

Double good news: Lower inflation and better IIP growth

The RBI expected to keep interest rates unchanged, but raise its inflation forecast

- Headline CPI inflation eased to 6.8% YoY in Aug'23 vs. 7.4% in Jul'23, led by lower food inflation, especially vegetables. The number was lower than the Bloomberg consensus and our forecast of 7.1%. Details suggest that the deceleration in inflation was mainly due to vegetables (weight = 6%), which witnessed a fall of 5.9% MoM, following a 38% MoM rise in Jul'23. CPI ex-veggies was unchanged at 5.4% YoY, compared to an average of 6.5% during FY21-FY23.
- Notably, core CPI (excluding food & beverages and fuel & light) came down to 4.8% YoY from 4.9% in Jul'23, the lowest in almost 41 months. It reinforces that the current surge in inflation is transitory.
- Other details suggest that: (1) Deflation in imported items, coupled with the deceleration in prices of domestically generated goods, helped pull down inflation. The prices of imported goods (weight 9.8%) declined by 4.7% YoY in Aug'23. Domestically generated inflation came in lower at 8.2% YoY in Aug'23, led by food inflation. (2) Standard core CPI (excluding food and energy, weight = 51.7%) decelerated to 5% in Aug'23 (vs. 5.2% in Jul'23), the lowest in 36 months. (3) Details of 299 sub-components confirm that only 53.7% of the basket posted +5% YoY inflation, the lowest in 18 months (vs. 61.2% in Jan'23). (4) While goods inflation remained firm at 7.6% in Aug'23 vs. 8.4% in Jul'23, services inflation came in at 4.1% vs. 4.2% in Jul'23, the lowest in 35 months. Core services inflation (excluding housing) came in at a 45-month low of 3.9% in Aug'23.
- The Index of Industrial Production (IIP) expanded at a 5-month fastest pace of 5.7% YoY in Jul'23 (vs. 3.8%/2.2% in Jun'23/Jul'22), the highest in five months. The acceleration, however, was not broad-based. The print is higher than the Bloomberg consensus of 5.3% YoY but much lower than our forecast of 8.2%.
- Although mining and electricity output growth was in line with our expectations, growth in the manufacturing sector was weaker than expected, which led to lower growth in IIP than our expectation. The manufacturing sector grew 4.6% YoY in Jul'23 vs. 3.1% each in Jun'23/Jul'22. According to the use-based classification, output of capital goods and infra & construction goods remained robust in Jul'23. Even consumer non-durables grew at a faster pace of 7.4% in Jul'23 vs. 0.3%/-2.9% in Jun'23/Jul'22. However, consumer durables still remained weak at 1% in Jul'23 (vs. 1.4%/-3.1% in Jun'23/Jul'22).
- Details of the manufacturing sector confirm that as much as 58% of the items within the sector grew slower than 5% (vs. 60.2% in Jun'23). Further, while IIP growth improved from 2.2% YoY a year ago to 5.7% YoY in Jul'23, 42.5% of the items grew slower in Jul'23 vs. last year.
- Overall, both inflation and IIP data were better than the market consensus. Going forward, we expect headline inflation to ease below 6% YoY in Sep'23 and average ~5% YoY in 2HFY24. IIP, on the other hand, could grow at a faster pace of 8-10% YoY in the next three months, supported by a favorable base effect and the onset of the festive season. Overall, the latest data suggests that the RBI will keep the interest rates unchanged in its next policy; however, it will raise its FY24 inflation forecasts.

CPI inflation eased to 6.8% in Aug'23: Headline CPI inflation eased to 6.8% YoY in Aug'23 vs. 7.4% in Jul'23, led by lower food inflation, especially vegetables (Exhibit 1). The number was lower than the Bloomberg consensus and our forecast of 7.1%.

