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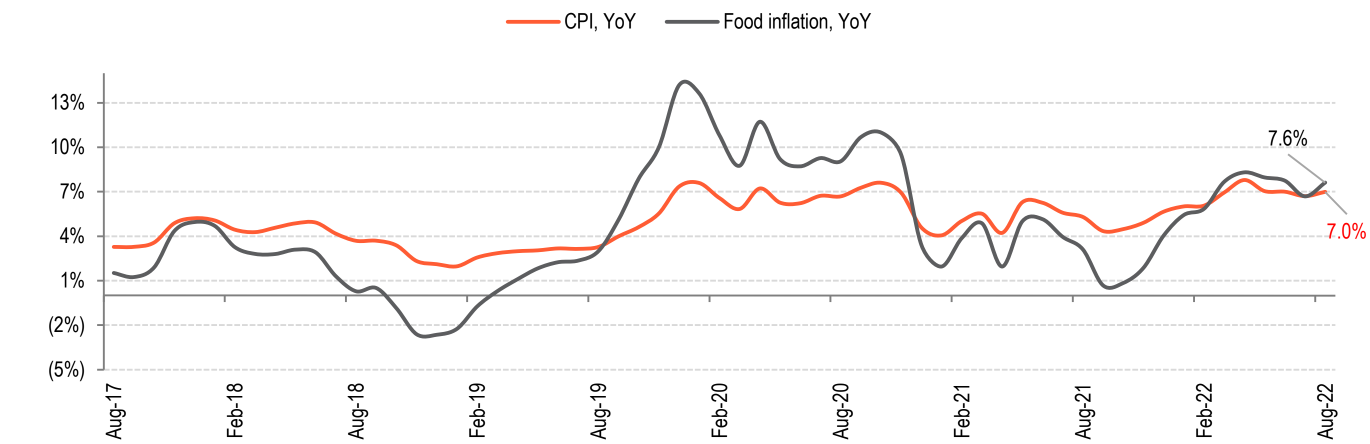
CPI hardens, IIP growth falters

Headline CPI rose to 7% in Aug'22 from 6.7% in Jul'22. Food inflation rose sharply to 7.6% from 6.7% in Jul'22 led by vegetables, fruit and milk and pulses. Core inflation remained sticky 5.8% in Aug'22. Going forward, outlook on core remains cautionary as high frequency indicators of growth for India is still performing better. In addition, with CPI still above RBI's target level we continue to expect 50bps rate hike in the current cycle. On the other hand, industrial growth decelerated further to 2.4% in Jul'22 (12.7% in Jun'22) led by contraction in mining output and slowdown in manufacturing and electricity production. Going ahead, global headwinds emerging from tight monetary conditions, weak demand from China owing to Covid-19 related lockdowns and looming energy crisis in Europe, will build pressures on domestic recovery.

CPI inches up

CPI inflation inched up: Against our estimate of 6.7% and compared to market consensus of 6.9%, headline CPI print was higher than estimated at 7% in Aug'22, on YoY basis. This is the 8th consecutive month that headline CPI print have remained above RBI's upper band of 6%. For Q2FY23, RBI estimated the print to be at 7.1%. Food inflation shot up considerably to 7.6% from 6.7% in Jul'22. Out of 12 food and beverage items of inflation, 7 of the food items have shown a pickup in momentum. Among them, vegetable inflation rose by 13.2% from 10.9% in Jul'22, fruits by 7.4% from 6.3%, milk and milk product by 6.4% from 5.8%, pulses from 2.5% against 0.2% in Jul'22. In Sep'22 as well, major food items such as vegetable, fruits, milk are showing a pickup in momentum. Further sowing of rice has been a concern which might put further pressure on cereal prices going ahead. However, government's supply management measures such as the recent restriction on rice exports might provide some comfort.

