ECONOMIC RESEARCH

INFLATION AND IIP REVIEW

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Growth-inflation dynamics: IIP falls, Inflation rises

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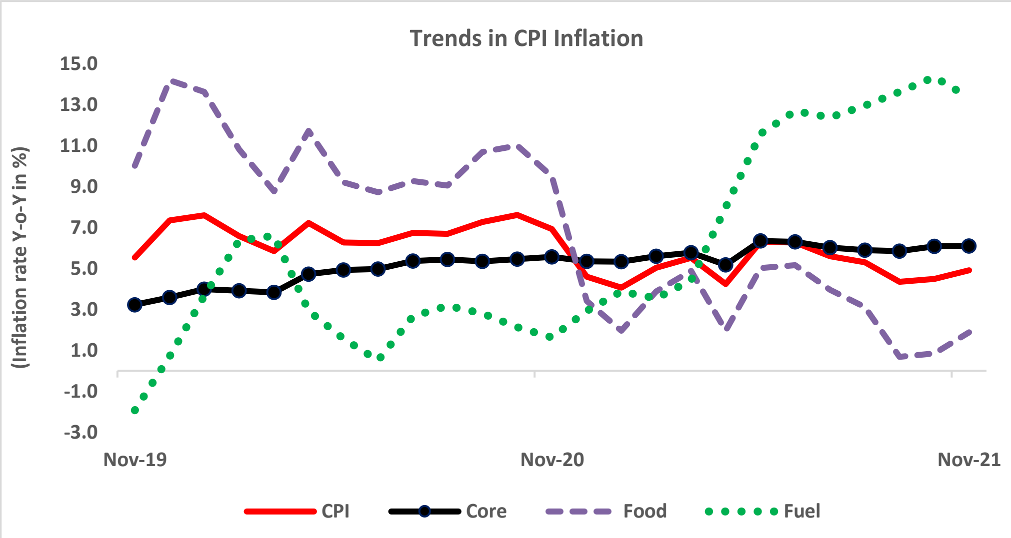
CPI inflation increased to three-month high in November 2021

Data released by the Ministry of Statistics and Programme Implementation (MOSPI) shows that the Consumer Price Index (CPI) rose by 43 basis points over the previous month to 4.91% (provisional estimates, measured by y-o-y change) in November 2021. It was 6.93% in November last year.

Although there has been a marginal increase in the inflation rate in the last two months, it is below the market expectation of 5%. However, the elevated level of core inflation at over 6% in the last two months is a matter for concern. Fuel inflation eased to 13.35% from 14.35% following the softening of international crude oil prices. The cut in excise duties by the centre and VAT rates in as many as 23 states and union territories have helped ease the price to some extent. In addition to supply bottlenecks and adverse weather conditions, the consequences of higher transportation costs on the other basket of goods is evident, with food inflation rising to 1.87% from 0.85% in the previous month. Given the 39.06% weight in the combined index, higher food inflation has accelerated the overall inflation rate. Within the food group, the prices of vegetables and fruits have risen due to unseasonal rains (Chart 1 and Table 1).

