ECONOMIC RESEARCH

INFLATION AND IIP REVIEW

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Surge in CPI inflation and Revival in IIP: Still Scope for Monetary Easing

Economy Report

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CPI Inflation has crossed 3% in May 2019 after a gap of 7 months

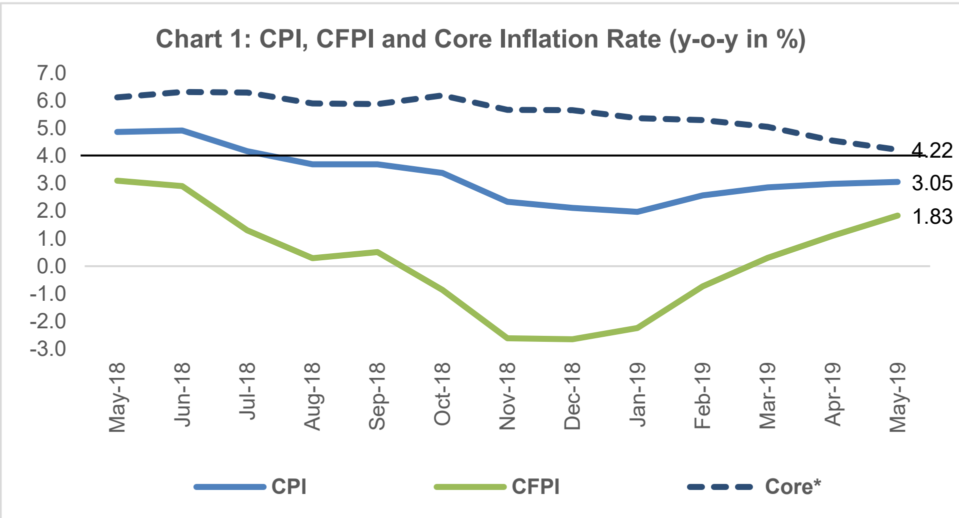
As per the latest data released by Ministry of Statistics and Programme Implementation (MOSPI), Consumer Prices Index (CPI) Inflation witnessed sequential rise for the fourth month in May 2019 to **3.05%** (provisional estimates, measured by y-o-y change) from 2.99% (revised from 2.92% reported earlier) in April 2019.

Supply constraints arising due to seasonal rise in food items kept the food inflation firm, hence CPI inflation crossed 3% levels after a gap of seven months. Yet, CPI inflation remained within the mid-point of the flexible inflation target of 4% given to the Monetary Policy Committee (MPC) of the Reserve Bank India (RBI). However, CPI is in the verge of crossing MPC's latest forecast of 3.0-3.1% set for H1:2019-20, which remained consistently below its expectations for last several months.

The reversal in food inflation trend which began in March 2019 continued and Consumer Food Price Inflation (CFPI) touched 11-months high in May at 1.83%. The rise in CFPI was the highest in a single month (73 bps) compared to other components of CPI during May 2019. Sharper than expected increase in vegetable prices coupled with broad-based pick-up in prices in several food items enhance inflationary expectations of food inflation.

CPI core inflation (excluding food and fuel), touched 22-months low of 4.22% in May, which helped to limit the upward pressure coming from food inflation. Although the food inflation is increasing, core inflation has been lower than 5% in the last 2 months. Core inflation is the indicator of inflation in services items, recently started easing reflecting weakened demand conditions.

The overall inflation rate is expected to be benign in the next few months and provides room for the rate cut. However, the risks arising from the US sanctions on Iran impacting the oil prices and possible impact of subnormal monsoon on food production and prices cannot be ignored.



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

Industry Perspective

“The anticipated pressure on headline inflation from summer related seasonality on food prices has started to play out, and is likely to unfold further depending upon the spatial and temporal outturn of south-west monsoon, there is an emergence of comfort from both fuel and core prices. We continue to expect headline CPI inflation to remain moderate at 3.5% in FY20 (3.4% in FY19). This would be the third consecutive year of below target inflation outturn for the Indian economy and is likely to continue to provide comfort to RBI’s MPC. Hence, we continue to expect the MPC to deliver another 25bps rate cut in the next monetary policy review in Aug-19, taking the cumulative monetary easing to 100 bps in the current cycle. The road thereafter would get data dependent with monsoon outturn, sustainability of the recent softness in global commodity prices, global trade outlook, and signals from the upcoming FY20 Union Budget”

Adds Vivek Kumar, Senior Economist at Yes Bank

Disclaimer: Views expressed by the third-party industry commentators and experts is personal and not the view of Brickwork Ratings.

