

Rising food prices hit retail inflation; IIP growth lowest in the series

India's retail inflation (CPI) rose to 14-month high of 4.0% in September, higher than market expectations (Refinitiv Datastream poll: 3.7%) vs. 3.3% in August. This was primarily on account of a sharp pick-up in food inflation, largely attributable to vegetables, meat & fish and pulses, partly offset by deflation in the fuel & light category for the third consecutive month. However, core inflation (excluding food and fuel) declined to 26-month low of 4.0%, thanks to a decline in transport and communication inflation amid low fuel prices, partly offset by higher inflation in personal care and effects (gold/silver). WPI inflation, on the other hand, fell to more than three-year lows of 0.3% in September 2019 (Refinitiv Datastream poll: 0.9%) vs. 1.1% in August, largely on account of continued deflation in fuel, mineral oils and electricity and a sharp drop in manufacturing products inflation. Industrial production disappointed and declined by 1.1% in August—the lowest in the series, vs. 4.6% growth in the previous month (Refinitiv Datastream poll: 1.8%), reflecting a broad-based slowdown.

Inflation is expected to continue to inch-up over the next few months, thanks to an unfavourable base and normalisation of food prices, even as core inflation remains benign amid weak domestic demand. Nevertheless, we expect the headline inflation to remain within the RBI's 4% +/- 2% target. Growth slowdown, however, seems to be deepening and remains a concern. As such, we expect the Central Bank to remain focussed on addressing demand slowdown and cut policy rates by another 25-50bps over the rest of the fiscal, *ceteris paribus*.

- **Sharp rise in food inflation causes retail inflation to jump to 14-month high:** Retail inflation (CPI) rose sharply from 3.2% in August to 4.0% in September—the highest in 14 months, and higher than the Consensus estimate of 3.7%. This has translated into Q2FY20 inflation of 3.5%, a tad higher than the RBI's projection of 3.4%. This was largely on account of higher vegetable and pulses inflation, which increased to 19-month and 36-month high to 15.4% and 8.4% respectively, albeit off a very low base (pulses were in deflation in 2007/18), as well as a sharp pick-up in meat & fish prices (rose to 68-month high of 10.3%). The inflation in other component of the food basket, however, remained fairly benign. High food inflation was partly offset by continued deflation in fuel & light (LPG, diesel), which declined to series-low of -2.2%.
- **Decline in core inflation points to weakening domestic demand:** Core inflation (ex-food ex-fuel) declined from 4.2% in August to 4.0% in September—the lowest in 26 months, signalling sustained weakness in domestic demand conditions. A sharp increase in gold (+21.3% YoY) and silver prices (+10% YoY), translating into higher inflation in personal care & effects category was more than offset by a sharp dip in transportation & communication prices (petrol, diesel) as well as a continued decline in inflation in household goods and services, health, and education. Excluding gold and silver, core inflation stood at 3.6% in September, implying a sequential decline of 30bps. Housing inflation also inched down by 10bps to 4.7%.
- **WPI inflation declines sharply to 39-month low:** Wholesale price inflation (WPI) declined sharply and came in at 39-month low of 0.3%, lower than the Consensus estimate of 0.9%. This was largely on account of continued deflation in fuel, mineral oils and electricity and a sharp drop in manufacturing products inflation, as well as moderation in non-food primary inflation. Within primary articles, while food inflation was broadly stable at 7.5% in September, crude, petroleum and natural gas remained in deflation for the fifth consecutive month, coming in at -13.4% in August (lowest in 38 months) vs. -7.7% in August. Manufactured products inflation also fell into the negative territory for the first time in 39 months to -0.4%.
- **Industrial production growth lowest in the series:** Industrial production fell by 1.1% YoY in August following a rebound to 8-month high YoY growth of 4.6% in July, significantly falling short of Consensus estimate of 1.8% growth. This sharp plunge has been on account of a slowdown across the board. Manufacturing production declined by 1.2% YoY—the steepest decline in 58 months, with 15/23 sectors reporting negative growth (vs. 10 in the previous month) led by motor vehicles, trailers and semi-trailers, machinery and equipment and other manufacturing products. Electricity production also declined for the second consecutive month after a strong show in Q1 FY20 (average growth at 7.2%), registering a decline of 0.9% YoY in August—the lowest in the series. Notably, this is still higher than the eight-core electricity print of -3.0% and hence faces downside risks.

The slowdown in investment and consumption was visible in the tepid performance of capital goods, infrastructure/construction goods and consumer durable goods that declined by 21.0% (lowest in the series), 4.5% and 9.1% respectively in August.