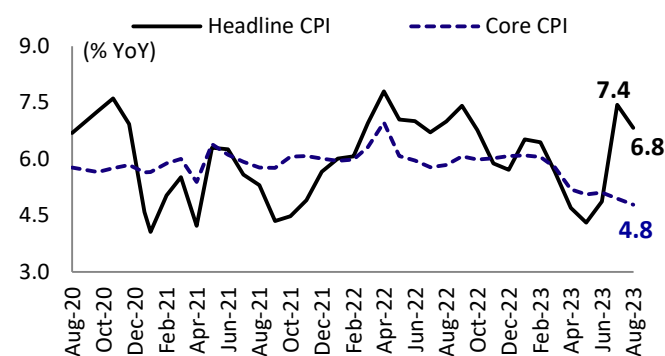
Deceleration led by lower food inflation: Details suggest that the deceleration in inflation was mainly due to vegetables (weight = 6%), which witnessed a fall of 5.9% MoM, following a 38% MoM rise in Jul'23 (Exhibit 2). CPI ex-veggies was unchanged at 5.4% YoY, compared to an average of 6.5% during FY21 to FY23. Within food, prices of cereals, oil & fats and vegetables grew at a slower pace, while prices of pulses, milk and spices remained firm. On the contrary, fuel & light inflation came in higher at 4.3% in Aug'23 (highest in three months) vs. 3.7% in Jul'23.

Core inflation at a 41-month low in Aug'23: Core CPI (excluding food & beverages and fuel & light) came down to 4.8% from 4.9% in Jul'23 (*Exhibit 1*), the lowest in almost 41 months. It reinforces that the current surge in inflation is transitory. Within core, clothing & footwear (5.2% in Aug'23 vs. 5.6% in Jul'23), personal care & effects (8.1% in Aug'23 vs. 8.9% in Jul'23) and household goods and services (4.8% in Aug'23 vs. 5.2% in Jul'23) came in lower. All other components were more or less sticky.

The deceleration in headline inflation was broad-based: Other details suggest that (1) Deflation in imported items, coupled with deceleration in prices of domestically generated goods, helped pull down inflation. The prices of imported goods (weight 9.8%) declined by 4.7% YoY in Aug'23. Domestically generated inflation came in lower at 8.2% YoY in Aug'23, led by food inflation (*Exhibit 3*). (2) Standard core CPI (excluding food and energy, weight = 51.7%) decelerated to 5% in Aug'23 (vs. 5.2% in Jul'23), the lowest in 36 months (*Exhibit 2*). (3) Details of 299 sub-components confirm that only 53.7% of the basket posted +5% YoY inflation, the lowest in 18 months (vs. 61.2% in Jan'23). Further, only 37.6% of the CPI basket posted +6% YoY inflation last month, the lowest share in 21 months (*Exhibit 4*). (4) While goods inflation remained firm at 7.6% in Aug'23 vs. 8.4% in Jul'23, services inflation came in at 4.1% vs. 4.2% in Jul'23, the lowest in 35 months. Core services inflation (excluding housing) came in at a 45-month low of 3.9% in Aug'23.

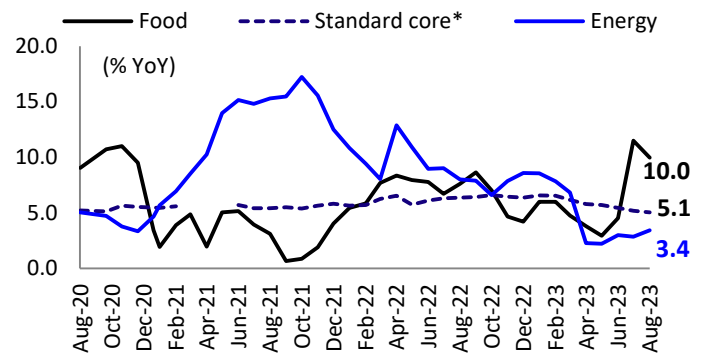
Our view: We believe that headline inflation could ease toward 5.7% YoY in Sep'23 and 5% in 2HFY24. It means inflation of 5.4% YoY in FY24, higher than our previous forecast of ~4.5%. Thus, we expect the RBI to keep interest rates unchanged in the foreseeable future, but it will raise its FY24 inflation forecast.