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

1. Inflation in “food and beverages” component of CPI increased by 65 basis points to 2.03% in May over April largely due to spike in the prices of ‘vegetables’, ‘pulses and products’, ‘sugar and confectionery’, ‘meat and fish’ and ‘spices’. Many food items moved out of deflation witnessed in the past several months. Considering the maximum weights assigned in CPI, this may have significant impact on overall inflation.

2. Inflation rate in “Pan, tobacco and intoxicants” group continued to fall and eased by 34 bps over the month to 3.93% in May.

3. Inflation rate in “Clothing and footwear” moderated further by 21 bps over the month and stood at 2.03% in May.

4. “Housing” inflation inched up by 6 bps over the previous month stood at4.82% in May.

5. Inflation rate in “Fuel and light” group softened by 8 bps over April and recorded at2.48% in May. Recent fall in oil prices which fell below USD 70 per barrel from 23rd May, eased upward pressure on domestic fuel prices.

6. Inflation in “Miscellaneous” group witnessed 48 bps fall in inflation rate Over April. Inflation rate in Miscellaneous group, which largely reflects changes in the prices of services items touched a low of 4.6% in May 2019, the lowest in last 14 months. Among 114 items included in this group, 30 items show rise in inflation, and 73 items show fall in inflation rates, while the remaining items reported no changes in prices compared to previous month.

Table 1: Inflation in CPI and its Major Components

Groups	**Weights (%)**	**Rate (Y-o-Y in %)**		
		Mar-19	**Apr-19**	**May-19**
CPI Combined (1+2+3+4+5+6)	**100.0**	**2.86**	**2.99**	**3.05**
1. Food and beverages	45.9	0.66	1.38	2.0
2. Pan, tobacco and intoxicants	2.38	4.61	4.27	3.93
3. Clothing and footwear	6.53	2.52	2.01	1.80
4. Housing	10.07	4.93	4.76	4.82
5. Fuel and light	6.84	2.34	2.56	2.48
6. Miscellaneous	28.32	5.68	5.10	4.62
Consumer Food Price Index	*39.06*	*0.30*	*1.10*	*1.83*

Note: The weights are indicative to show relative importance of groups
Source: Mospi, BWR Research

BWR View – CPI Inflation expected to increase moderately

Prevailing uncertainties relating to the monsoon, spikes in vegetable prices, volatile international crude oil prices, geo-political tensions and the fiscal scenario continue to drive inflationary expectations. Reserve Bank’s May 2019 survey on Inflation expectations of households suggests a decline of 20 bps for the forthcoming three-month horizon compared with the previous round, but remained unchanged for the one-year ahead horizon.

Considering the transmission of the past three consecutive policy rate cuts and evolving demand-supply conditions arising due to uncertain crude oil prices coupled with sluggish pace of the monsoon so far, BWR expects CPI inflation to inch-up further in the coming months, but to remain below the target of 4% mandated to the MPC. With continued moderation in core inflation, MPC may cut repo rate by 25 bps in the next monetary policy review in August 2019.

IIP growth rebound in April 2019 to 3.4% helped by improved Manufacturing output

As per the latest provisional data released by MOSPI, the growth in Index of Industrial Production (IIP) improved to 3.4% during April 2019, as against 0.1% growth registered a month ago. Contrary to expectations on account of election led uncertainty and poor core sector output in April, IIP grew much faster compared to last 5 months, in line with manufacturing output.