- Addressing growth slowdown to remain RBI's prime focus for now:** While headline inflation is expected to inch-up over the next few months, largely due to an unfavourable base and normalisation of food inflation (vegetables, pulses), a sustained moderation in core inflation reflects a pervasive slowdown in the economy. This is also evident from a sharp contraction in industrial production, thanks to a broad-based slowdown, even as favourable base may provide some respite in the second half of FY20. Nevertheless, weak domestic demand and faltering exports are likely to weigh on IIP growth in the near-term, making it imperative for the RBI to continue with monetary easing. As such, we expect policy rates to come off by another 25-50bps in the rest of the fiscal, *ceteris paribus*. In the medium-term, a combination of monetary (declining interest rates) and fiscal stimulus (corporate tax cuts, among others recent steps announced) is likely to provide some fillip to economic activity.

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

| | Weight (%) | Sep-19 | Aug-19 | Sep-18 | FY20TD | FY19TD |
|----------------------------|------------|--------|--------|--------|--------|--------|
| CPI | | 4.0 | 3.3 | 3.7 | 3.3 | 4.3 |
| Food & Beverages | 45.9 | 4.7 | 3.0 | 1.0 | 2.6 | 2.1 |
| Pan, Tobacco & Intoxicants | 2.4 | 4.6 | 5.0 | 5.6 | 4.5 | 6.9 |
| Clothing & Footwear | 6.5 | 1.0 | 1.2 | 4.6 | 1.5 | 5.2 |
| Housing | 10.1 | 4.7 | 4.8 | 7.1 | 4.8 | 8.0 |
| Fuel & Light | 6.8 | (2.2) | (1.7) | 8.6 | 0.5 | 7.2 |
| Miscellaneous | 28.3 | 4.5 | 4.7 | 5.6 | 4.7 | 5.5 |

Source: CSO, NSE

Figure 2: Wholesale price inflation in September 2019 (%YoY)

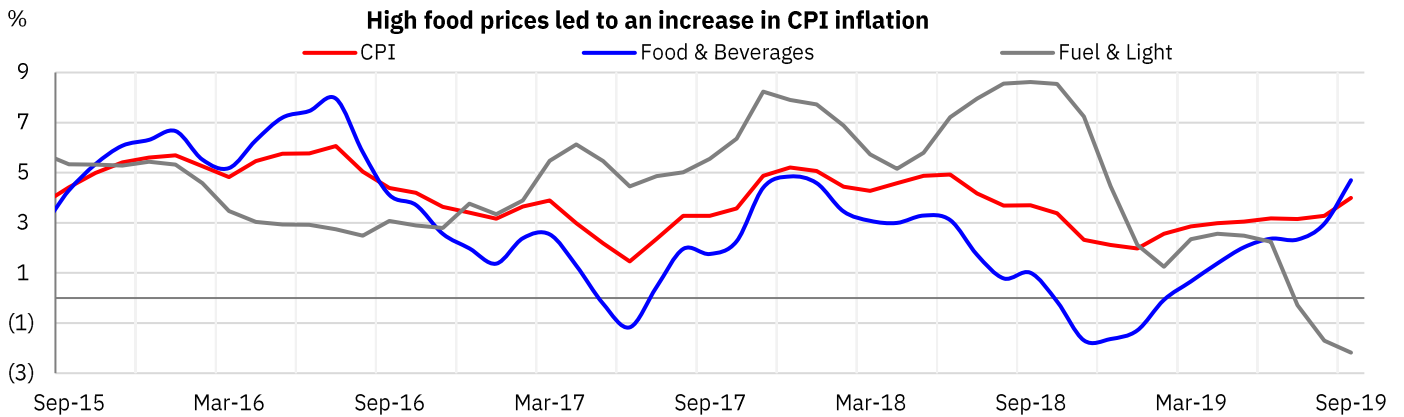
| | Weight (%) | Aug-19 | Jul-19 | Aug-18 | FY20TD | FY19TD |
|-----------------------|------------|------------|------------|------------|------------|------------|
| WPI | | 0.3 | 1.1 | 5.2 | 1.8 | 4.9 |
| Primary articles | 22.6 | 5.5 | 6.4 | 3.0 | 6.2 | 2.7 |
| Fuel & power | 13.2 | (7.1) | (4.0) | 17.3 | (1.9) | 15.0 |
| Manufactured products | 64.2 | (0.4) | - | 4.1 | 0.7 | 4.1 |
| Food group | 24.4 | 6.0 | 5.8 | 0.1 | 5.3 | 0.1 |

