

INFLATION AND IIP

12 October 2021

Inflation cools, growth recovers

IIP growth improved to 11.9% in Aug'21 (11.5% in Jul'21). Both mining and electricity output expanded at a faster pace. Notably, over a 2-year horizon, output is up by 3.9% in Aug'21 (contraction of 0.3% in Jul'21). CPI inflation cooled off to 4.3% in Sep'21 led by food inflation at 0.7% (240bps MoM decline). Vegetable prices contracted sharply (22.5%) led by base effect. However, core remained sticky at 5.8%. We expect inflation at 5.5% in FY22 (RBI: 5.3%) and RBI to hike reverse repo rate in Q4FY22.

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IIP growth inch up: Industrial output rose to 11.9% in Aug'21 from 11.5% in Jul'21. Both mining and electricity output have registered an improvement by 23.6% (19.5% in Jul'21) and 16% (11.1% in Jul'21) respectively in Aug'21. However, manufacturing output moderated to 9.7% from 10.5% in Jul'21. Within manufacturing, only primary (17% from 12.4%) and FMCG goods (5.2% from a decline of 1.8%) have improved considerably. Slower pace of expansion was seen in capital (19.9%), intermediate (10.3%), infrastructure (11.1%) and consumer durable goods (8%). Over a 2-year horizon, IIP growth has expanded by 3.9% in Aug'21 with both mining (12.8% in Aug'21) and electricity (13.9%) clocking double digit growth. Domestic demand has also strengthened, reflected by improvement in non-oil-non-gold imports in Sep'21.

Food inflation eases significantly: CPI inflation moderated to 4.3% in Sep'21 from 5.3% in Aug'21 led by steep decline in food inflation to 0.7% from 3.1%. Within food, vegetable prices contracted by 22.5% (-11.7% in Aug'21), and that of meat and fish (8% versus 9.2%) and eggs (7.1% versus 16.3%) decelerated. Prices of fruits (3.7% versus 6.7%) also cooled down. On the other hand, prices of cereals contracted less sharply, while that of oils and fat and milk inched up considerably. Perishables may exert pressure on food inflation post Nov'21 as base effect wanes.

Core inflation sticky: Core inflation in Sep'21 remained unchanged from Aug'21 at 5.8%. Increase in prices of clothing and footwear (7.2% in Sep'21 versus 6.8% in Aug'21) was countered by decline in housing (3.6% versus 3.9%), while that of miscellaneous items (6.4%) remained steady. Within miscellaneous items, prices of household goods and services (5.9% versus 5.4%), recreation and amusement (7.6% versus 6.5%) and personal care and effects (1.9% versus 1%) rose. However, that of health, education, and transport and communication eased.

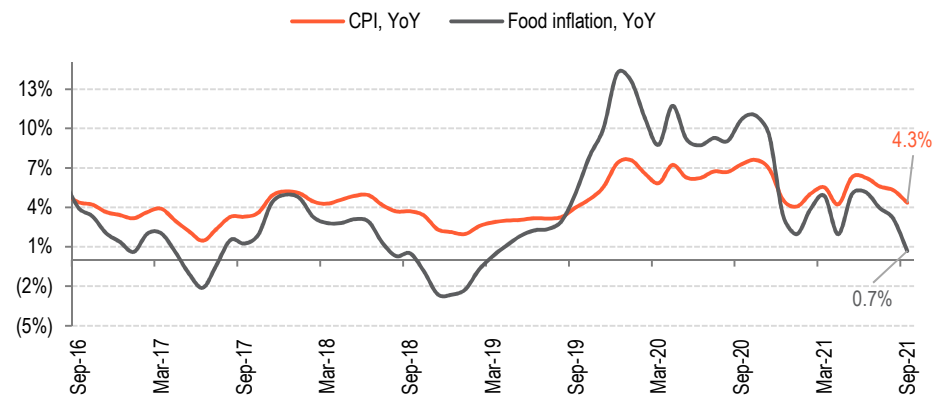
Recently, RBI has revised its CPI projection downward to 5.3% in FY22 from 5.7% earlier, owing to record Kharif production and government's supply management policies. We maintain our CPI projection of 5.5% for FY22, as risks are tilted towards the upside with elevated global commodity prices. We thus expect RBI to reduce the gap between repo and reverse repo in Q4FY22 before lifting off repo rate in FY23.