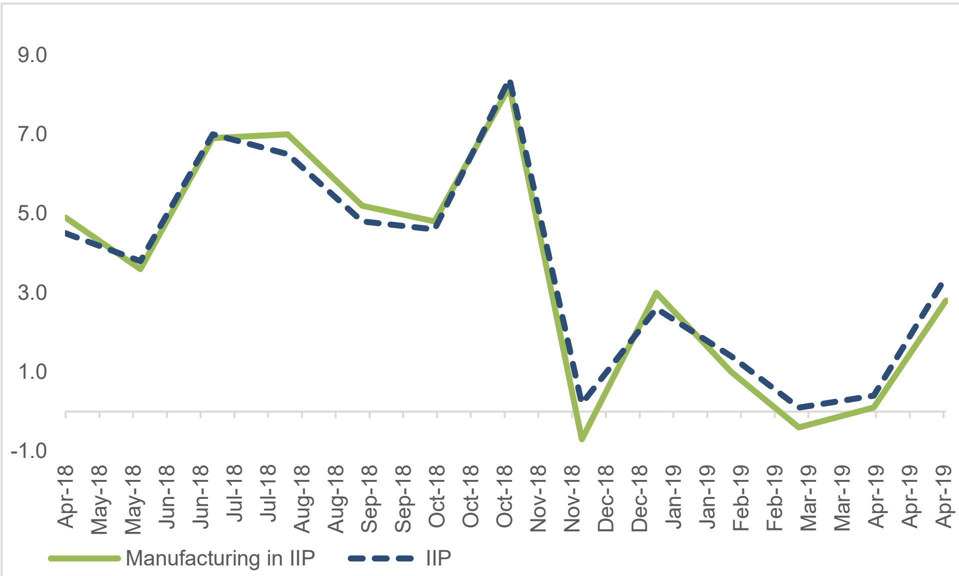
The composite Purchasing Managers' Index (PMI) produced by Nikkei and IHS Market improved to 52.7 in May from 51.8 in April, which also signify improved manufacturing activity.

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

	Weights	2018-19	Apr-18	Mar-19	Apr-19
IIP (General)	**100**	**3.6**	**4.5**	**0.4**	**3.4**
Mining	14.4	2.9	3.8	0.8	5.1
Manufacturing	77.6	3.5	4.9	0.1	2.8
Electricity	8.0	5.2	2.1	2.2	6.0
Use-based category					
Primary goods	34.0	3.5	2.7	2.6	5.2
Capital goods	8.2	2.8	9.8	-8.4	2.5
Intermediate goods	17.2	-0.6	0.4	-2.5	1.0
Infrastructure/ construction goods	12.3	7.5	8.5	6.4	1.7
Consumer durables	12.8	5.3	3.9	-3.1	2.4
Consumer non-durables	15.3	3.8	7.5	1.0	5.2

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

Chart 2: Y-o-Y growth in IIP and Manufacturing industries (%)



Source: mospi.nic.in/, BWR Research. Note: Data is provisional

Sectoral Output

After the continuous slowdown witnessed in the last five months, IIP reported revival in production. The Increase in production is largely attributed to pick-up in manufacturing production. The manufacturing sector, which represents nearly 77.6% of total industrial production witnessed 2.8% growth during April as against 0.1% reported in the last month. Strengthening demand conditions, improved business sentiments on expectations of pro-business public policies helped the manufacturing sector to gain momentum.

Mining and electricity sectors reported sharp upturn in output during April and the growth rates touched 6- months high in both the sectors.

In terms of use-based classification, all the six sub sectors reported growth in output during April. Primary goods and consumer non-durables reported notable 5.2% increases each followed by capital goods and Consumer durables showing positive growth of 2.5% and 2.4% respectively (see table 2).

View – Proactive initiatives expected to revive Industrial output

Amidst downward forecast of India's GDP growth for 2019-20 at 7.0% from 7.2% earlier estimates and estimates of 5-year low growth for 2018-19 at 6.8%, rebound in IIP growth comes as a surprise. If the growth in IIP sustains in line with the capacity utilisation which was at the highest level at 75.9 in Q3 2018-19, the growth prospects for 2019-20 is likely to improve. To boost new investments and revive consumption demand the new government is likely to announce pro-business public policies. The recent rate cut by RBI MPC expected to increase flow of credit to industries but, transmission of rate cuts by banks takes some time.

Going forward, BWR expects industrial activity to register better growth, provided the new government undertake fresh investments and initiate higher spending.

Fiscal Outlook

The shortfall in actual revenue collections from the revised estimates for 2018-19 by Rs.1.67 trillion raises some concerns about the continuation of fiscal consolidation in fiscal 2020. To achieve the projected gross tax revenue collections of the centre at Rs. 25.5 trillion, it will have to record a growth rate of 22.6% and the net tax revenues will have to increase by 28.8% over the actuals in fiscal 2019 which is unrealistic. In addition, resources have to be found for PM-Kisan, Ayushman Bharat and many of the promises made in the election manifesto. The budget to be presented by the new Finance Minister is being keenly awaited to see the fiscal policy direction of the government.

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