Exhibit 1: Retail inflation declined to 6.8% in Aug'23...



Core CPI excludes food & beverages and fuel & light

Exhibit 2: ...led by the drop in food inflation



* Excluding food & energy

Exhibit 3: Thus, domestically-generated inflation eased during the month...

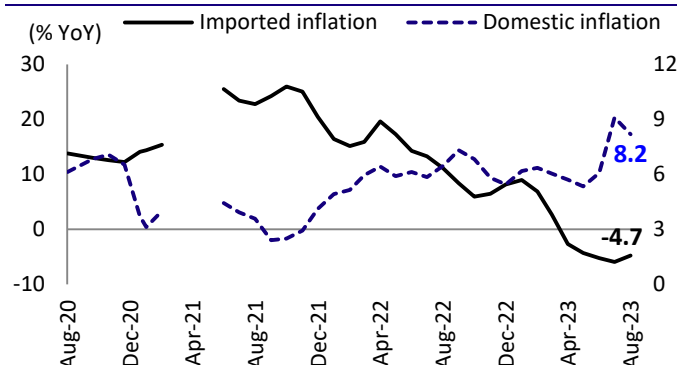
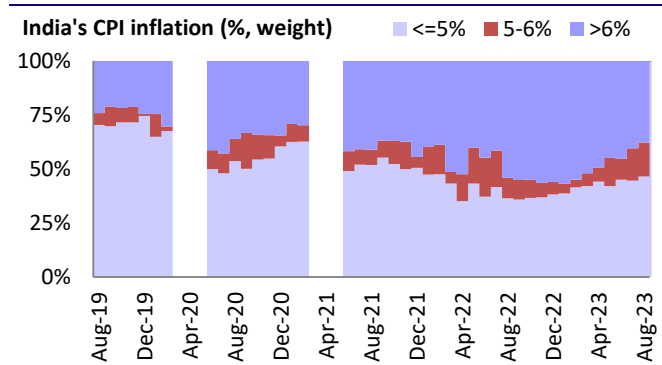


Exhibit 4: ...and only 37.6% of CPI basket posted more than 6% inflation in Aug'23, the lowest in 21 months



Based on 299 items

Exhibit 5: CPI and key components

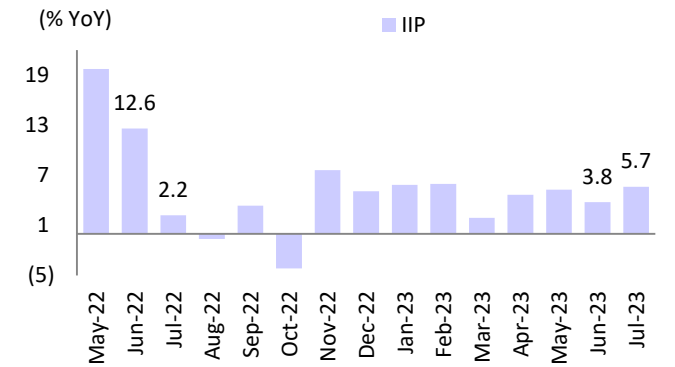
	FY21	FY22	FY23	Aug-22	Jun-23	Jul-23	Aug-23
Overall CPI	6.2	5.5	6.7	7.0	4.9	7.4	6.8
Food and beverages	7.3	4.2	6.7	7.6	4.7	10.6	9.2
Cereal and products	3.8	0.5	11.0	9.6	12.8	13.0	11.9
Pulses and products	16.4	6.0	2.4	2.6	10.6	13.3	13.0
Meat and fish	15.4	7.9	4.2	1.0	1.5	2.3	3.7
Milk and products	5.4	2.8	7.4	6.4	8.6	8.3	7.7
Fruits and vegetables	4.8	-3.4	3.5	11.4	0.0	26.6	19.4
Pan, tobacco, and intoxicants	9.9	4.5	2.2	1.7	3.7	3.9	4.1
Fuel and light	2.7	11.3	10.3	10.8	3.9	3.7	4.3
Housing	3.3	3.7	4.3	4.1	4.6	4.5	4.4
Clothing and footwear	3.4	7.2	9.5	9.9	6.1	5.6	5.2
Miscellaneous	6.6	6.7	6.3	6.0	5.2	5.1	4.9
Transport and communication	9.9	10.1	5.9	5.2	2.5	2.5	2.5
Core CPI	5.3	6.1	6.3	6.1	5.2	5.0	4.8