Figure 3: Industrial production in August 2019 (%YoY)

| | Weight (%) | Jul-19 | Jun-19 | Jul-18 | Apr-Jul'19 | Apr-Jul'18 |
|--------------------------|------------|--------|--------|--------|------------|------------|
| IIP | | (1.1) | 4.6 | 4.8 | 2.5 | 5.3 |
| Sector-based indices | | | | | | |
| Mining | 14.4 | 0.1 | 4.8 | (0.6) | 2.8 | 3.8 |
| Manufacturing | 77.6 | (1.2) | 4.5 | 5.2 | 2.1 | 5.5 |
| Electricity | 8.0 | (0.9) | 4.8 | 7.6 | 5.0 | 5.8 |
| Use-based Goods | | | | | | |
| Primary Goods | 34.0 | 1.1 | 3.5 | 2.5 | 2.4 | 5.4 |
| Capital Goods | 8.2 | (21.0) | (7.2) | 10.3 | (8.0) | 7.7 |
| Intermediate Goods | 17.2 | 7.0 | 14.7 | 2.9 | 10.0 | 1.3 |
| Infra/Construction Goods | 12.3 | (4.5) | 3.5 | 8.0 | (0.1) | 8.6 |
| Consumer Goods | 28.2 | (1.8) | 3.3 | 6.1 | 1.8 | 5.8 |
| Consumer Durables | 12.8 | (9.1) | (2.7) | 5.5 | (4.0) | 8.7 |
| Consumer Non-durables | 15.3 | 4.1 | 8.4 | 6.5 | 6.6 | 3.5 |

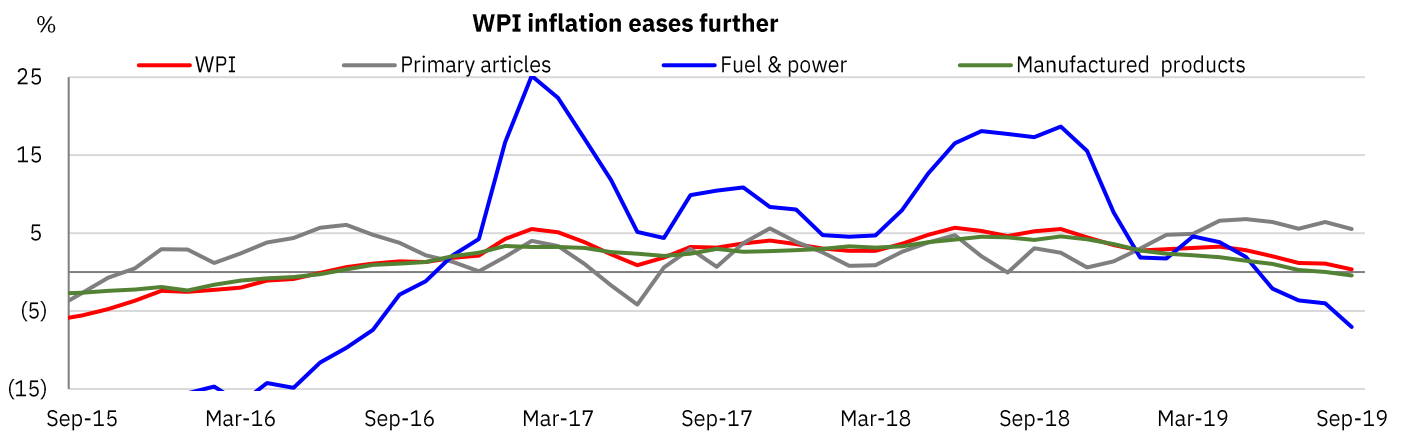
Source: CSO, NSE

Figure 4: CPI inflation inches up in September...



