CPI and IIP

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Inflation and industrial growth: horns of dilemma?

CPI inflation came in as per our expectation of 5.6%. Unfavorable base came into play in pushing CPI higher. Even inflationary pressure was observed in major food categories such as cereals and products, milk, oils etc. Core was also sticky at 6.1%. Industrial production eased for the third consecutive month to 1.4% in Nov'21. Notably, IIP growth over a 2-year basis fell by 0.2%. Thus RBI is faced with the double whammy and likely to be on a wait and watch mode before taking any decision on rates.

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CPI inches up: Inflation for Dec'21 came in at 5.6% which was higher than that in Nov'21 when it was 4.9% and 4.5% in Oct'21. Unfavourable base (4.6% in Dec'20 against 6.9% in Nov'20) came into play in lifting CPI print higher. Inflation was higher than the country average in case of 9 items: oils and fats, non-alcoholic beverages, prepared meals and snacks, clothing and footwear, fuel and light, household goods and services, health, transport and communication and recreation and amusement categories. Core CPI (excl. food and fuel) was sticky at 6.1%. Even core excl. Pan & Tobacco, remained elevated at 6.3% in Dec'21 compared to 6.2% in Nov'21.

CPI to average at 5.2%: Inflation is sticky remaining above 5%. Even, price pressure is visible across major food categories. Core inflation is also a cause of worry and hence will be closely watched by RBI. We expect inflation to average 5.2% in FY22. While it is within the tolerance band of the MPC, it is definitely on the higher end and would ideally support the view that the repo rate needs to be hiked. However, the RBI has maintained that growth is priority and here the industrial production performance needs to be viewed in the light of the NSO projecting GDP growth at 9.2% against RBI's 9.5%.

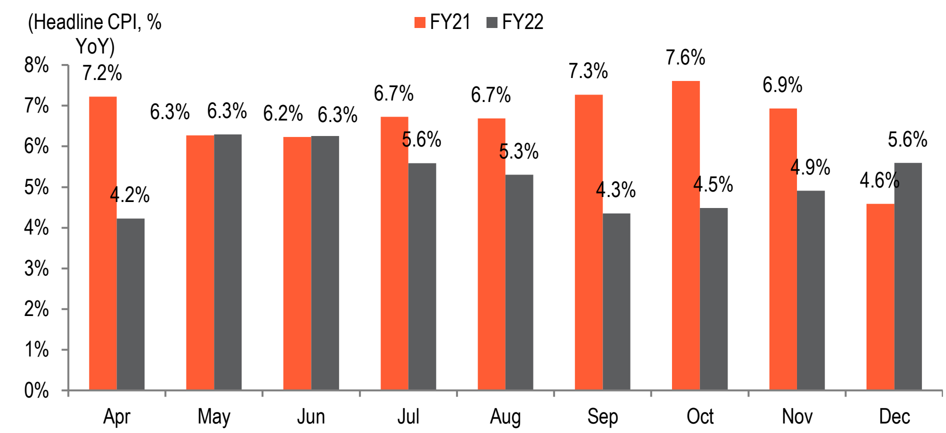
IIP easing: Industrial output in Nov'21 eased for the third consecutive month to 1.4% from 4% in Oct'21. Slowdown was broad based with mining and manufacturing slowing the most. Within manufacturing, transport equipment and machinery production fell the most. Amongst the use-based classification, capital goods and consumer durables production contracted sharply in Nov'21.

Recovery in IIP hanging in balance: During Apr-Nov'21, IIP has risen by 17.4% compared with a decline of 15.3% in the same period over the previous year. However, a worrying trend emerged in Nov'21 as the IIP growth over a 2-year basis fell by 0.2% in Nov'21 compared with pre-pandemic levels. This trend was seen despite sharp improvement in domestic activity owing to festive and holiday season. One reason could be fewer working days and the other could be stocking of products by wholesalers well in advance. Going ahead, we expect some impact of Omicron on production as case load across the country rises and demand slows.

CPI

CPI inflation at its 4-month high of 5.6, % is still worrisome as it remains considerably above RBI's 4% target.

