



ECONOMIC RESEARCH

INFLATION AND IIP REVIEW

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IIP growth trends and marginal increase in CPI Inflation provide headroom for MPC to consider Monetary easing

Economy Report

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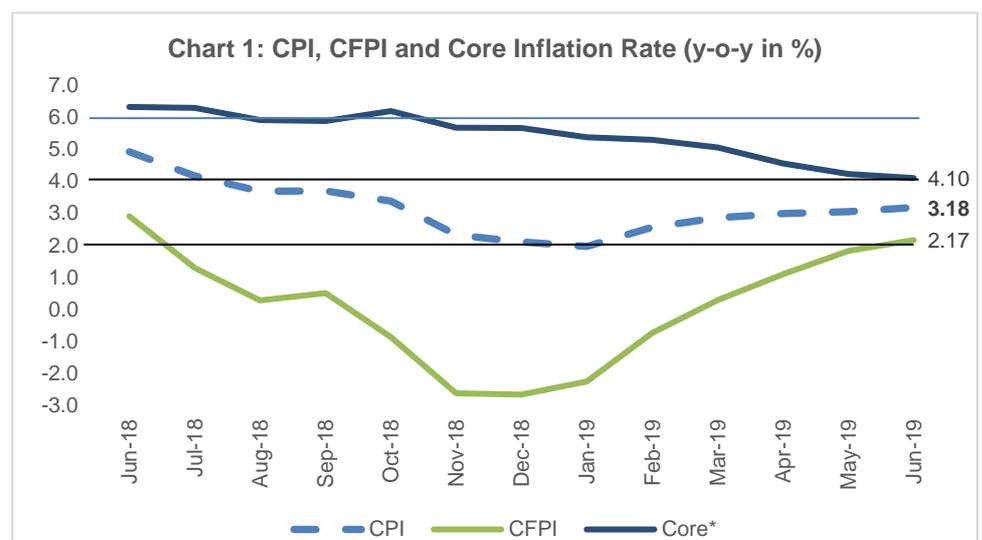
CPI Inflation touches 3.18% in June

In the July release of Ministry of Statistics and Programme Implementation (MOSPI), the Consumer Prices Index (CPI) witnessed increase for the fifth month in a row. CPI inflation rose to **3.18%** (provisional estimates, measured by y-o-y change) compared to 3.05% reported in May 2019. Despite touching 3.18% in June, CPI inflation remained within the mid-point of the flexible inflation target of 4% mandated to the Monetary Policy Committee (MPC) of the Reserve Bank India (RBI). This is the eleventh straight month where CPI inflation remained below MPC's target, thus providing hope for further monetary easing. Moreover, the current level of inflation across groups of CPI is much lower compared to corresponding period last year.

After remaining in deflationary path between October 2018 and February 2019, Consumer Food Price Inflation (CFPI) which accounts for about 39% of the overall inflation basket, touched 12-months high of 2.17% during June. The 34 basis points rise in CFPI over the previous month was largely due to the sharp surge in the prices of pulses and products and fruits. The reversal in food inflation trend which began in March 2019, largely contributed to the recent sequential jump in overall inflation.

CPI core inflation (excluding food and fuel), showed a declining trend and touched a 23-months low at 4.1% in June indicating falling inflation in services. Core inflation is no longer sticky at high levels observed in the last one and half years, thus neutralising the upward pressure coming from food inflation.

The overall inflation rate is expected to remain within the comfort zone of MPC in the next few months with rising inflation in food items being offset by falling inflation in services items. However, the volatile oil prices and subnormal monsoon so far continued to pose inflationary risks.



*calculated (excluding 'Food & Beverages', 'Pan, Tobacco & Intoxicants' and 'Fuel & Light'), June 2019 data is provisional.

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

CPI Inflation: Group wise (Refer Table 1 for relative weights in CPI)

Industry Perspective

"We see headline inflation averaging ~3.6% for FY20 (3.4% in FY19). While we are in consonance with RBI on near-term inflation dynamics, we see marginal upside risk to inflation in 4QFY20. We are already seeing signs of sequential bottoming of food prices, while there could also be increased policy focus ahead to correct food anomalies to favour agriculture terms of trade. Monsoon progress will also be pertinent. On the other hand, we continue to see core inflation component fiddling a tad above 4% average in FY20, but admittedly moderating sharply from 5.8% in FY19. The current growth-inflation mix has been favourable for counter-cyclical monetary stance. With inflation at sub 4% in foreseeable future, the MPC will likely focus on tackling weaker growth dynamics as output gap appears to have widened. We see more easing in the offing, with cut beyond 25bps in August being data-dependent"

