

## INFLATION AND IIP

12 December 2018

### Inflation fell as growth improves

**IIP rose to an 11-month high of 8.1% in Oct'18 led by double-digit increase in capital good and consumer durables. At the same time, CPI inflation was at a 17-month low of 2.3% in Nov'18 led by (-) 2.6% decline in food inflation. Core inflation also moderated to 5.7% from 6.2% as international oil prices fell and INR appreciated. Inflation trajectory in FY20 is pointing to a below 4% print unless oil prices or pass-through of MSPs is seen in food prices. This may call for a change in RBI's stance in Feb/ Apr policy.**

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**IIP growth improves remarkably:** Industrial output surprised positively at an 11-month high of 8.1% in Oct'18 versus 4.5% in Sep'18. Electricity output registered a double digit growth of 10.8% in Oct'18 (from 8.2% in Sep'18), mining growth increased to 7% in Oct'18 from 0.1% in Sep'18 and manufacturing output increased to 7.9% in Oct'18 from 4.5% in Sep'18. Within manufacturing, capital goods and consumer durable goods (3-year high) expanded the most clocking double-digit growth of 16.8% and 17.6% respectively. The positive momentum may not last from Nov'18 on account of base effect, reduction in government spending and liquidity issues with the NBFCs.

**Food inflation declined sharply:** Food inflation declined by (-) 2.6% YoY in Nov'18 compared with a decline of (-) 0.9% in Oct'18. This was led by (-) 15.6% decline in vegetable prices in Nov'18 compared with (-) 8.1% decline in Oct'18. Cereal inflation also moderated to 1.3% in Nov'18 from 2.6% in Oct'18 even as government has raised paddy MSP by 12.9%. With inadequate pass-through of MSPs and muted international prices, food inflation is likely to remain benign.

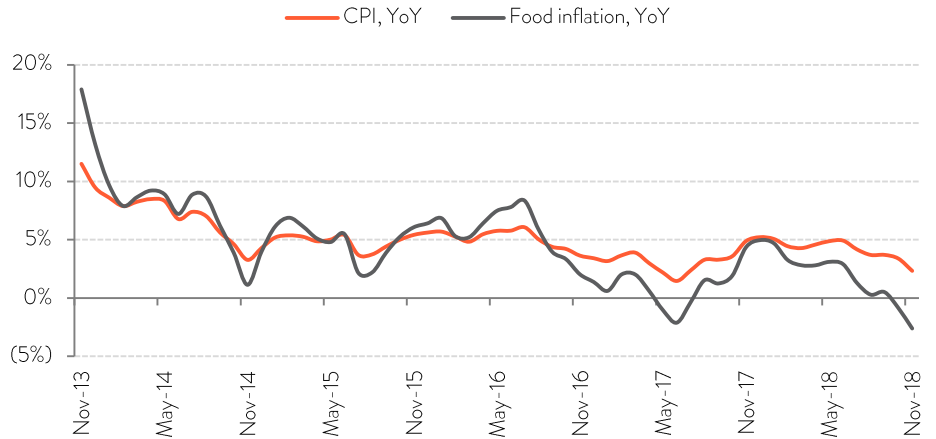
**Core inflation down to 8-month low:** Core inflation decelerated to 5.7% in Nov'18 from 6.2% in Oct'18 as statistical impact of HRA revision waned. With 18% decline in international oil prices in Nov'18 (MoM basis), transport & communication index dipped by 164bps. Health index also decelerated by 60bps. However, education (40bps) and recreation (91bps) saw some hardening. Given the subdued food inflation and decline in international oil prices, the outlook on inflation is far more benign. H1FY20 inflation is estimated at 3.6% versus RBI's estimation of 4%. If oil prices sustain, this may lead to change in stance in Feb/ Apr policy.

#### KEY HIGHLIGHTS

- CPI inflation cools off to 17-month low of 2.3% in Nov'18 led by food inflation.
- Core inflation down to 5.7%.
- IIP growth bumps to 8.1% in Oct'18.