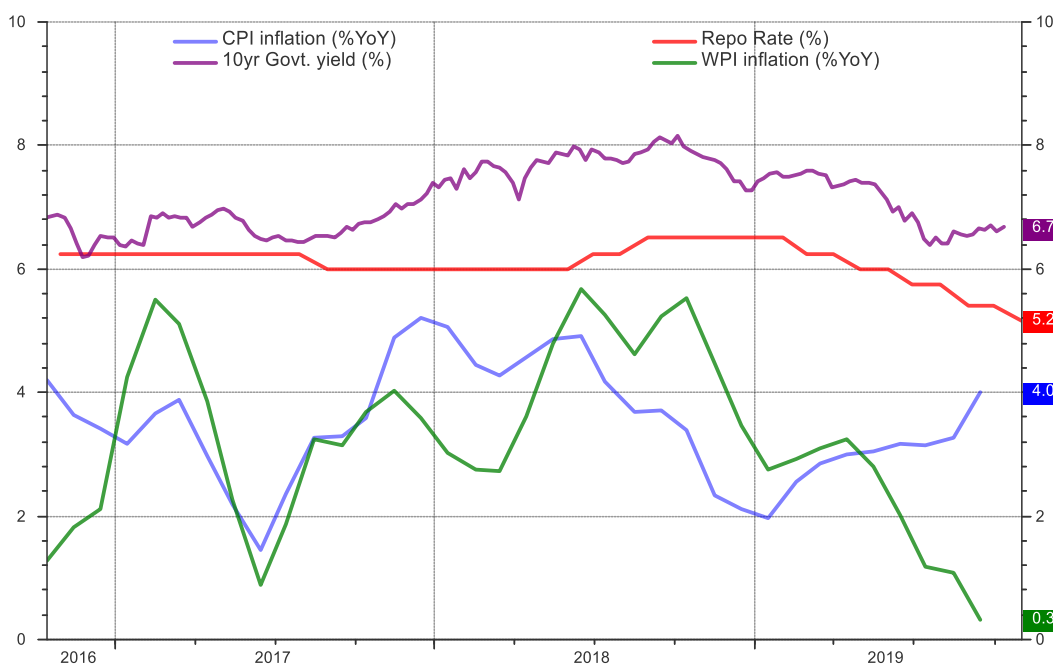
Source: CSO, Ministry of Commerce, NSE

Figure 5: but WPI inflation declines sharply

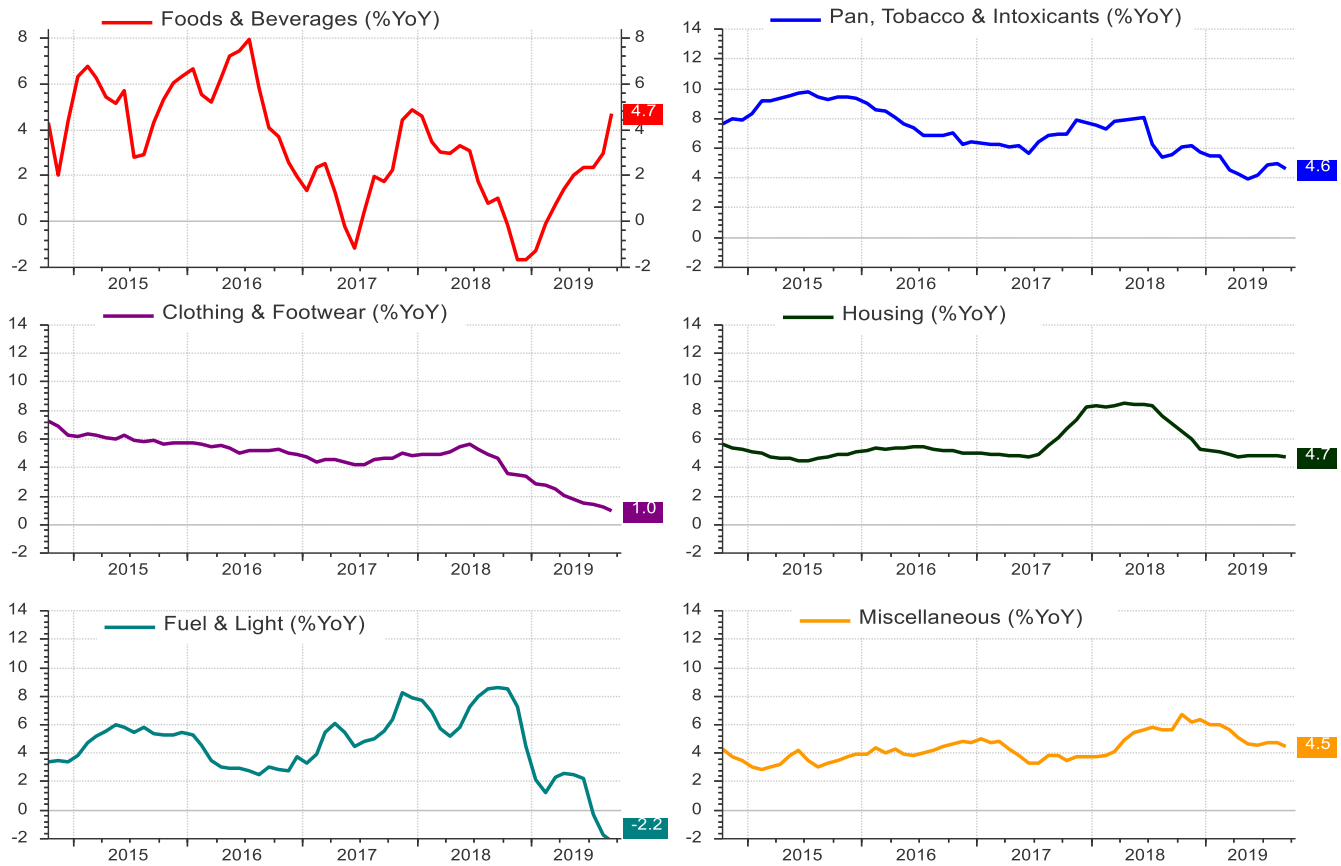


Source: CSO, Ministry of Commerce, NSE

