

## Double good news: Lower-than-expected inflation and better-than-expected IIP

### Inflation returns to RBI's comfort level after a two-month gap

- Headline CPI inflation eased to 5% YoY in Sep'23 vs. 6.8% in Aug'23, mainly led by lower food inflation. This aligns precisely with the projections made by the RBI in its recent monetary policy statement. This implies that CPI averaged 6.4% in 2QFY24 (vs. our expectation of 6.7%), in line with RBI expectations. The number was lower than the Bloomberg consensus of 5.4% and our forecast of 5.7%.
- Details suggest that the deceleration in inflation was broad-based. Vegetables (weight = 6%) witnessed a fall of 15.8% MoM, following a 5.7% MoM fall in Aug'23. CPI ex-veggies slid lower to 5.1% YoY from 5.5% last month, and an average of 6.5% during FY21-23. On the other hand, inflation in cereals, pulses, and spices remain sticky and in double-digits. Inflation in fuel & light declined 3.9% MoM in Sep'23, marking the highest fall on record. Notably, core CPI (excluding food & beverages and fuel & light) came down to 4.5% from 4.8% in Aug'23 (Exhibit 1), the lowest in almost 42 months.
- 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 at a sharper pace of 5.9% in Sep'23 vs. a decline of 4.7% last month. Domestically generated inflation came in lower at 6.3% YoY in Sep'23, led by food inflation (Exhibit 3). (2) Details of 299 sub-components confirm that only 44% of the basket posted +5% YoY inflation in Sep'23, the lowest in 28 months (vs. 53.9% in Aug'23). Further, only 35.6% of the CPI basket posted +6% YoY inflation last month, the lowest share in 28 months (Exhibit 4). (3) Services inflation came in at 3.8% in Sep'23 vs. 4.1% in Aug'23, the lowest on record. Core services inflation (excluding housing) came in at a 40-month low of 3.7% in Sep'23.
- Industrial production (IIP) clocked a 14-month high growth of 10.3% YoY in Aug'23 (vs. 6%/-1.6% in Jul'23/Aug'22), mainly led by a low base. The acceleration in growth was broad-based. The print is higher than the Bloomberg consensus of 9% YoY and our forecast of 9.1%.
- Manufacturing activity remained robust in Aug'23; it printed a 14-month high growth of 9.3% during the month vs. 5% in Jul'23 and -0.5% in Aug'22. The acceleration in growth was mainly led by a low base. Details of the manufacturing sector confirm that only 32% of the items within the sector grew slower than 5% (vs. 57.5% in Jul'23). Further, while IIP growth improved sharply from -0.5% YoY a year ago to 10.3% YoY in Aug'23, 21.8% of the items grew at a slower pace vs. last year.
- Electricity output grew at a much sharper pace of 15.3% in Aug'23 vs. an average of 2.1% in the last five months. Additionally, mining activity remained strong owing to below-normal rainfall this year. Mining output grew by 12.3% in Aug'23 (the highest in 24 months) vs. 10.7% in Jul'23 and a pre-Covid average growth of 2.9% in the month of August.
- Output of capital goods and infra & construction goods remained robust in Aug'23. Growth in both of these segments remained strong, which was not entirely led by the base effect. Capital goods output grew 12.6% in Aug'23 vs. 4.3% in Aug'22, the best in 14 months. Infra & construction goods grew at a 15-month high of 14.9% in Aug'23 vs. 3% in Aug'22. Consumer goods though was up 7.6% in Aug'23, it was weaker than our expectations.
- Overall, a great set of data, falling inflation and strong growth. The RBI/MPC will not need to do anything in the next monetary policy, though we need to keep a watch on the global economy. Going forward, we expect core inflation to ease gradually toward 4% by Mar'24 though the headline inflation may stay 4.5-5%. With another 5% MoM fall in veggies in Oct'23, headline inflation could be ~4.5%. IIP to remain strong over the next few months, supported by a favorable base effect and the onset of the festive season.

