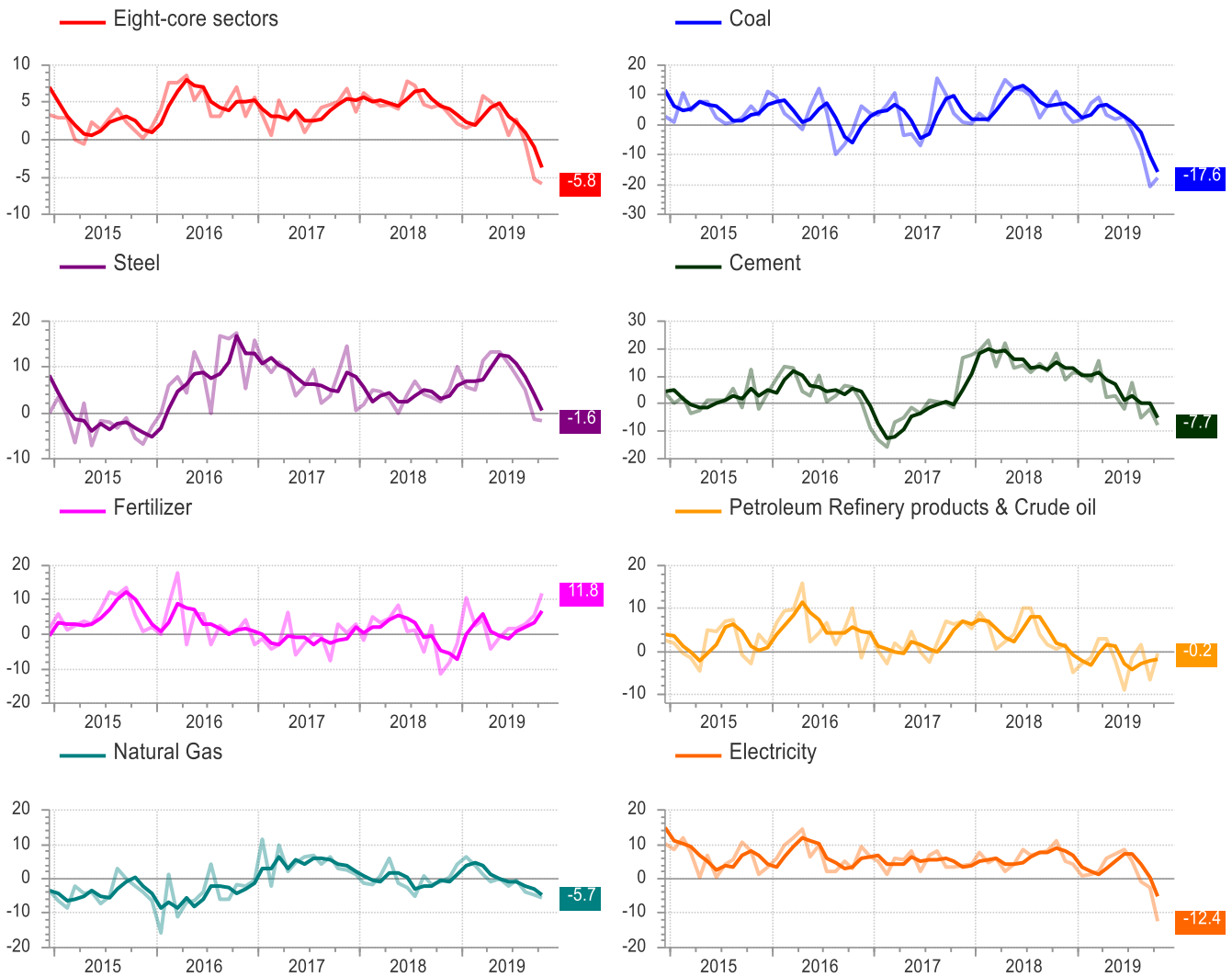
Source: Refinitiv Datastream, NSE

Figure 8: India industrial production (3MMA)


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

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