Figure 6: India inflation vs. interest rates



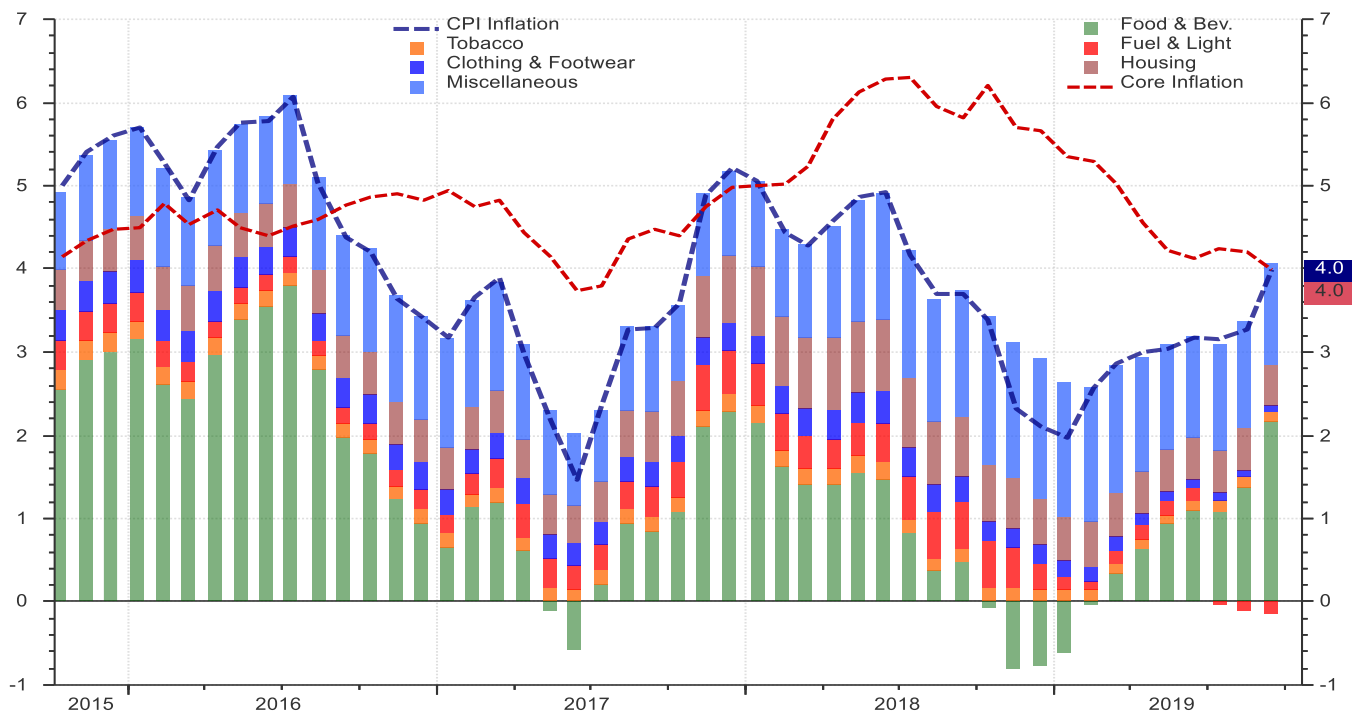
Source: Refinitiv Datastream, NSE

Figure 7: Category-wise India consumer price inflation (CPI)


