

ECONOMIC RESEARCH

INFLATION AND IIP REVIEW

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Revival in manufacturing activity reinvigorates economic prospects

Economy Report

Saturday, 14 September 2019

IIP growth improved to 4.3% in July 2019

- Revival in Manufacturing activity boosts IIP trends
- Recovery in Manufacturing sector was due to improved production in basic metals and food products

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As per the quick estimates of Index of Industrial Production (IIP) for July 2019, released by Ministry of Statistics and Programme Implementation (MOSPI) on 12th September 2019, the growth in Index of Industrial Production (IIP) went up to 4.3% in July 2019, compared to 2% growth registered a month ago, led by improved manufacturing activity (Table 1).

Ahead of festive season, manufacturing activity started showing some revival after reeling under severe consumption slowdown in the recent period. Manufacturing index in IIP represents nearly 77.6% of total industrial production. Growth rate in Manufacturing index improved to 4.2% in July compared to a 0.2% growth reported in the previous month (Chart 1 and Table 1).

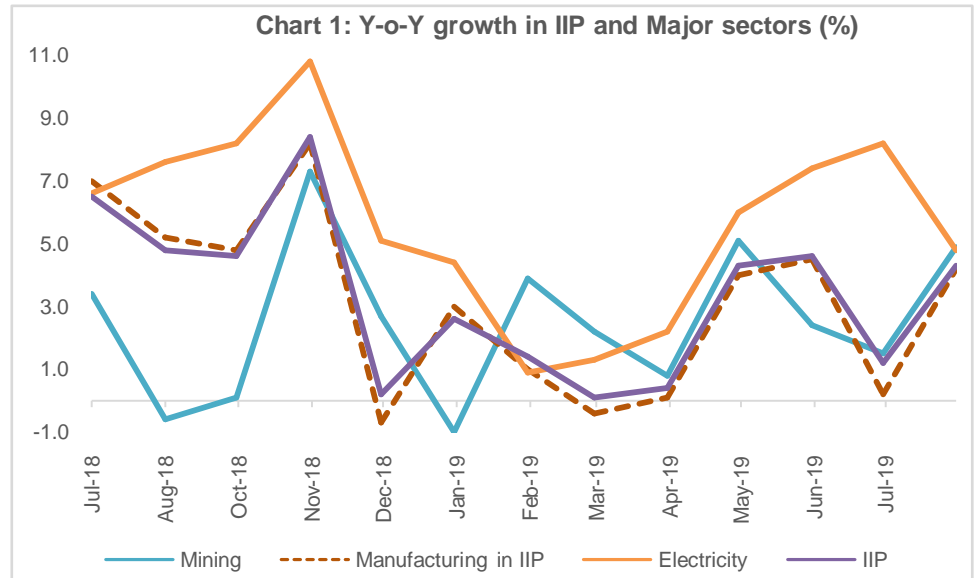
Industrial output, as classified by the end-use of goods reported varied growth trends reflecting weak consumption and investment scenario. Capital Goods and Consumer Durables continued with lower production growth witnessing the demand slowdown in the economy, whereas Intermediate Goods maintained their production growth and reported the highest 13.9% (y-o-y) jump in output in July (Chart 1 and Table 1).

	Weights	April to July		Jul-18	Jun-19	Jul-19
		2018-19	2019-20			
IIP (General)	100	5.4	3.3	6.5	1.2	4.3
Mining	14.4	4.9	3.4	3.4	1.5	4.9
Manufacturing	77.6	5.6	2.8	7.0	0.2	4.2
Electricity	8.0	5.3	6.6	6.6	8.2	4.8
Use-based category						
Primary goods	34.0	6.1	2.7	6.8	0.4	3.5
Capital goods	8.2	7.1	-4.3	2.3	-6.8	-7.1
Intermediate goods	17.2	0.8	10.8	1.3	12.6	13.9
Infrastructure/ construction goods	12.3	8.7	0.4	9.2	-1.9	2.1
Consumer durables	12.8	9.5	-2.7	14.1	-10.2	-2.7
Consumer non-durables	15.3	2.8	7.2	5.3	7.1	8.3

Data is provisional, Source: <http://www.mospi.gov.in>, BWR Research

Most of the manufacturing items used in the production of automobiles (auto parts and services like logistics) continued to cut down production on account of reduced production and sales of automobiles. The fall in auto sales reflected in the decline in consumer durables sector as well. Thus, the July growth in IIP is below the growth rate registered in the corresponding period a year ago (6.5%), hence the cumulative growth stands low at 3.3% during April to July 2019 compared to 5.4% during April to July 2018 (Table 1).