**CPI inflation eased to 5% in Sep'23, in line with RBI's forecast:** Headline CPI inflation eased to 5% YoY in Sep'23 vs. 6.8% in Aug'23, mainly led by lower food inflation. This is exactly what RBI had projected in its recent monetary policy. This implies that CPI averaged 6.4% in 2QFY24 (vs. our expectation of 6.7%), in line with RBI expectations. The number was lower than the Bloomberg consensus of 5.4% and our forecast of 5.7%.

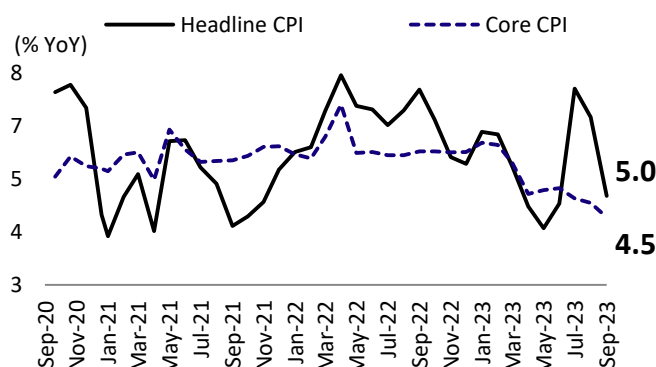
**Broad-based slowdown in CPI inflation:** Food inflation came down to 6.6% YoY in Sep'23 vs. 9.9% in Aug'23 and 8.6% in Sep'22. Sequentially, it fell 2.2% MoM in Sep'23 (the highest sequential contraction in 46 months). Details suggest that the deceleration in inflation was mainly due to vegetables (weight = 6%), which witnessed a fall of 15.8% MoM, following a 5.7% MoM fall in Aug'23. CPI ex-veggies slid lower to 5.1% YoY from 5.5% last month, and an average of 6.5% during FY21-23. On the other hand, inflation in cereals, pulses, and spices remain sticky and in double-digits. Inflation in pulses increased to 16.4% in Sep'23 (4.1% MoM) vs. 13% last month, led by lower sowing and below normal rainfall in pulses-growing states. Inflation in protein-based products remain firm too. Inflation in fuel & light declined 3.9% MoM in Sep'23, marking the highest fall on record. This implies that higher crude oil prices have not been transmitted to petrol and diesel prices in the country. Standard core CPI came in at 38-month low of 4.7% in Sep'23 vs. 5% in Aug'23. (*Exhibit 2*).

**Core inflation at a 42-month low in Sep'23:** Core CPI (excluding food & beverages and fuel & light) came down to 4.5% in Sep'23 from 4.8% in Aug'23 (*Exhibit 1*), the lowest in almost 42 months. The deceleration is broad-based. All the components within core came in lower, except for personal care & effects, which grew 8.5% in Sep'23 compared with 8.1% in Aug'23 and 6.8% in Sep'22.

**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 at a sharper pace of 5.9% in Sep'23 vs a decline of 4.7% last month. Domestically generated inflation came in lower at 6.3% YoY in Sep'23, led by food inflation (*Exhibit 3*). (2) Details of 299 sub-components confirm that only 44% of the basket posted +5% YoY inflation in Sep'23, the lowest in 28 months (vs. 53.9% in Aug'23). Further, only 35.6% of the CPI basket posted +6% YoY inflation last month, the lowest share in 28 months (*Exhibit 4*). (3) Services inflation came in at 3.8% in Sep'23 vs. 4.1% in Aug'23, the lowest on record. Core services inflation (excluding housing) came in at a 40-month low of 3.7% in Sep'23.