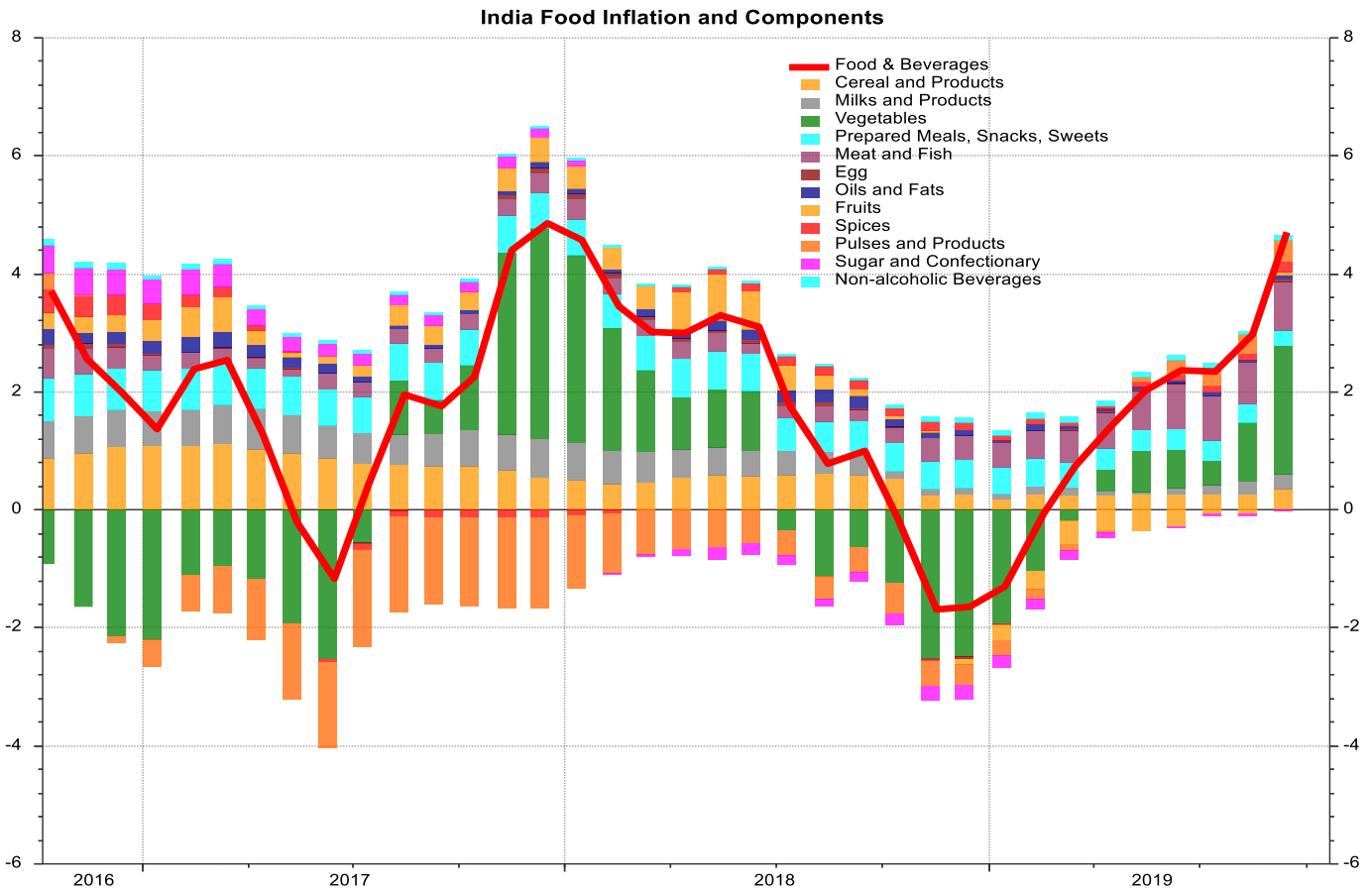
Source: Refinitiv Datastream, NSE

Figure 8: Category-wise contribution to India consumer price inflation (CPI)

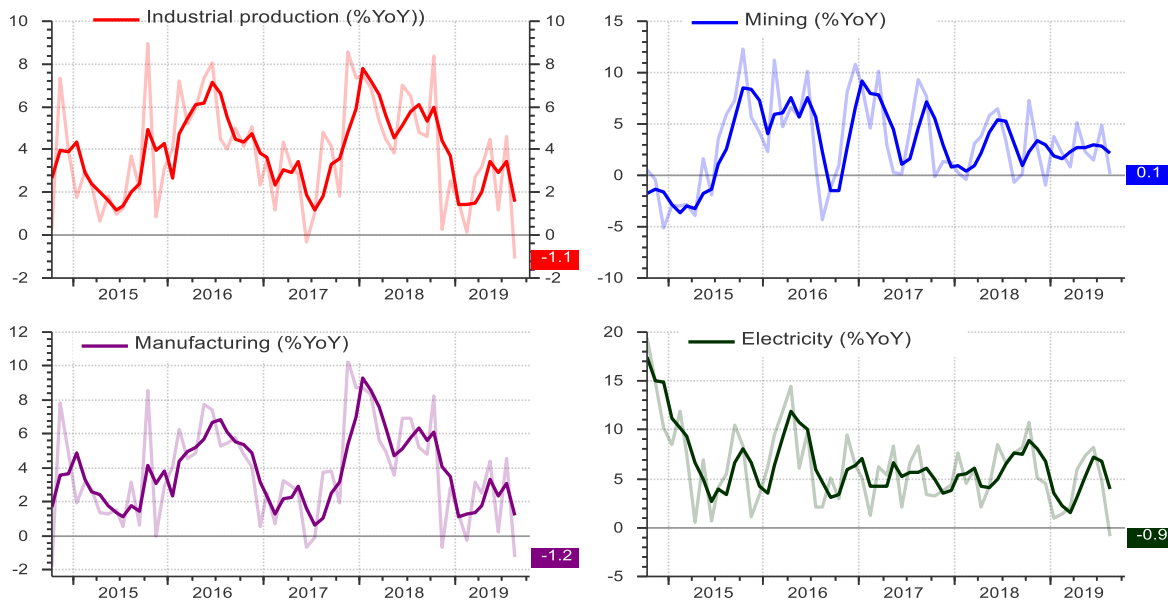
India Consumer Inflation and Components (Sep 19)