Key highlights

- CPI inflation edged down to 4.3% in Sep'21 from 5.3% in Aug'21.
- Food inflation fell to 0.7%. Core inflation sticky at 5.8%.
- IIP improves to 11.9% in Aug'21 from 11.5% in Jul'21. It has risen by 3.9% over a 2-year horizon.

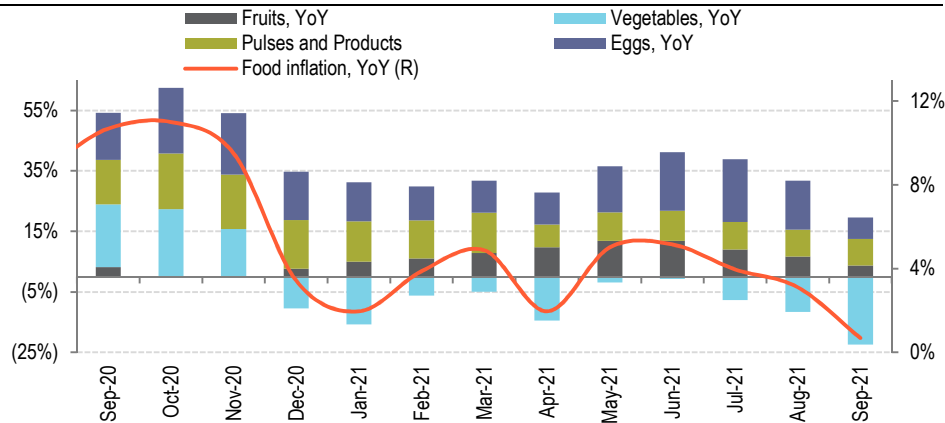


Fig 1 – CPI eases further...



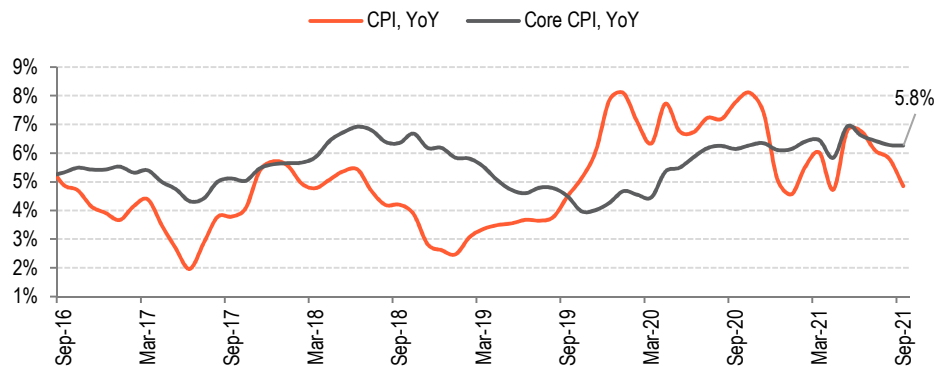
Source: CEIC, Bank of Baroda Research

Fig 2 – ...Led by vegetables, fruits, and eggs



Source: CEIC, Bank of Baroda Research

Fig 3 – Core inflation sticky



Source: CEIC, Bank of Baroda Research

Fig 4 – IIP growth improves in Aug'21

Sectoral (%)	Weight	Aug-21	Aug-20	Apr-Aug'22	Apr-Aug'21
IIP	100.0	11.9	(17.1)	28.6	(25.0)
Mining	14.4	23.6	(8.7)	25.1	(18.0)
Manufacturing	77.6	9.7	(7.6)	31.2	(27.9)
Electricity	8.0	16.0	(1.8)	15.4	(10.4)
Use-Based					
Primary Goods	34.1	17.0	(10.7)	18.2	(16.4)
Capital Goods	8.2	19.9	(14.4)	60.1	(47.6)
Intermediate Goods	17.2	10.3	(4.8)	39.9	(27.2)
Infrastructure and Construction Goods	12.3	11.1	0	44.9	(30.2)
Consumer Durables Goods	12.8	8.0	(10.2)	54.0	(47.5)
Consumer Non-Durables Goods	15.3	5.2	(3.0)	10.2	(10.3)

Source: CEIC, Bank of Baroda Research

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