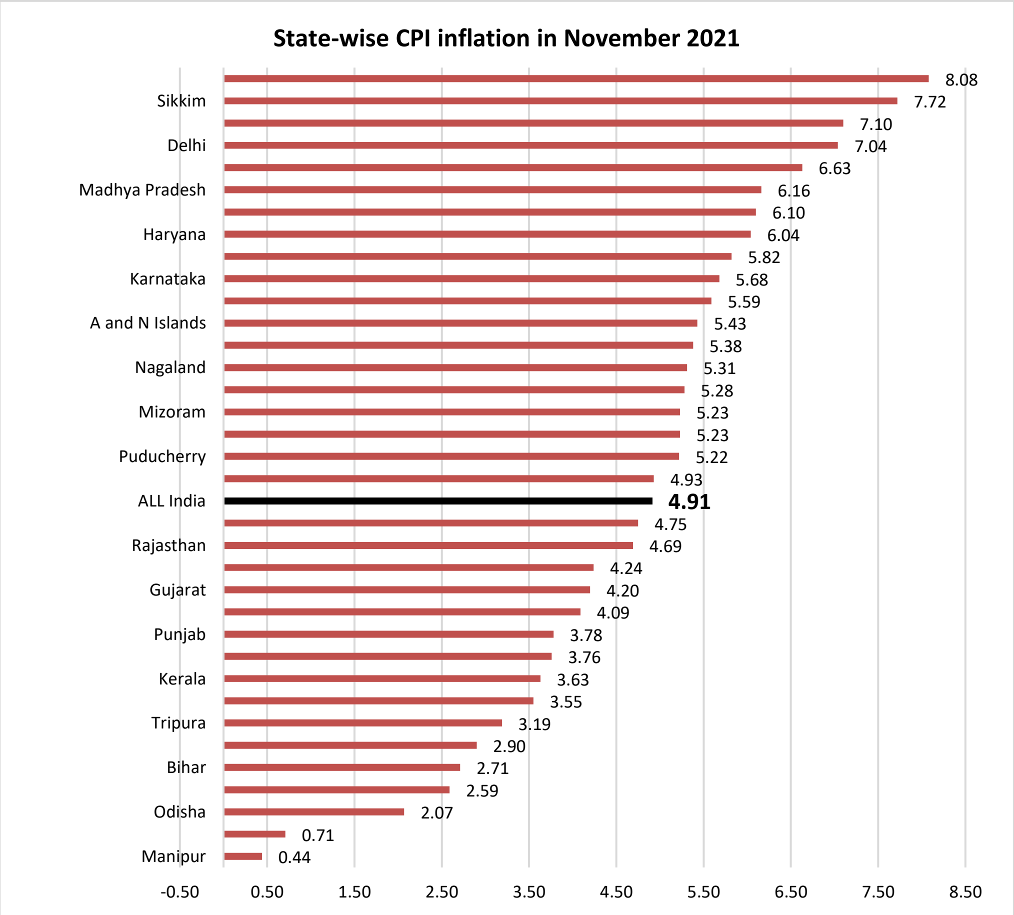
The average inflation for April to November 2021 stood at 5.18% compared to 6.87% in the corresponding period in the previous year. This is slightly lower than the Monetary Policy Committee's (MPC's) inflation outlook of 5.3% for FY22. The inflation outlook, although driven by the supply situation, is a cause for concern and needs close monitoring.



Note: Core inflation is calculated (excluding 'Food & Beverages', 'Pan, Tobacco & Intoxicants' and 'Fuel & Light'), Data for the latest month is provisional.
Source: www.mospi.gov.in, BWR Research

Table 1: Inflation in CPI and its Major Components						
Groups	Weights (%)	Inflation Rate (y-o-y changes in %)				
		FY21	April to Nov 2021	Nov-20	Oct-21	Nov-21
CPI Combined (1+2+3+4+5+6)	**100**	**6.16**	**5.18**	**6.93**	**4.48**	**4.91**
1. Food and beverages	45.9	7.31	3.46	8.89	1.82	2.60
2. Pan, tobacco and intoxicants	2.38	9.92	5.54	10.42	4.27	4.05
3. Clothing and footwear	6.53	3.38	6.36	3.36	7.53	7.94
4. Housing	10.07	3.33	3.74	3.19	3.54	3.66
5. Fuel and light	6.84	2.7	12.39	1.62	14.35	13.35
6. Miscellaneous	28.32	6.56	6.71	7.01	6.83	6.75
Consumer Food Price Index	***39.06***	***7.7***	***2.82***	***9.50***	***0.85***	***1.87***
Note: The weights are indicative to show relative importance of groups.						
Source: MOSPI, BWR Research						

Among the states and union territories, 19 reported inflation higher than the all-India levels in November 2021.