Fig 1 – Headline CPI inflation month wise for FY21 and FY22



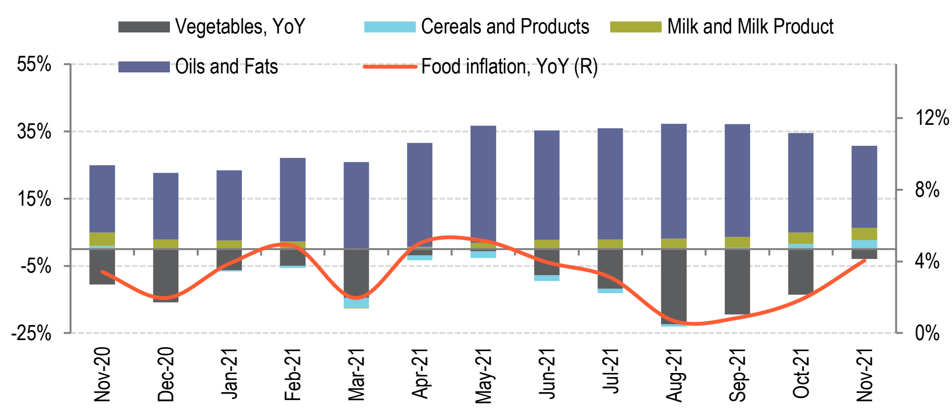
Source: CEIC, Bank of Baroda Research

Inflation has averaged 6.2% in FY21 and 5.2% so far in the first 9 months of FY22.

Amongst major categories

Food and beverages: Inflation in this category shot up to 5-month high of 4.5% in Dec'21 and against 2.6% in Nov'21. This was on account of inflationary pressure observed in major categories such as cereals and products (2.6% in Dec'21 from 1.5% in Nov'21), milk and product (3.8% from 3.4%), vegetables -3% from -13.6%) and prepared meals and snacks (6.6% from 6.5%). Apart from this, even for oils and fats category, inflation remained in double digits at 24.3%. Notably, 5 out of 12 food and beverage category items have remained above 4%.

Fig 2 – Categories of food inflation exhibiting pressure

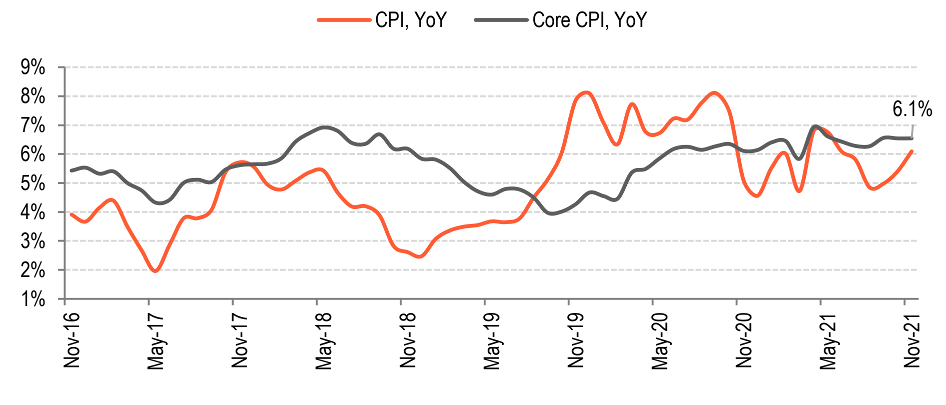


Source: CEIC, Bank of Baroda Research

Clothing and footwear: Inflation in this category rose to its high since May'14 to 8.3% in Dec'21 from 7.9% in Nov'21. It is worth mentioning here that inflation in this category is further likely to inch up from Jan'21 onwards, on account of GST rate hike (currently attracts 5% and revised to 12%).

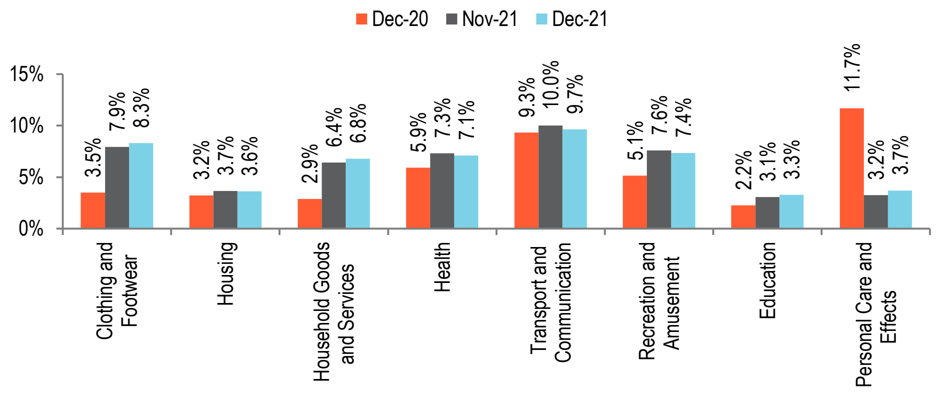
Core inflation: Core inflation is what would be critical from monetary policy standpoint. It has been observed that core inflation has remained sticky at 6.1% in Dec'21 as well. Component wise, education (3.3% in Dec'21 from 3.1% in Nov'21) and personal care and effects (3.7% from 3.2%) inched up. However, inflation in the transport and communication category moderated to 9.7% in Dec'21 from 10% in Nov'21, due to moderation of average petrol and diesel prices (fell by 1.9% in Dec'21), in line with drop in international crude prices (9% fall in Dec'21).