*Excluding food & beverages and fuel & light

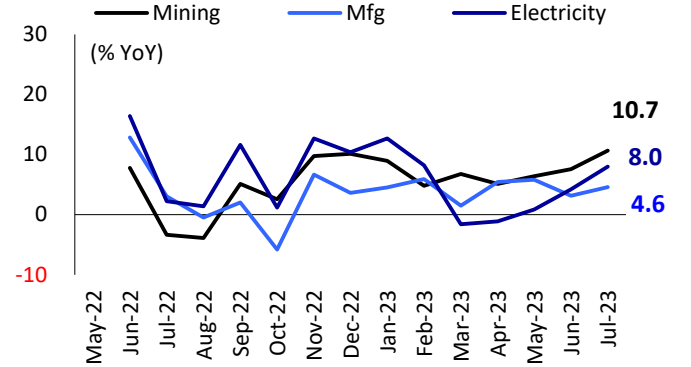
Source: Central Statistics Office (CSO), MOFSL

II. IIP growth hits 5-month high

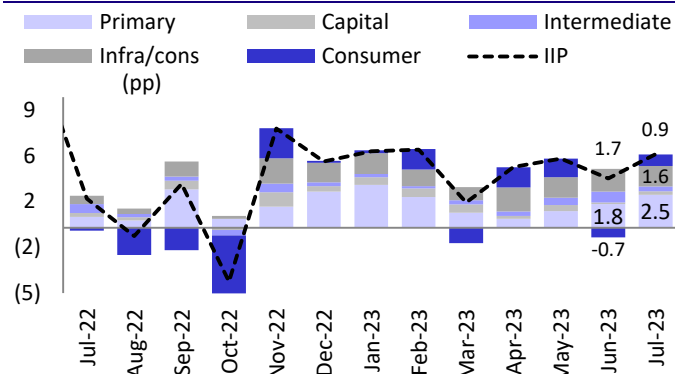
- **IIP growth at a 5-month high in Jul'23:** IIP expanded at a faster pace of 5.7% YoY in Jul'23 (vs. 3.8%/2.2% in Jun'23/Jul'22), the highest in five months. The acceleration, however, was not broad-based. The print is higher than the Bloomberg consensus of 5.3% YoY and lower than our forecast of 8.2%. (*Exhibit 6*).
- **Manufacturing activity grew slower than expected...:** Although mining and electricity output growth was in line with our expectations, growth in the manufacturing sector was weaker than expected, which led to lower growth in IIP vs. our estimate. The acceleration in growth was partly led by a low base. Apart from the base effect, mining activity remained strong owing to below-normal rainfall this year. Mining output grew by 10.7% in Jul'23 (highest in 14 months) vs. 7.6% in Jun'23 and a pre-Covid average growth of 4.3% in the month of July. Electricity output grew at a 5-month high rate of 8% in Jul'23 vs. an average of 0.6% in the last four months. The manufacturing sector too witnessed an acceleration in growth, but it is still weak. It grew 4.6% in Jul'23 vs. 3.1% each in Jun'23/Jul'22. (*Exhibit 7*).
- **...and growth was not broad-based:** Details of the manufacturing sector confirm that as much as 58% of the items within the sector grew slower than 5% (vs. 60.2% in Jun'23). Further, while IIP growth improved from 2.2% YoY a year ago to 5.7% YoY in Jul'23, 42.5% of the items grew at a slower pace vs. last year (*Exhibit 9*).
- **Infra & construction goods and capital goods remained strong:** According to the use-based classification, output of capital goods and infra & construction goods remained robust in Jul'23. Even consumer non-durables grew at a faster pace of 7.4% in Jul'23 vs. 0.3%/-2.9% in Jun'23/Jul'22. However, consumer durables still remained weak (1% in Jul'23 vs. 1.4%/-3.1% in Jun'23/Jul'22). (*Exhibit 8*)
- **Our view:** We expect IIP growth to pick up to 8-10% YoY in the next three months, supported by a favorable base effect and the onset of the festive season.