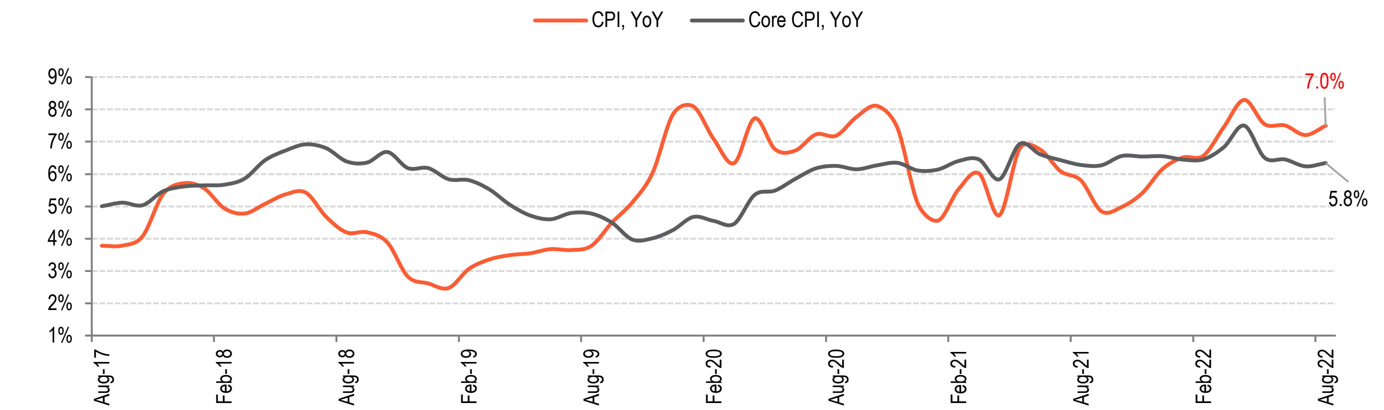
Fig 1 – CPI rose to 7%, aided by food inflation



Source: CEIC, Bank of Baroda Research

Core inflation also sticky: Core (CPI excl. food and fuel) was sticky at 5.8% in Aug'22 as well. However, core excl. pan, tobacco and intoxicants- a closely looked indicator by RBI has remained elevated at 6.1% against 6% in Jul'22. Within core, housing inflation rose to 4.1% from 3.9% in Jul'22. Household goods and services inflation remained elevated at 7.5% from 7.4% in the previous month. Despite fall in gold prices, inflation in the personal care and items edged up by 7% from 6% earlier. Inflation in education was also higher at 5.5% against 5% earlier. Going forward, outlook on core remains cautionary as high frequency indicators of growth for India is still performing better.

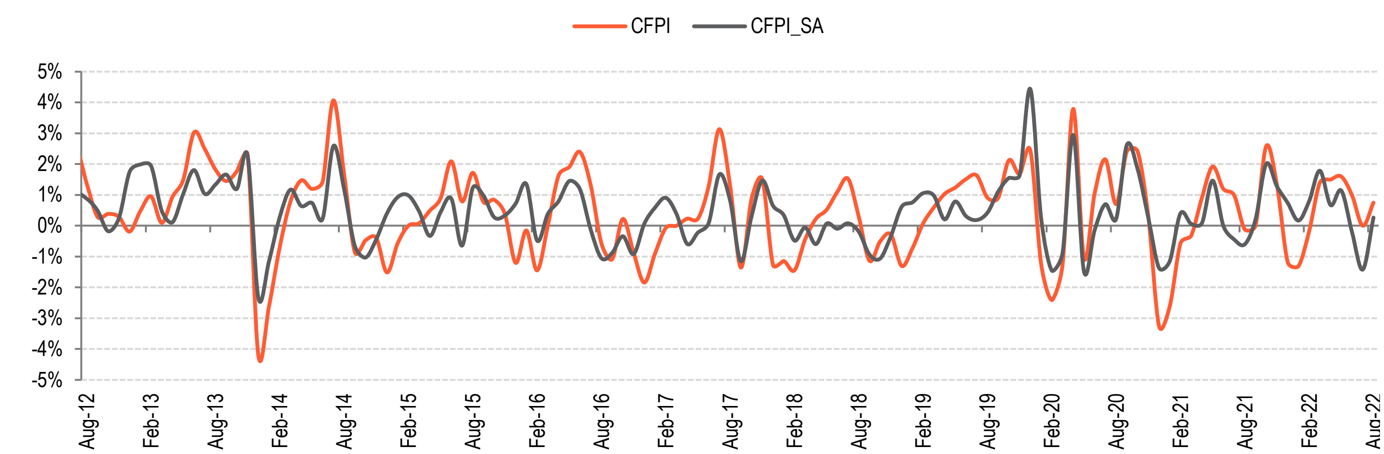
Fig 2 – Core CPI still remaining sticky



Source: CEIC, Bank of Baroda Research

On sequential basis too, inflation picked up pace: On MoM basis, CPI edged up to 0.52% from 0.46% in Jul'22. The major sequential pick up was led by food inflation (+0.7% against 0% in Jul'22). Within food apart from fruits, protein based items and non-alcoholic beverage, all food items noted pickup in inflation. The most notable among them being pulses (1.7% against 0% in Jul'22) and cereals (2.4% versus 1%). Core inflation rose by 0.5%, MoM. Within core, housing (0.7% versus 0.6%) and personal care items (0.9% versus 0.2%) should the maximum increase with respect to sequential momentum. Lower oil prices comforted transport and communication inflation.