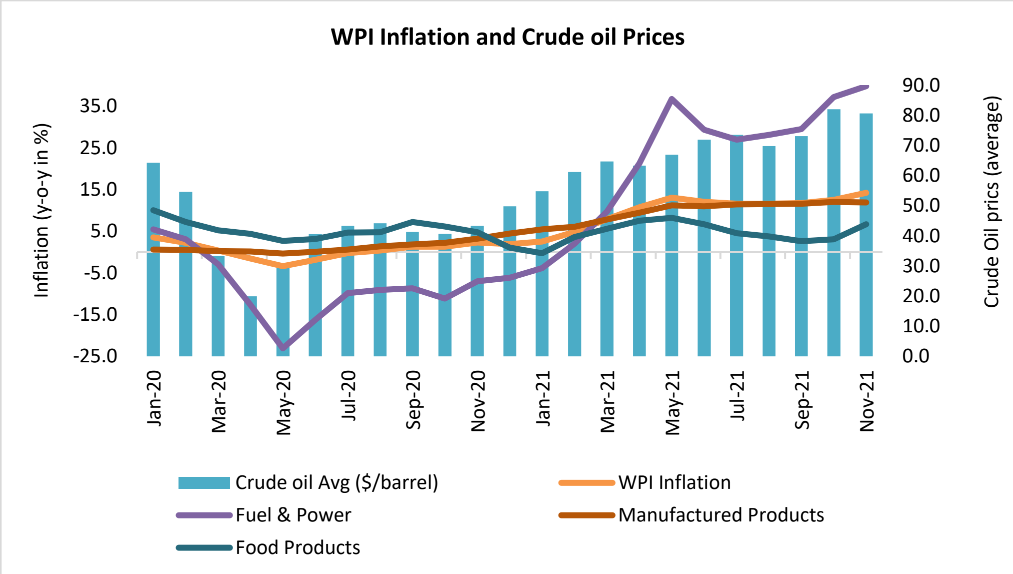


Source: www.mospi.gov.in, BWR Research

WPI inflation at a record high in November 2021

A sharp increase in fruit and vegetable prices, rising input costs due to an increase in raw material prices particularly arising out of imported commodities and the non-availability of semiconductors pushed the WPI inflation to a record high in November 2021. The WPI inflation touched an all-time high of 14.23% y-o-y in November 2021. Rising wholesale inflation in the manufacturing products group (64.32% weight in the WPI) at 11.92% in November reflects higher input costs, which are likely to be passed on to consumers gradually.

The RBI had adopted the CPI as the key measure of inflation beginning April 2014; the pass through of the WPI to the CPI cannot be overlooked. It has been observed that the transient effect of the WPI is generally felt in the CPI inflation in the succeeding 2 to 3 months.



Source: eaindustry.nic.in, BWR Research

CPI Inflation Outlook

Food and fuel inflation rates are expected to be volatile due to exogenous factors such as weather and global commodity prices. With the prices of food items showing a steep rise due to unseasonal rains and higher transportation cost, and a shortage of semiconductors affecting the manufacturing sector, the price situation requires close monitoring. Crude oil prices softening from their elevated levels may bring some respite to fuel inflation, while the hike in telephone tariffs may add to the problem. In addition, December will not have a favourable base effect. We expect the December inflation to cross 5.5% and third quarter (Q3) inflation to remain below the RBI's inflation outlook of 5.1%.

With the waning base effect and improving domestic demand conditions, the inflation outlook for the remaining months does not look bright. The MPC of the RBI has maintained the estimate of the CPI inflation at 5.3% for FY22 in its December meeting, but has revised the estimate for Q3 from 4.5% to 5.1% and has reduced the Q4 inflation outlook from 5.8% to 5.7%. Although the MPC did not highlight any serious concerns on inflation for the present, it has continued the process of draining liquidity through variable reverse repo rate (VRRR) auctions at a faster rate. With the uncertainty surrounding fuel and food inflation, and with the core inflation steady at around the 6% level, the RBI may continue to drain liquidity through VRRR auctions, and the possibility of hiking the policy rates in the next MPC is minimal. We expect the RBI to continue with the accommodative monetary policy stance, otherwise it would pose risks to the recovery process.

IIP growth stagnant at 3.2% in October 2021

As per the quick estimates of the Index of Industrial Production (IIP) for September 2021 released by the MOSPI, growth in the IIP decelerated to 3.2% from 3.3% growth reported in the previous month (Table 2 and Chart 2).

