

INFLATION AND IIP

12 November 2021

IIP cools, Inflation heats up

IIP growth slowed to 3.1% in Sep'21 from 12% in Aug'21, owing to base effect. This was broad-based, with production of consumer durables and non-durables falling the most. However, over a 2-year horizon, output was up by 4.1% in Sep'21 (4% in Aug'21). CPI inched up to 4.5% in Oct'21 versus 4.3% in Sep'21, despite favourable base. Core inflation rose by 30bps, led by transport and communication. We expect RBI to continue the process of normalisation by raising reverse repo rate in Q4FY22.

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IIP growth softens: Industrial output eased sharply to 3.1% in Sep'21 from 12% in Aug'21. Base effect played a major role in this (Sep'20: 1%; Aug'20: -7.1%). Slowdown was broad based with mining output easing to 8.6% in Sep'21 from 23.6% in Aug'21, electricity output down to 0.9% from 16% and manufacturing output softening to 2.7% from 9.9%. Within manufacturing, slowdown was across categories. Production of consumer durables (-2% versus 8.2%) and non-durables (-0.5% versus 5.6%) fell the most. Production of capital goods (1.3% versus 19.9%) and primary goods (4.6% versus 17%) too slowed. Over a 2-year horizon, IIP growth has expanded by 4.1% in Sep'21 with only mining (10.1%) clocking double digit growth. We expect IIP to pick up pace as domestic demand improves further (also reflected in non-oil-non-gold imports in Oct'21).

CPI inched up led by core: Despite a favourable base (7.6% in Oct'20), CPI inched up to 4.5% in Oct'21 against 4.3% in Sep'21. This was on account of higher core inflation (CPI excl. food and fuel) which rose by 30bps to 6.2% from 5.8% in Sep'21. Within core, transport and communication rose to 10.9% from 9.5% in Sep'21. Higher retail price of petrol and diesel contributed to this increase (+4.8%, MoM in Oct'21). Significant jump was also visible in personal care and effects (up by 57bps to 2.5% from 1.9%), clothing and footwear (+30bps to 7.5% from 7.2%) and household goods and services (+25bps to 6.2% from 5.9%). Core is likely to remain elevated in FY22 as demand gathers steam. However, government's recent decision to cut petrol and diesel rates, might provide some relief in the future.

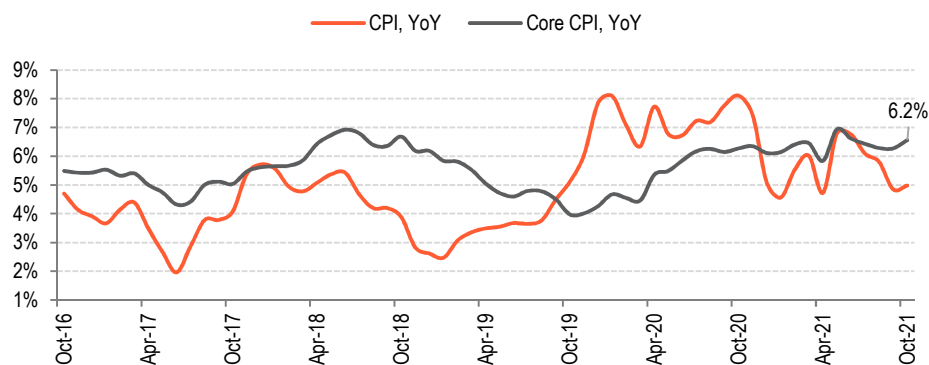
Food inflation inched up marginally: Food inflation edged up to 0.8% in Oct'21 from 0.7% in Sep'21. Price pressure was visible in cereals (+0.4% against -0.6% in Sep'21), vegetables (-19.4% against -22.4% in Sep'21), fruits (4.9% against 3.6%) and sugar (5.4% against 3%). Going forward, better sowing would support food prices. However, inflation risks are tilted to the upside on the back of elevated energy and commodity prices. We expect CPI to be ~ 5.5% in FY22 (RBI's estimate: 5.3%). Even global central banks are likely to be hawkish on the back of rising inflationary pressure worldwide. Thus, we expect RBI to continue the process of normalisation by raising reverse repo in Q4FY22 before lifting off repo rate in FY23.