In line with Manufacturing sector, the other two components of IIP, viz, Mining and Electricity sectors reported 4.9% and 4.8% growth, respectively in July 2019. Mining activity improved in July 2019 compared to June while, Electricity generation reported marginal fall in growth rate after showing steady rise in the last three months (Chart 1).



Note: IIP data for July 2019 are quick estimates. Source: MOSPI, BWR Research

Approving the proposal for review of Foreign Direct Investment (FDI) in various sectors including the coal sector is positive for both mining and electricity sectors. The new policy envisages for sale of coal, 100% FDI under automatic route for coal mining including associated processing infrastructure. This is expected to attract international players to create an efficient and competitive coal market. Coal fired power plants account for approximately 70% of India's electricity generation. Apart from electricity there are other industries which use coal as input, like steel and cement.

It has been expected that issues regarding availability and affordability of financing, increasing cost of acquisition of vehicles and change in axle load capacity for commercial vehicles that have hurt the demand are expected to be addressed soon with some stimulus package, including GST reduction, more liquidity and relaxation of credit facilities for retailers.

Recent measures announced by the government such as scrapping the angel tax on start-ups, faster GST refunds to MSMEs, opening up some more sectors such as single brand retail and coal mining for FDI and activating the government purchase of new cars to replace the old is likely to revive the overall industrial activity.

CPI Inflation accelerated to a ten-month high in July 2019, though remained below RBI's median inflation target of 4%

- Rising food inflation led the CPI inflation to inch up
- Falling fuel prices capped additional rise

The Consumer Prices Index (CPI) inflation increased marginally in August 2019 due to sharp uptick in food inflation on the back of rising vegetable prices (6.9% inflation in July). After falling in July 2019, the CPI inflation touched a ten-month high at 3.21% in August as per the provisional estimates on CPI inflation released by MOSPI on 12th September 2019. The current level of inflation is still below the RBI MPC's target range, which further enhances the scope for more rate cuts given the current dismal economic conditions.

BWR in its previous report on **IIP and Inflation Review** had forecast vegetable prices to rise in August as the recent flood-like situation in the country across regions disrupted production and supply conditions resulting rise in the prices of food items particularly of vegetables. The rising trend in food inflation is likely to continue in the coming months also.

Industry Perspective

"CPI inflation rose moderately to 3.21% in August, with slower sequential uptick in most food and non-food components. The core inflation reverted to the easing momentum at 4.1% as demand fragilities weigh in. We are in consonance with RBI on near-term inflation dynamics and see headline inflation averaging ~3.6% for FY20 (3.4% in FY19), with core moderating sharply to ~4.2% (5.8% in FY19). The current growth-inflation mix has been favourable for counter-cyclical monetary stance and with inflation likely to remain sub 4% in the foreseeable future, the MPC will likely focus on tackling weaker growth dynamics as wide output gap continues to persist. We see scope for more easing, with terminal repo rate at least towards 5% in this easing cycle, admittedly contingent on data outcomes"