Exhibit 6: IIP growth accelerated to 5.7% YoY in Jul'23...


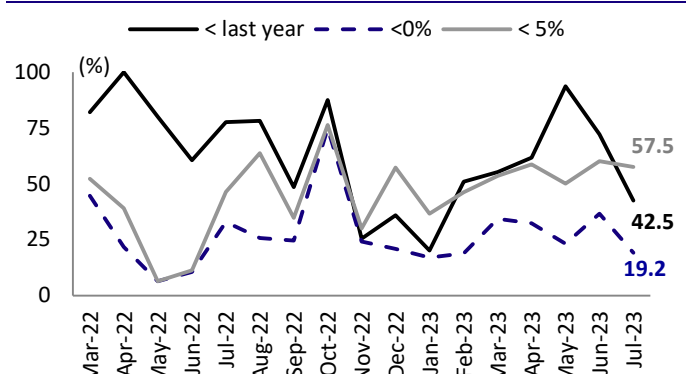
Source: CSO, MOFSL

Exhibit 7: ...due to uptick in mining and electricity sectors


Source: CSO, MOFSL

Exhibit 8: Infra & construction goods remained robust


Source: CSO, MOFSL

Exhibit 9: About 19.2% of the manufacturing basket witnessed contraction in Jul'23 vs. 36.6% in Jun'23


Source: CSO, MOFSL

Exhibit 10: Key components of IIP

% YoY	Weight	FY20	FY21	FY22	FY23	Jul-22	May-23	Jun-23	Jul-23
Industry-based classification									
Mining	14.4	1.6	(7.8)	12.2	5.8	(3.3)	6.4	7.6	10.7
Manufacturing	77.6	(1.4)	(9.6)	11.7	4.7	3.1	5.8	3.1	4.6
Electricity	8.0	0.9	(0.5)	8.0	8.9	2.3	0.9	4.2	8.0
IIP	100.0	(0.8)	(8.5)	11.4	5.3	2.2	5.3	3.8	5.7
Use-based classification									
Primary Goods	34.0	0.7	(7.0)	9.6	7.5	2.5	3.6	5.3	7.6
Capital Goods	8.2	(14.0)	(18.7)	17.0	13.0	5.1	8.1	2.0	4.6
Intermediate Goods	17.2	9.1	(9.4)	15.4	3.8	3.7	3.0	4.6	1.9
Infrastructure/Construction	12.3	(3.6)	(8.7)	18.8	8.4	4.8	11.3	12.9	11.4
Consumer Goods	28.2	(3.8)	(7.3)	6.6	0.6	(0.8)	5.5	(2.6)	3.2
Durable Goods	12.8	(8.8)	(14.9)	12.4	0.6	2.3	1.2	(6.7)	(2.7)
Non-Durable Goods	15.3	(0.1)	(2.1)	3.2	0.7	(2.9)	8.4	0.3	7.4

Source: CSO, MOFSL

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