Fig 3 – Stickiness in Core inflation observed



Source: CEIC, Bank of Baroda Research

Fig 4 – Major categories of core inflation also remained sticky



Source: CEIC, Bank of Baroda Research

Even Core excl. pan & tobacco, remained elevated at 6.3% in Dec'21 compared to 6.2% in Nov'21. Also, core excluding major volatile items such as transport and communication, personal care and effects and pan, tobacco and intoxicants remained elevated at 5.7% in Dec'21 and against 5.6% in Nov'21.

Fuel and light which has a weight of 6.84% has shown some moderation to 11% in Dec'21 from 13.3% in Nov'21, despite remaining in double digits. This was led by drop in PDS prices of Kerosene by 2.4% in Dec'21.

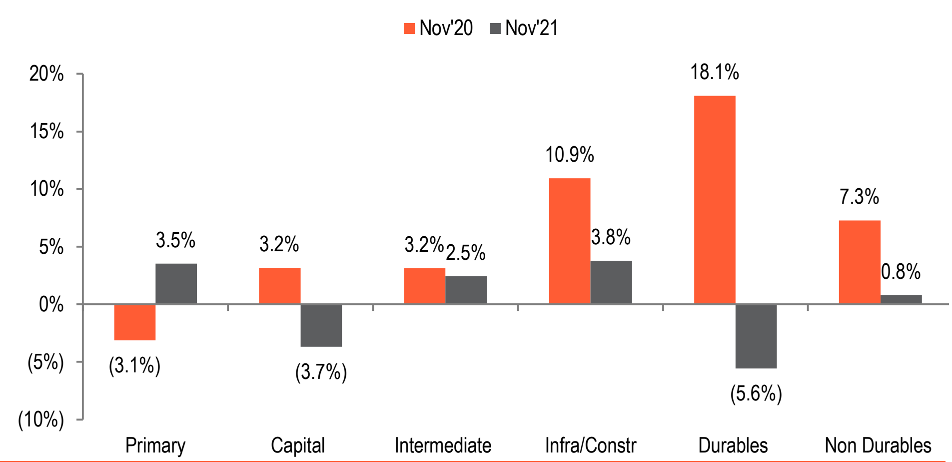
Industrial growth

IIP growth softens: Industrial output in Nov'21 eased for the third consecutive month to 1.4% from 4% in Oct'21. The base effect has been wearing off, which has led to the print being on the lower side. Slowdown was broad-based with mining sector growth cooling the most (5% versus 11.5% in Oct'21), followed by growth in manufacturing (0.9% versus 3.1%) and electricity production (2.1% versus 3.1%). As a first in four months, even over a 2-year horizon, IIP index is 0.2% below the pre-pandemic level. Both mining (-0.7%) and manufacturing (-0.8%) have fallen below the pre-pandemic levels, while electricity production is still holding up (5.7%).

Manufacturing under pressure: Amongst the 23 broad sectors covered, 11 sectors under manufacturing reported contraction in Output in Nov'21. Amongst these, output of other *transport equipment, machinery and equipment and leather and related products* fell the most. On the other hand, output of computer and electronics, basic metals and furniture picked up. Over a 2-year horizon, 18 out of the 23 sectors reported contraction in Nov'21, with other transport equipment, machinery and equipment, printing and media, leather and related products and beverages taking the lead.

Capital goods-a drag: Within use-based classification, there has been a broad based decline across sectors. Capital goods output has contracted to 9-month low of 3.7% in Nov'21 compared 1.5% decline see in Oct'21, while FMCG output contracted to 15-month low of 5.6% versus 3.6% decline see in Oct'21. Infra and primary goods output seems to be losing momentum and moderated by 3.8% (6.6% in Oct'21) and 3.5% (9% in Oct'21) respectively in Nov'21. Even output of intermediate goods (2.5% versus 3.8%) and consumer non-durables (0.8% versus 0.9%) moderated. Over a 2-year horizon also, there has been a broad-based slowdown in all the sectors, with output of capital goods (-10.9%) and FMCG products (-8.6%), falling below pre-pandemic levels.

Fig 5 – Use Based: Growth Rate



Source: CEIC, Bank of Baroda Research

Table 1: IIP growth moderates in Nov'21

(% change)	Nov'20	Nov'21	Apr-Nov'20	Apr-Nov'21
Mining	(5.4)	5.0	(12.2)	18.2
Manufacturing	(1.6)	0.9	(17.2)	18.5
Electricity	3.5	2.1	(4.6)	10.2
IIP general	(1.6)	1.4	(15.3)	17.4

Source: CEIC, Bank of Baroda Research

Concluding remarks

The lockdown like conditions which are in force from mid-December which will continue till March, will keep production levels depressed and growth in the coming quarter would be in the region of not more than 3-5% even on a low base.

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