Adds Madhavi Arora,
Economist, Edelweiss
Securities

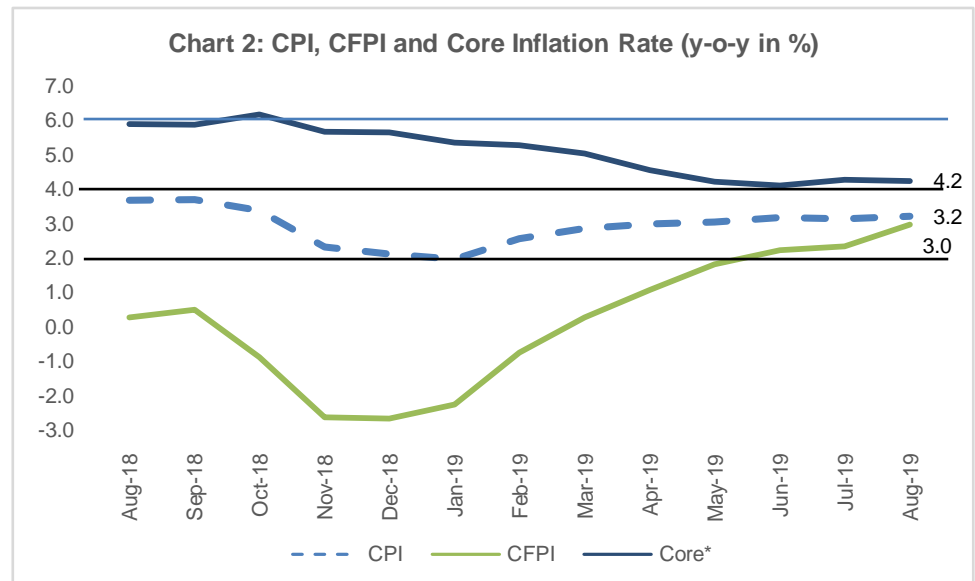
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Groups	Weights (%)	Rate (Y-o-Y in %)		
		Aug-18	Jul-19	Aug-19
CPI Combined (1+2+3+4+5+6)	100.0	3.69	3.15	3.21
1. Food and beverages	45.9	0.78	2.33	2.96
2. Pan, tobacco and intoxicants	2.38	5.41	4.89	5.00
3. Clothing and footwear	6.53	4.88	1.37	1.23
4. Housing	10.07	7.59	4.87	4.84
5. Fuel and light	6.84	8.55	-0.29	-1.70
6. Miscellaneous	28.32	5.60	4.73	4.71
Consumer Food	39.06	0.29	2.36	2.99
Core *	44.91	5.91	4.28	4.24
Note: The weights are indicative to show relative importance of groups				
*calculated (excluding 'Food & Beverages', 'Pan, Tobacco & Intoxicants' and 'Fuel & Light')				
Source: MOSPI, BWR Research				

Sharp rise in food inflation was being offset by deflation in fuel index

Consumer Food Price Inflation (CFPI) accounting ~ 39% of the overall inflation basket, rose to 15-month high at 2.99% during August largely due to spike in vegetable prices. In the CPI basket, 'Food and beverages group' is the only to report increase in inflation compared to the year ago period. CPI core inflation (excluding food and fuel), remained almost unchanged at 4.2% in August 2019 compared to previous month, but softened by 1.7 percentage points compared to a year ago. 'Fuel and light group' continued with deflationary trend as in the previous month, whereas the remaining groups witnessed benign inflationary trends (Chart 2 and Table 2).

Fall in crude oil prices overseas helped easing domestic fuel prices, resulting in deflation in fuel items since June 2019. If the trend continues, this will have a huge impact on domestic economy as maintaining inflation at RBI MPC's target of 4% level becomes easier at a time when food items have become pricier.



*calculated (excluding 'Food & Beverages', 'Pan, Tobacco & Intoxicants' and 'Fuel & Light'), August 2019 data is provisional.
Source: www.mospi.gov.in, BWR Research

Bountiful monsoon, benign inflation awaits further rate cuts

In the August 2019 Monetary Policy, MPC revised upwards minimally the CPI inflation to 3.5%-3.7% for H2:2019-20 from its previous estimates of 3.4-3.7% for the same period. The country received 3% excess rainfall in the current monsoon season so far (June to Sept), but uneven distribution of monsoon is likely to exert pressure on food inflation with an upward bias in the coming months. Low crude oil prices confine the upward pressure coming from food inflation. Moreover, Core inflation is also no longer sticky despite policy rate cuts. BWR feels CPI inflation continue to remain benign within the RBI's target, but may inch up moderately in the coming months.

Benign inflationary levels augur well for the MPC to continue with accommodative stance and cut interest rate to address growth concerns. BWR expects IIP growth to revive ahead of festive season, backed by governments measures to revive the economy particularly the manufacturing sector. However, transmission of such rate cuts to lowering bank interest rates could still be an issue, going by the past trends.

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