

INFLATION AND IIP

12 January 2021

Inflation ebbs, industrial activity slips

India's recovery in industrial output hit a snag in Nov'20 as it fell by 1.9% following a 4.2% increase in Oct'20. Capital goods and intermediate goods fell the most. CPI inflation too eased significantly to 4.6% in Dec'20 from 6.9% in Nov'20. This was driven by (-) 10% vegetable inflation. Other food items too moderated as did core inflation. While the dip in CPI inflation is positive, some of it may not sustain with reversal in vegetable prices. Thus RBI will remain on hold and maintain accommodative stance. Focus shifts to Budget.

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IIP slips: Industrial output contracted by 1.9% in Nov'20 compared with an increase of 4.2% in Oct'20. Mining output declined at a 3-month low of (-) 7.3% in Nov'20. Manufacturing output too declined. Electricity output moderated to 3.5% in Nov'20 from 11.2% in Oct'20. Base effect and Diwali falling in month of November explain some of the variation. Decline in manufacturing sector is led by capital goods at (-) 7.1%. Intermediate goods output fell by 3%. High frequency indicators show revival holding up in Dec'20.

CPI falls, driven by food: CPI inflation slipped to 15-month low of 4.6% in Dec'20. Food inflation edged lower from 9.5% in Nov'20 to 3.4% in Dec'20 led by sharp contraction in vegetables (decline of 10.4% in Dec'20 versus an increase of 15.5% in Nov'20). Moderation was also seen in other food categories such as pulses (16% versus 18.1% in Nov'20), eggs (16.1% versus 20.4%), and meat and fish (15.2% versus 17% in Nov'20). Cereal inflation fell to 1% versus 2.5% in Nov'20. While a part of decline can be explained by a favourable base, the decline is relatively broad-based and thus encouraging.

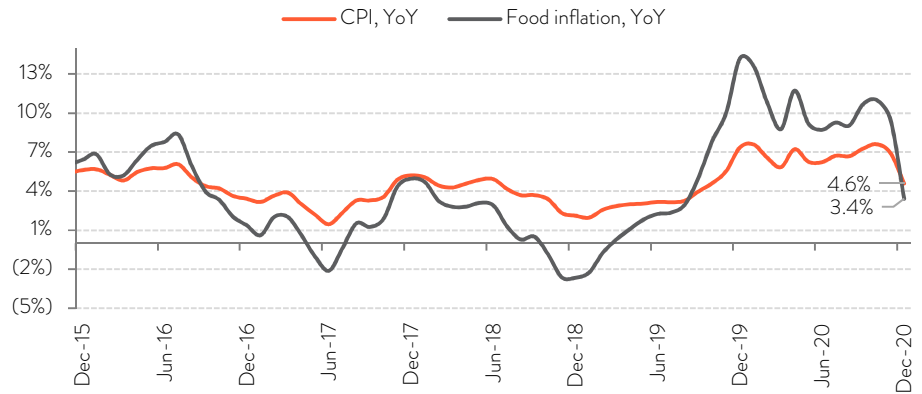
Core inflation eases: Core inflation too eased by 30bps to 5.7% in Dec'20 from 6% in Nov'20. This was driven by moderation in transport and communication inflation to 9.3% from 11.1% in Nov'20 despite rising domestic and international oil prices. A favourable base explains the above. Some moderation was also seen in personal care and education. However, health inflation rose by 40bps MoM to 6%. The underlying economic recovery and mean reversion implies core inflation is likely to remain elevated next year. Food inflation is likely to trend lower than FY21 as supply conditions turn favourable. The current CPI print does not change our hypothesis that RBI will remain on an extended pause and continue to absorb excess domestic liquidity in a calibrated manner through reverse repo auctions as the economy normalises.

KEY HIGHLIGHTS

- CPI inflation moderated to 4.6% in Dec'20 from 6.9% in Nov'20 led by food inflation.
- Core inflation edged down by 30bps to 5.7% in Dec'20.
- IIP growth contracted by 1.9% following a rise of 4.2% in Oct'20.