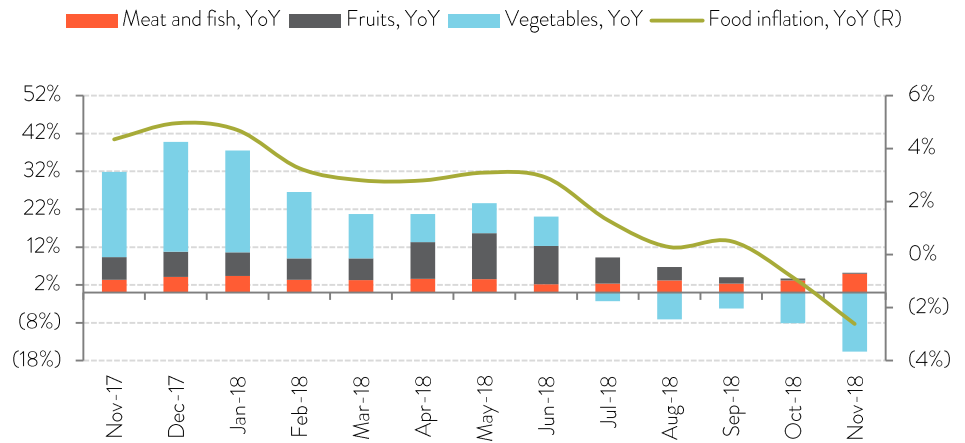


**FIG 1 – CPI SOFTENED TO 2.3% LED BY FOOD**



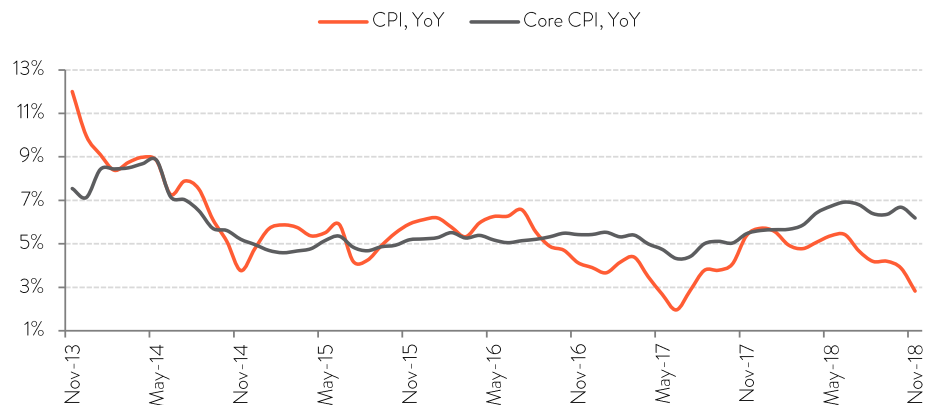
Source: CEIC, Bank of Baroda Research

**FIG 2 – VEGETABLES DROVE THE DIP IN FOOD INFLATION**

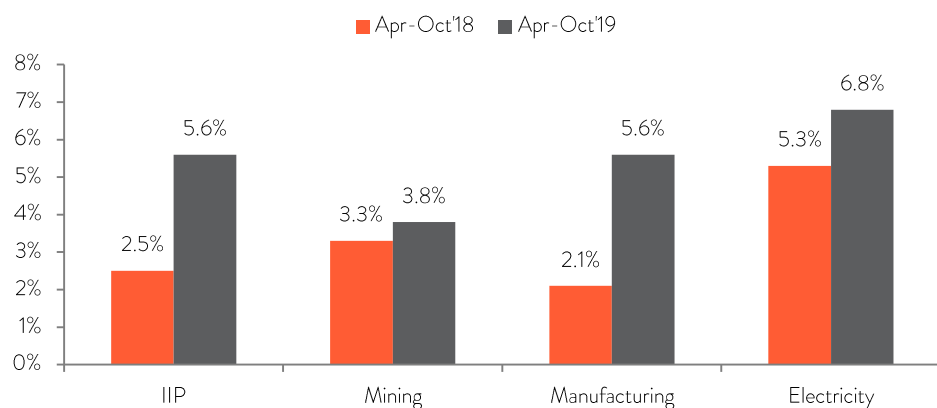


Source: CEIC, Bank of Baroda Research

**FIG 3 – CORE DECELERATED TO 5.7%**



Source: CEIC, Bank of Baroda Research

**FIG 4 – IIP GROWTH ACCELERATES**

Source: CEIC, Bank of Baroda Research

**FIG 5 – BROAD BASED IMPROVEMENT**

Sectoral (%)	Weight	Oct-18	Sep-18	Oct-17	Apr-Oct'18	Apr-Oct'17
IIP	100.0	8.1	4.5	1.8	5.6	2.5
Mining	14.4	7.0	0.1	(-0.2)	3.8	3.3
Manufacturing	77.6	7.9	4.6	2.0	5.6	2.1
Electricity	8.0	10.8	8.2	3.2	6.8	5.3
<b>Use-Based</b>						
Primary Goods	34.1	6.0	2.6	2.4	5.1	3.5
Capital Goods	8.2	16.8	6.5	3.5	8.7	0.7
Intermediate Goods	17.2	1.8	1.5	0.2	1.4	0.2
Infrastructure and Construction Goods	12.3	8.7	9.3	5.8	8.7	2.6
Consumer Durables Goods	12.8	17.6	5.2	(9)	9.4	(2.2)
Consumer Non-Durables Goods	15.3	7.9	6.1	8.2	4.5	7.6

Source: CEIC, Bank of Baroda Research

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