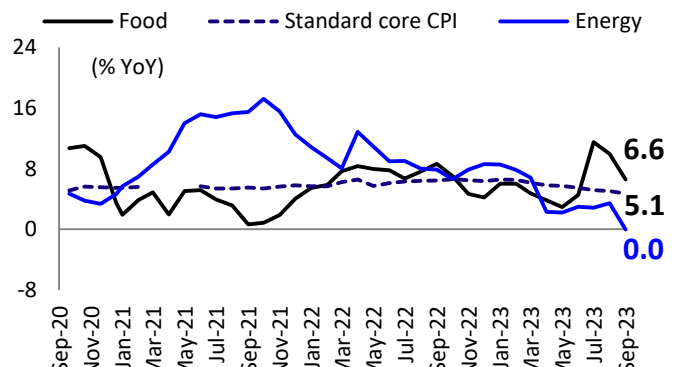
**Our view:** Overall, a great set of data, falling inflation, and strong growth. The RBI/MPC is not anticipated to take any immediate action in the upcoming monetary policy, though we need to keep a watch on the global economic situation. Going forward, we expect core inflation to gradually ease toward 4% by Mar'24, while the headline inflation may hover between 4.5% and 5%. With another 5% MoM fall in veggies in Oct'23, headline inflation could be ~4.5%.

**Exhibit 1: Retail inflation eased to 5% in Sep'23...**

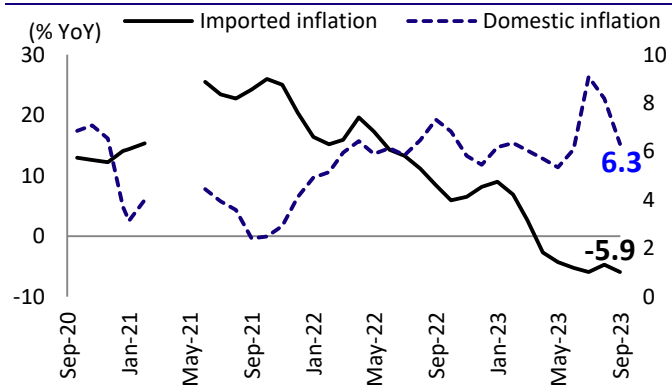
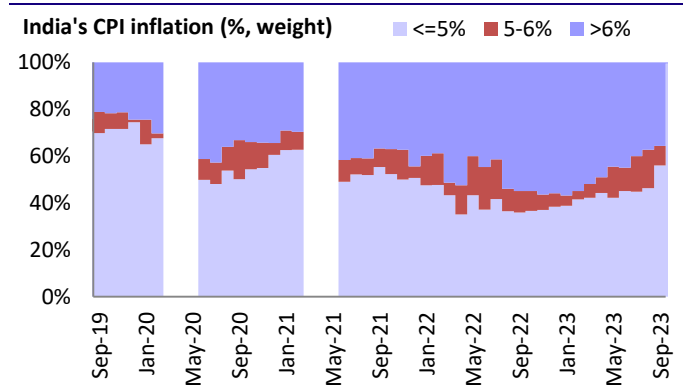


# Core CPI excludes food & beverages and fuel & light

**Exhibit 2: Broad-based deceleration in inflation**



\* Excluding food & energy

**Exhibit 3: Thus, domestically generated inflation eased during the month...****Exhibit 4: ...and only 35.6% of CPI basket posted more than 6% inflation in Sep'23, the lowest in 28 months**

Based on 299 items

**Exhibit 5: CPI and key components**

	FY21	FY22	FY23	Sep-22	Jul-23	Aug-23	Sep-23
<b>Overall CPI</b>	6.2	5.5	6.7	7.4	7.4	6.8	5.0
<b>Food and beverages</b>	7.3	4.2	6.7	8.4	10.6	9.2	6.3
Cereal and products	3.8	0.5	11.0	11.5	13.0	11.9	10.9
Pulses and products	16.4	6.0	2.4	3.0	13.3	13.0	16.4
Meat and fish	15.4	7.9	4.2	2.5	2.3	3.7	4.1
Milk and products	5.4	2.8	7.4	7.1	8.3	7.8	6.9
Vegetables	5.8	-7.2	3.0	5.7	3.1	4.0	7.3
<b>Pan, tobacco, and intoxicants</b>	9.9	4.5	2.2	2.0	3.9	4.1	3.9
<b>Fuel and light</b>	2.7	11.3	10.3	10.4	3.7	4.3	-0.1
<b>Housing</b>	3.3	3.7	4.3	4.6	4.5	4.4	4.0
<b>Clothing and footwear</b>	3.4	7.2	9.5	10.2	5.6	5.2	4.6
<b>Miscellaneous</b>	6.6	6.7	6.3	6.1	5.0	4.9	4.8
Transport and communication	9.9	10.1	5.9	5.4	2.5	2.5	2.3
<b>Core CPI</b>	5.6	6.0	6.1	6.1	4.9	4.8	4.5