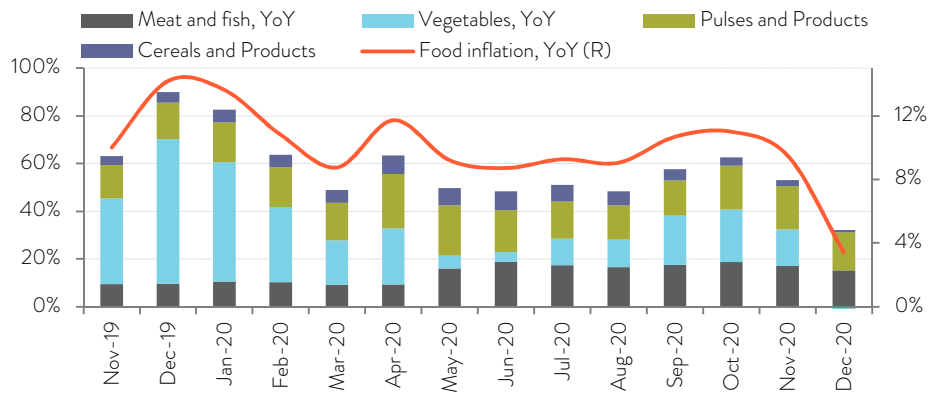


FIG 1 – CPI INFLATION FALLS TO 15-MONTH LOW DRIVEN BY FOOD



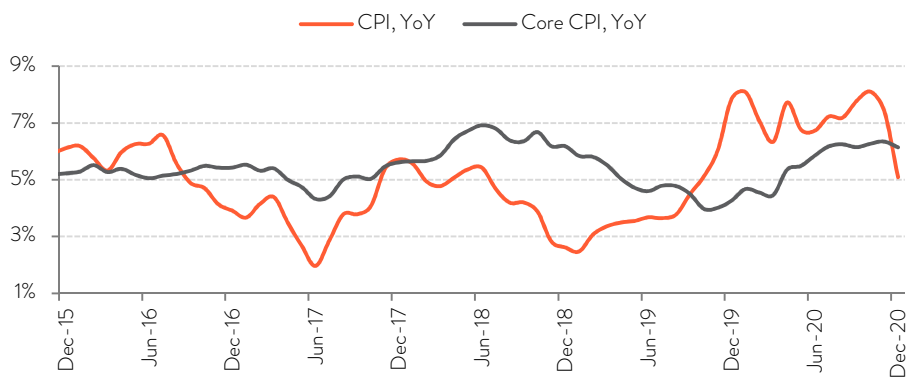
Source: CEIC, Bank of Baroda Research

FIG 2 – VEGETABLE PRICES LED THE DECREASE

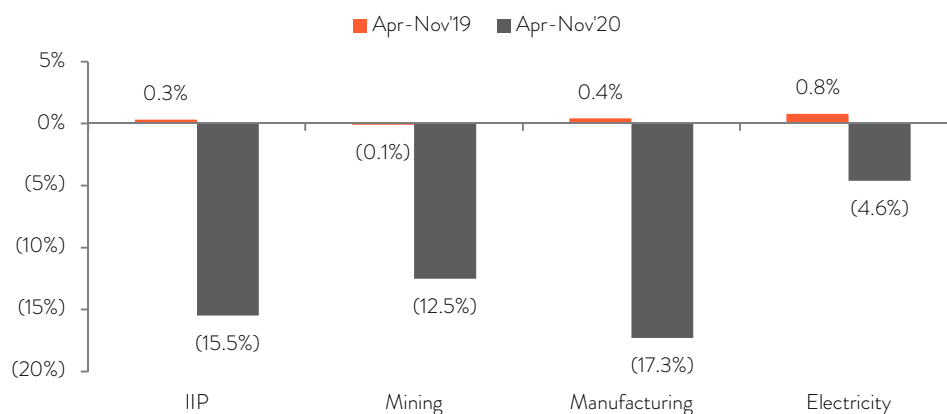


Source: CEIC, Bank of Baroda Research

FIG 3 – CORE EDGES FURTHER DOWN



Source: CEIC, Bank of Baroda Research

FIG 4 – BROAD BASED SLOWDOWN ON FYTD BASIS

Source: CEIC, Bank of Baroda Research

FIG 5 – IIP GROWTH SLIPS IN NOV'20

Sectoral (%)	Weight	Nov-20	Oct-20	Nov-19	Apr-Nov'20	Apr-Nov'19
IIP	100.0	(1.9)	4.2	2.1	(15.5)	0.3
Mining	14.4	(7.3)	(1.3)	1.9	(12.5)	(0.1)
Manufacturing	77.6	(1.7)	4.1	3.0	(17.3)	0.4
Electricity	8.0	3.5	11.2	(5.0)	(4.6)	0.8
Use-Based						
Primary Goods	34.1	(2.6)	(3.2)	(0.2)	(11.3)	0.1
Capital Goods	8.2	(7.1)	3.5	(8.9)	(31.1)	(11.7)
Intermediate Goods	17.2	(3.0)	2.1	17.2	(17.2)	10.3
Infrastructure and Construction Goods	12.3	0.7	9.9	(0.7)	(17.7)	(2.4)
Consumer Durables Goods	12.8	(0.7)	18.0	(1.4)	(28.1)	(6.6)
Consumer Non-Durables Goods	15.3	(0.7)	7.1	1.1	(5.4)	3.5

Source: CEIC, Bank of Baroda Research

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