Fig 3 – On a seasonally adjusted basis as well, food inflation is picking pace



Source: CEIC, Bank of Baroda Research

Upside risks to outlook persist: Inflationary pressure is still evident throughout the basket. Especially the food basket is a concern. More than 50% of it has remained above 6% in FYTD23. Even the high frequency growth indicators such as air passenger, port cargo, rail freight, and auto sales have shown considerable pickup in momentum. Thus core is also likely to remain sticky in the coming months. PMI data is also reflective of the fact that services activity is impressive. However, the spillover impact of global growth slowdown and tightening financial conditions worldwide would impinge on the demand conditions of the economy sooner or later. RBI is also expected to continue with another round of rate hike. Our expectation is an addition of 50bps rate hike in the current cycle. This will further quell inflationary pressure and anchor inflation expectation going forward. Our headline CPI forecast for FY23, stands at 6.5%, with risks remaining on the upside.

Industrial Production slows

IIP growth moderates: As against our expectations (5.4%), industrial output eased to 2.4% in Jul'22 from 12.7% in Jun'22. Slowdown was expected on account of unfavourable base, and it was visible across sectors. Mining output contracted (-3.3%) for the first time since Feb'21 (-4.4%) and was down from 7.8% in Jun'22. Electricity production was down to 2.3% following 16.4% increase in Jun'22, while manufacturing growth slowed to 3.2% from 13% in the previous month. Within manufacturing, output contracted the most in case of electrical equipment (-15.6% in Jul'22 versus 11.8% in Jun'22), leather (-12.8% versus 1.3%), tobacco products (-8.8% versus 52.8%) and textiles (-8.6% versus -2.9%). Output of chemicals, pharma products, basic metals, computer and electronic items also moderated sharply in Jul'22 from the previous month. Compared with the levels seen in 2019 (pre-pandemic period), IIP growth was up by 14.2% in Jul'22 versus 28.3% in Jun'22.

Consumer non-durables a drag: Within use-based too, broad based moderation continued across all sectors. Output of consumer non-durables contracted in Jul'22 (-2%) after returning to growth in May'22 (1%) and Jun'22 (3%). Amongst others, sharp moderation was registered under capital goods (5.8% versus 29.1%) and consumer durable goods (2.4% versus 25.1%). Production of primary goods (2.5% versus 13.8%), intermediate goods (3.6% versus 10.5%) and infrastructure and construction goods (3.9% versus 9.3%) also disappointed.

Recovery facing pressures: While favourable base is expected to support growth in the latter half of H2FY23, tight global monetary conditions are beginning to show impact on global demand. In line with manufacturing PMIs of other major economies (down in Europe and China, stable in US), manufacturing PMI for India also eased a tad in Aug'22 to 56.2 from 56.4 in Jul'22. GST collections also softened marginally in Aug'22. Looming energy crisis in Europe and faltering demand in China due to Covid-19 restrictions remain key risks to recovery.

Fig 4 – IIP growth moderates to 12.3% in Jun'22 from 19.6% in May'22

Sectoral (%)	Weight	Jul-22	Jun-22	Jul-21	Apr-Jul'22	Apr-Jul'21
IIP	100.0	2.4	12.7	11.5	10.0	33.9
Mining	14.4	(3.3)	7.8	19.5	6.1	25.4
Manufacturing	77.6	3.2	13.0	10.5	10.2	38.8
Electricity	8.0	2.3	16.4	11.1	13.2	15.2
Use-Based						
Primary Goods	34.1	2.5	13.8	12.4	11.0	18.6
Capital Goods	8.2	5.8	29.1	30.3	23.0	77.4
Intermediate Goods	17.2	3.6	10.5	14.6	9.5	50.6
Infrastructure and Construction Goods	12.3	3.9	9.3	12.3	8.6	57.8
Consumer Durables Goods	12.8	2.4	25.1	19.4	19.6	76.7
Consumer Non-Durables Goods	15.3	(2.0)	3.0	(2.3)	0.3	11.6

Source: CEIC, Bank of Baroda Research

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