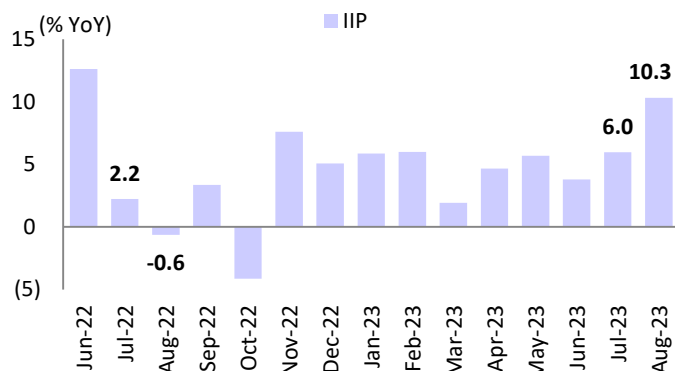
\*Excluding food &amp; beverages and fuel &amp; light

Source: Central Statistics Office (CSO), MOFSL

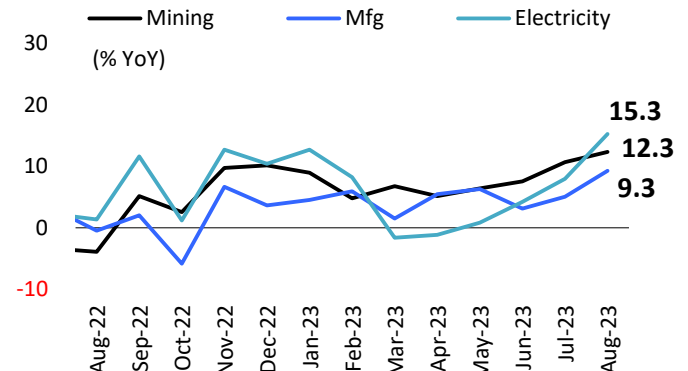
## II. IIP growth hits 14-month high

- **IIP growth came in better than expected:** Industrial production (IIP) clocked a 14-month high growth of 10.3% YoY in Aug'23 (vs. 6%/-1.6% in Jul'23/Aug'22), mainly led by a low base. The acceleration in growth was broad-based. The print is higher than the Bloomberg consensus of 9% YoY and our forecast of 9.1%. (*Exhibit 6*).
- **Acceleration in growth is broad-based:** Manufacturing activity remained robust in Aug'23; it printed a 14-month high growth of 9.3% during the month vs. 5% in Jul'23 and -0.5% in Aug'22. The acceleration in growth was mainly led by a low base. Details of the manufacturing sector confirm that only 32% of the items within the sector grew slower than 5% (vs. 57.5% in Jul'23). Further, while IIP growth improved sharply from -0.5% YoY a year ago to 10.3% YoY in Aug'23, 21.8% of the items grew at a slower pace vs. last year (*Exhibit 9*).
- Electricity output grew at a much sharper pace of 15.3% in Aug'23 vs. an average of 2.1% in the last five months. Additionally, mining activity remained strong, owing to below-normal rainfall this year. Mining output grew 12.3% in Aug'23 (the highest in 24 months) vs. 10.7% in Jul'23 and a pre-Covid average growth of 2.9% in the month of August. (*Exhibit 7*).