Source: Refinitiv Datastream, NSE

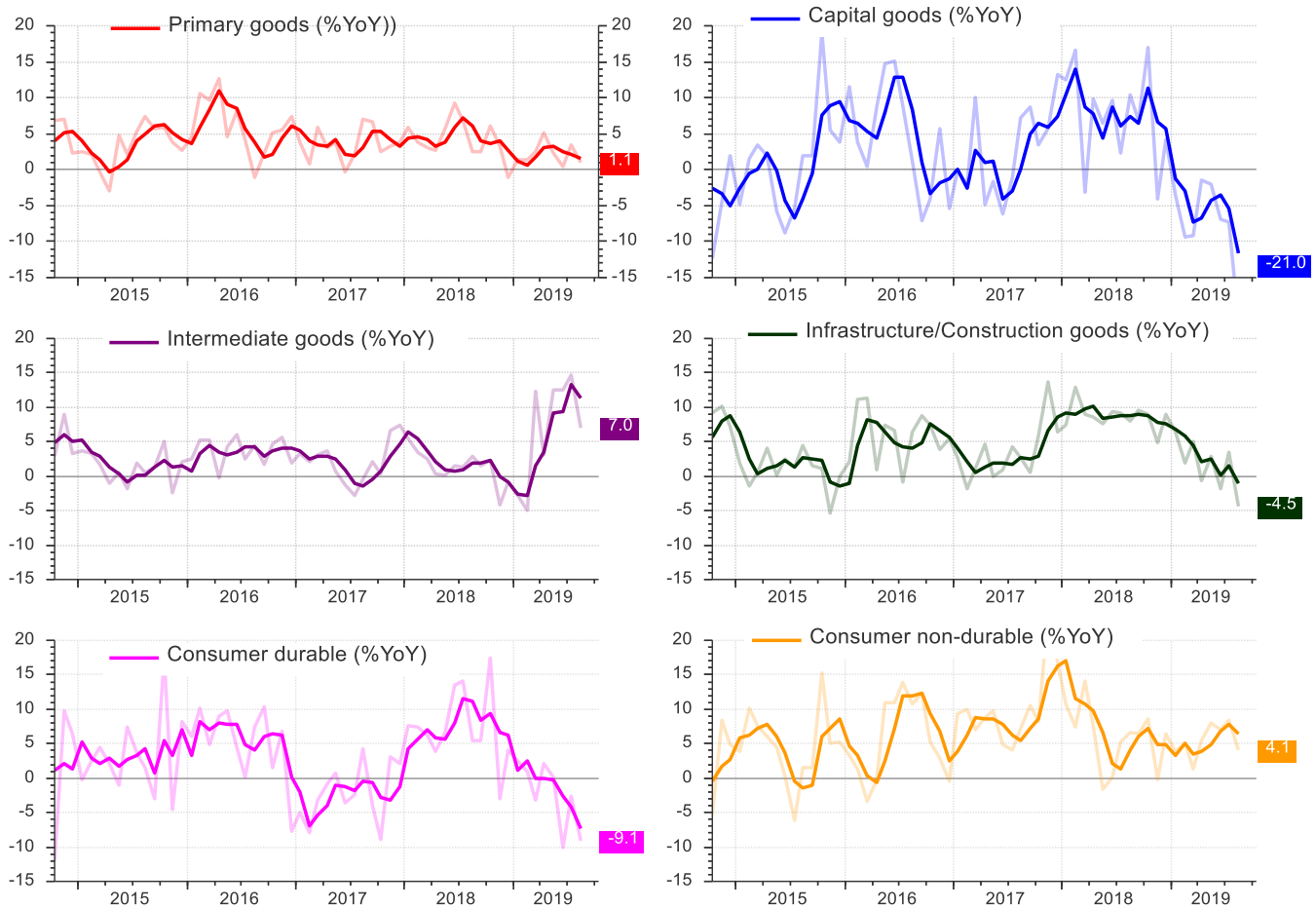
Figure 9: Category-wise contribution to India Food and Beverages inflation (CPI)