Adds Madhavi Arora, Economist at Edelweiss Securities Ltd

1. Inflation in "food and beverages" component of CPI increased by 34 basis points to 2.17% in June compared to previous month. Within this group, prices of 'pulses and products', 'meat and fish' and 'milk and products' witnessed a spike in prices. Most of the food items moved out of deflationary trend recently however, the sub-groups, viz., fruits and sugar, showed deflation in June, the extent of deflation in fruits moderated. Considering the maximum weights assigned in CPI, broad-based pick-up in prices in several food items may push the food inflation upwards.
2. Inflation rate in "Pan, tobacco and intoxicants" group ticked up marginally by 18 bps over the month to 4.11% in June.
3. Inflation rate in "Clothing and footwear" continued to moderate as in the previous month and eased by 14 bps over the month at 1.5% in June.
4. "Housing" group reported marginal increase of 2 bps in inflation over the month, but 4.84% inflation in June is relatively higher compared other groups of CPI.
5. Inflation rate in "Fuel and light" group softened by 16 bps over May to 2.32%, thanks to fall in crude oil prices in June. Despite showing volatility, crude oil prices moved in the range of USD 61.6 and 67.5 per barrel during June, easing upward pressure on domestic fuel prices. Impact of increase in cess and excise duty imposed on petrol and diesel announced in the Union Budget will be felt in the coming months.
6. Inflation in "Miscellaneous" group witnessed 17 bps fall over May and touched 15-month low of 4.45% in June. Among 114 items included in this group, 66 items show fall in inflation, 44 items show rise in inflation, and the remaining items reported no changes in inflation rates during June over May.

Groups	Weights (%)	Rate (Y-o-Y in %)		
		Jun-18	May-19	Jun-19
CPI Combined (1+2+3+4+5+6)	100.0	4.92	3.05	3.18
1. Food and beverages	45.9	3.11	2.03	2.37
2. Pan, tobacco and intoxicants	2.38	8.05	3.93	4.11
3. Clothing and footwear	6.53	5.60	1.80	1.52
4. Housing	10.07	8.45	4.82	4.84
5. Fuel and light	6.84	7.22	2.48	2.32
6. Miscellaneous	28.32	5.66	4.62	4.45
<i>Consumer Food Price Index</i>	<i>39.06</i>	<i>2.91</i>	<i>1.83</i>	<i>2.17</i>
Note: The weights are indicative to show relative importance of groups				
Source: www.mospi.gov.in, BWR Research				

BWR View – CPI Inflation to rise moderately

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With the government proposing to spend more funds to boost the economic activities, may impose inflationary pressures. The recent hike in MSP for all Kharif Crops of 2019-20 Season which may marginally increase food prices, while is also expected to create demand by boosting farmers' income. More importantly, the subnormal monsoon and the shrinkage in the area under cultivation of various crops can pose a threat to the food price situation. In the June 2019 Monetary Policy, MPC revised the path of CPI inflation to 3.0-3.1% for H1:2019-20 and to 3.4-3.7% for H2:2019-20. The June inflation already crossed RBI's projections set for H1:2019-20. The three consecutive rate cuts, probable deficit rainfall, uncertainty of crude oil prices can impact inflationary trends with an upward bias. **Therefore, BWR expects CPI inflation to inch-up further in the coming months, and to cross 4% levels in the second half of 2019-20. However, in the near-term the benign price situation is expected to continue. With continued moderation in core inflation, MPC may cut repo rate by 25 bps in the next monetary policy review in August 2019.**

Industry Perspective

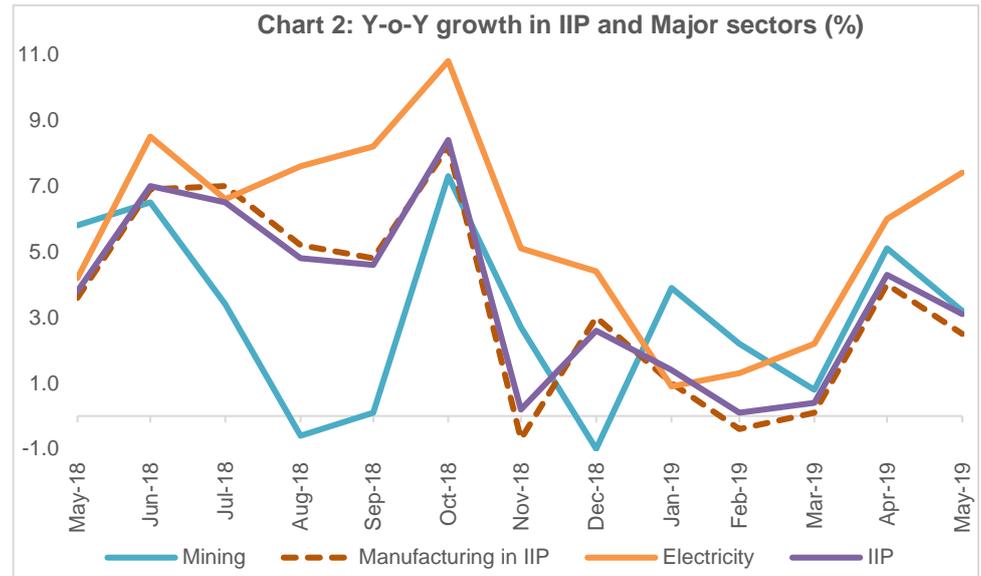
“Continued tight financial conditions amid the NBFC stress and slower demand will likely weigh on the industrial sector in coming months, with lower interest rates helping demand at the margin”