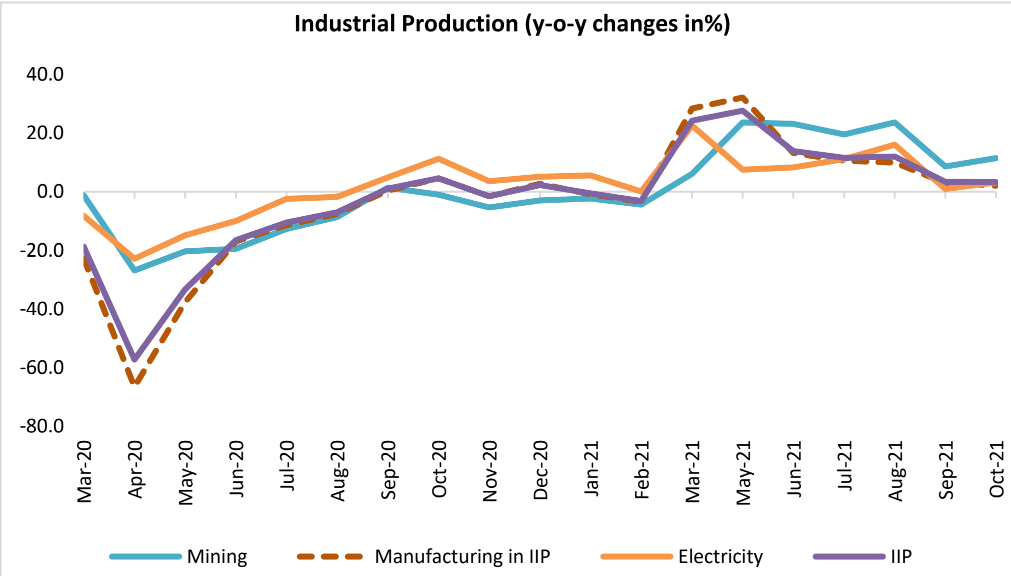
In the first few months of the current fiscal, industrial activities reported significant improvements, following the easing of restrictions, but supply constrains derailed the growth momentum. The manufacturing sector output was constrained by severe power outages due to a supply shortage in coal in the last few months. In addition, supply disruptions in semiconductors led to significant contraction in the despatches of automobiles. In the manufacturing sector, 10 out of 23 industries reported contractions in growth, with the automobile and transport equipment segments witnessing major decline.

Industrial output, as classified by the end-use of goods, is also showing declining growth trends. Capital goods and consumer durables reported a 1.1% and 6.1% contraction, respectively, while consumer non-durables reported just 0.5% growth over the year.

Table 2: IIP and Sectoral growth rates in IIP (y-o-y changes in %)

	Weights	2020-21	April to Oct 2021	Oct-20	Sep-21	Oct-21
IIP (General)	**100.0**	**-8.4**	**19.9**	**4.5**	**3.3**	**3.2**
Mining	14.4	-7.8	20.5	-1.0	8.6	11.4
Manufacturing	77.6	-9.6	21.2	4.5	3.0	2.0
Electricity	8.0	-0.5	11.3	11.2	0.9	3.1
Use-based category						
Primary goods	34.0	-7.0	14.8	-3.1	4.6	9.0
Capital goods	8.2	-18.6	35.4	3.2	2.4	-1.1
Intermediate goods	17.2	-9.4	27.0	3.2	5.0	2.1
Infrastructure/ construction goods	12.3	-8.7	31.1	10.9	7.8	5.3
Consumer durables	12.8	-15.0	28.4	18.1	-1.9	-6.1
Consumer non-durables	15.3	-2.2	7.2	7.3	0.2	0.5

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



Note: IIP data for the latest month are quick estimates.
Source: MOSPI, BWR Research

Outlook on IIP growth

The deceleration in industrial production for the consecutive two months is a matter of concern. The outlook for the coming months looks even worse, given the continued shortage of semiconductors due to global logistics and supply chain bottlenecks. With the monsoon receding, coal and power output may increase. However, there are renewed concerns on global demand following the emergence of a new Covid variant. With the inflation rates touching 6.8% in the US and rising trend seen in other developed countries, there are concerns about tapering liquidity, which may cause significant capital outflow, putting pressure on the volume of investment and exchange rate, as well as escalating the inflation; although the effect would be less than the 2013 taper experience. These factors pose downside risks to the recovery process. The RBI too has revised its Q3 and Q4 GDP growth outlook downwards to 6.6% and 6%, respectively, in its December MPC while maintaining 9.5% growth for the full fiscal.

We expect the growth estimates for IIP in November may be even worse, but may remain in a positive territory due to a favourable base effect.

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