Source: Refinitiv Datastream, NSE

Figure 10: India industrial production (3MMA)


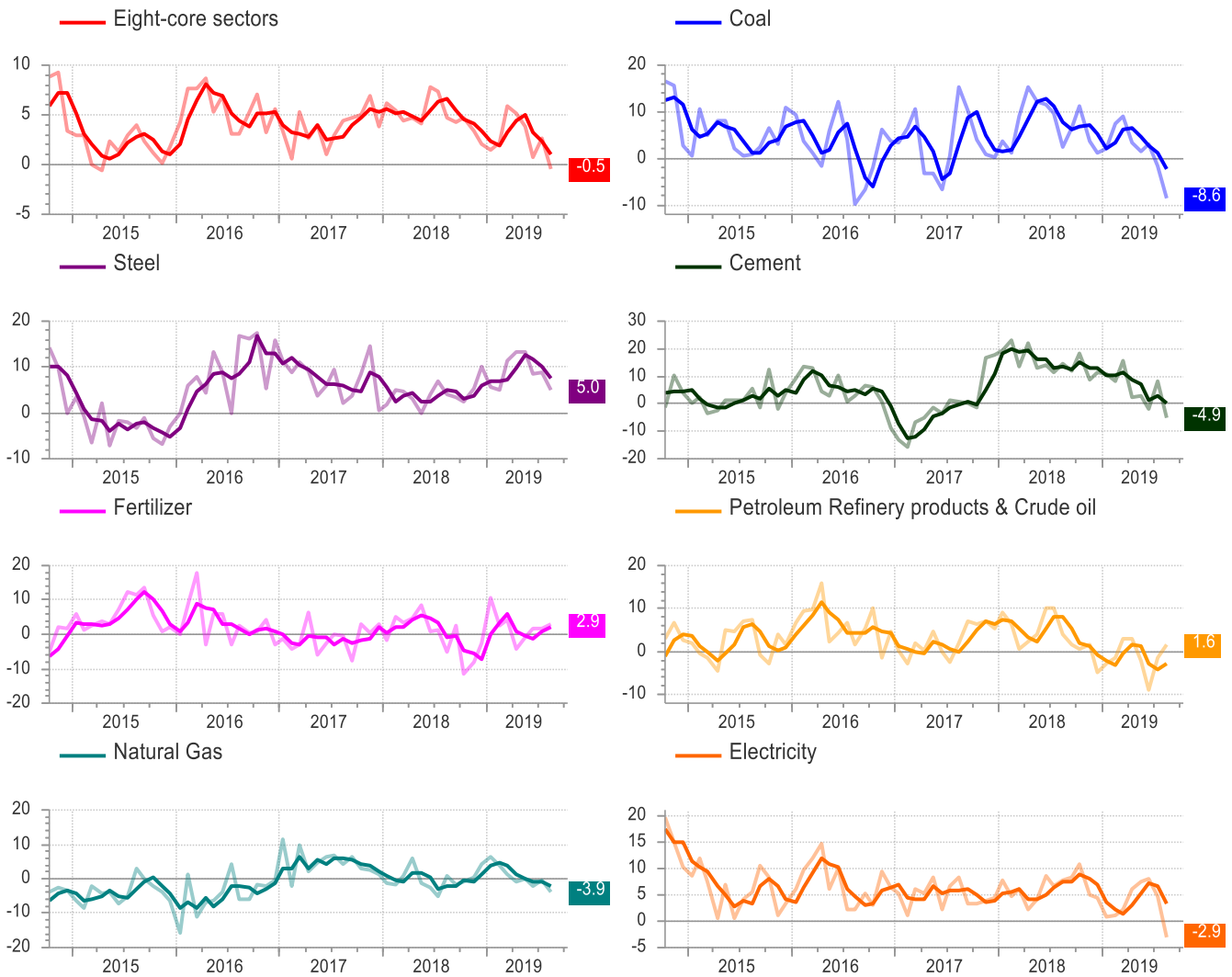
Source: Refinitiv Datastream, NSE

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

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