Adds Madhavi Arora,
Economist at Edelweiss
Securities Ltd

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IIP growth moderated 3.1% in May 2019

As per the quick estimates of IIP for May released by MOSPI, the growth in Index of Industrial Production (IIP) moderated to 3.1% in May, compared to the revised 4.3% growth registered a month ago. After rebounding in April, mining and manufacturing activity slowed down in May whereas, electricity generation showed improvement in output. Industrial output, as classified by the end-use of goods also showed fluctuation in growth trends reflecting mixed picture of the economy.



Source: mospi.nic.in/, BWR Research. Note: Data for May 2019 are quick estimates

Sectoral Output

The manufacturing sector, which represents nearly 77.6% of total industrial production witnessed 2.5% growth during May as against 4.0% reported in the previous month. Mining sector also underperformed compared to previous month. Electricity sectors reported sharp upturn in output during May and the growth rates touched 7- months high (Table 2 and Chart 2).

Table 2: IIP and Sectoral growth rates in IIP (y-o-y in %)					
	Weights	2018-19	May-18	Apr-19	May-19
IIP (General)	100	3.6	3.8	4.3	3.1
Mining	14.4	2.9	5.8	5.1	3.2
Manufacturing	77.6	3.5	3.6	4.0	2.5
Electricity	8.0	5.2	4.2	6.0	7.4
Use-based category					
Primary goods	34.0	3.5	5.7	5.1	2.5
Capital goods	8.2	2.8	6.4	1.2	0.8
Intermediate goods	17.2	-0.6	0.1	1.9	0.6
Infrastructure/ construction goods	12.3	7.5	7.6	7.2	5.5
Consumer durables	12.8	5.3	6.7	2.2	-0.1
Consumer non-durables	15.3	3.8	-1.6	5.9	7.7

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

In terms of **use-based classification**, consumer non-durables registered the maximum growth of 7.7% suggesting rise in discretionary income followed by infrastructure and construction sector (5.5%). Remaining sectors reported muted growth with consumer durables showing 0.1% fall in production, reflecting stress in the auto sector. Witnessing the subdued production of machine and equipment, capital goods also reported marginal rise in May.

BWR View – Proactive initiatives expected to improve Industrial output

In the Union Budget, government announced slew of measures to boost new investments and revive demand. The recapitalisation of public sector banks and the accommodation provided to the NBFCs in the budget is likely to improve lending to both corporate and small-scale sectors. The recent rate cuts by RBI MPC is expected to increase flow of credit to industries but, effective transmission of rate cuts takes effect with a lag.

Going forward, BWR expects industrial activity to register better growth, backed by easy monetary policy and government's initiative to boost infrastructure sector. The composite Purchasing Managers' Index (PMI) produced by Nikkei and IHS Market also remained well above 50-mark and stood at 52.1 in June, but slightly below compared to May (52.7).

As per the government's annual budget announced on July 5th, 2019, the Indian economy needs to grow at 8% on an annual basis (and exchange rate should remain stable) to be an ambitious USD 5 trillion economy by 2024-25. In the absence of any direct steps to boost the economy, the current comfortable inflationary levels augur well for the MPC to continue with accommodative stance. BWR expects IIP growth to revive in the coming months, provided fresh investments suggested through budget proposals take effect.

CPI and IIP both are the key two economic indicators considered by the RBI MPC on deciding policy rates. Since the retail inflation is still below the targeted median rate of 4%, and IIP growing at a slower pace there is need to boost investment activity.

BWR expects RBI MPC to cut repo rate in August policy review, fourth successive rate cut in the current calendar year.

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