Key highlights

- CPI inflation edged up to 4.5% in Oct'21 from 4.3% in Sep'21, despite favourable base.
- Core inflation rose to 6.2%. Food inflation picked up marginally to 0.8%.
- IIP eased to 3.1% in Sep'21 from 12% in Aug'21. It has risen by 4.1% over a 2-year horizon.

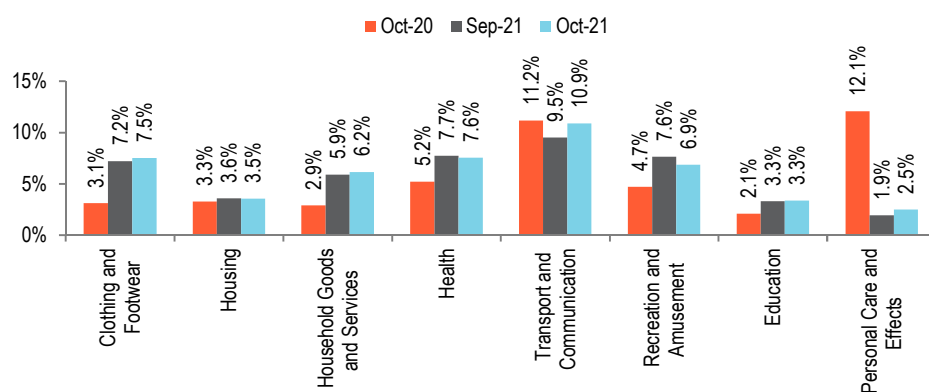


Fig 1 – CPI inched up as core shoots to 6.2% from 5.8% in Sep'21



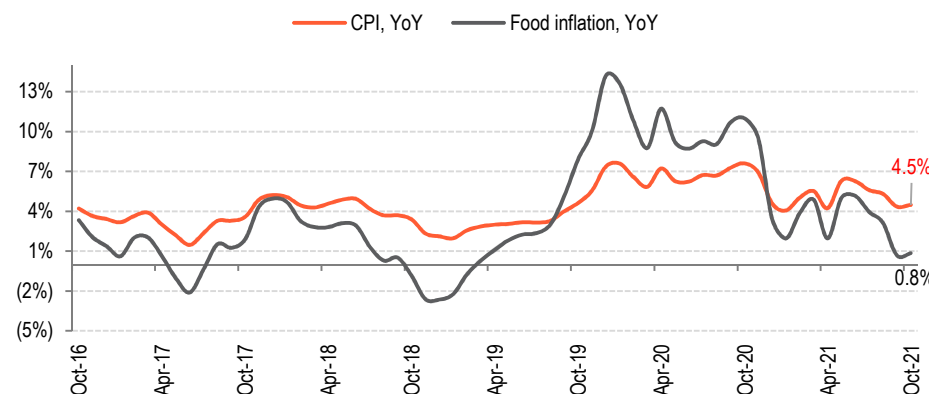
Source: CEIC, Bank of Baroda Research

Fig 2 – ...Led by transport and communication and personal care and effects



Source: CEIC, Bank of Baroda Research

Fig 3 – Food inflation inched up to 0.8% from 0.7% in Sep'21



Source: CEIC, Bank of Baroda Research

Fig 4 – IIP growth improves in Aug'21

Sectoral (%)	Weight	Sep-21	Sep-20	Apr-Sep'22	Apr-Sep'21
IIP	100.0	3.1	1.0	23.5	(20.8)
Mining	14.4	8.6	1.4	22.3	(15.2)
Manufacturing	77.6	2.7	0.4	25.3	(23.3)
Electricity	8.0	0.9	4.9	12.8	(8.0)
Use-Based					
Primary Goods	34.1	4.6	(1.5)	15.8	(14.2)
Capital Goods	8.2	1.3	(1.2)	44.9	(40.2)
Intermediate Goods	17.2	4.9	(0.4)	32.4	(22.8)
Infrastructure and Construction Goods	12.3	7.4	4.0	36.9	(24.8)
Consumer Durables Goods	12.8	(2.0)	5.3	38.4	(39.0)
Consumer Non-Durables Goods	15.3	(0.5)	2.4	8.3	(8.2)

Source: CEIC, Bank of Baroda Research

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