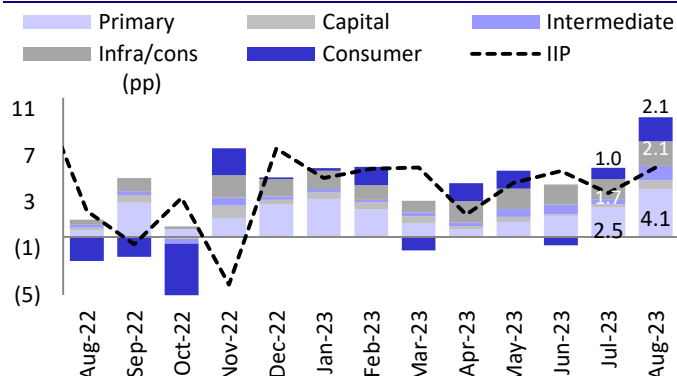
- **Infra & construction goods and capital goods did exceptionally well:** According to the use-based classification, output of capital goods and infra & construction goods remained robust in Aug'23. Growth in both of these segments remained strong, which was not entirely led by the base effect. Capital goods output grew 12.6% in Aug'23 vs. 4.3% in Aug'22, the best in 14 months. Infra & construction goods grew at a 15-month high of 14.9% in Aug'23 vs. 3% in Aug'22. Consumer goods though was up 7.6% in Aug'23, it was weaker than our expectations. (Exhibit 8)
- **Our view:** We expect IIP growth to pick up to 8-10% YoY in the next two months, supported by a favorable base effect and the onset of the festive season.

**Exhibit 6: IIP growth accelerated to 10.3% YoY in Aug'23...**

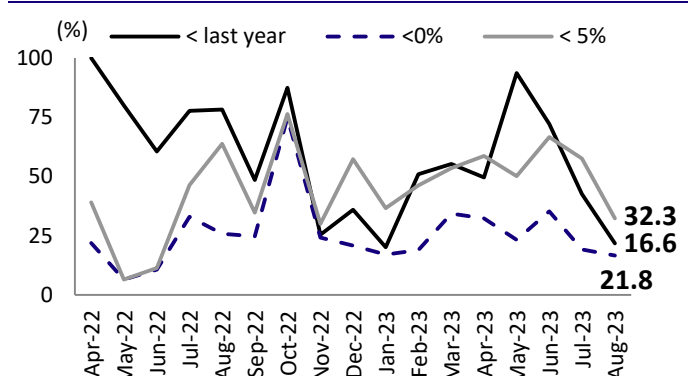
Source: CSO, MOFSL

**Exhibit 7: ...led by broad-based growth and low base effect**

Source: CSO, MOFSL

**Exhibit 8: Infra & construction goods remained robust**

Source: CSO, MOFSL

**Exhibit 9: About 21.8% of the manufacturing basket grew slower than last year vs. 42.5% in Jul'23**

Source: CSO, MOFSL

**Exhibit 10: Key components of IIP**

% YoY	Weight	FY20	FY21	FY22	FY23	Aug-22	Jun-23	Jul-23	Aug-23
<b>Industry-based classification</b>									
Mining	14.4	1.6	(7.8)	12.2	5.8	(3.9)	7.6	10.7	12.3
Manufacturing	77.6	(1.4)	(9.6)	11.7	4.7	(0.5)	3.1	5.0	9.3
Electricity	8.0	0.9	(0.5)	8.0	8.9	1.4	4.2	8.0	15.3
IIP	100.0	(0.8)	(8.5)	11.4	5.3	(0.7)	3.8	6.0	10.3
<b>Use-based classification</b>									
Primary Goods	34.0	0.7	(7.0)	9.6	7.5	1.7	5.3	7.6	12.4
Capital Goods	8.2	(14.0)	(18.7)	17.0	13.0	4.3	2.0	4.5	12.6
Intermediate Goods	17.2	9.1	(9.4)	15.4	3.8	1.3	4.6	2.4	6.5
Infrastructure/Construction	12.3	(3.6)	(8.7)	18.8	8.4	3.0	12.9	12.4	14.9
Consumer Goods	28.2	(3.8)	(7.3)	6.6	0.6	(7.2)	(2.6)	3.5	7.6
Durable Goods	12.8	(8.8)	(14.9)	12.4	0.6	(4.4)	(6.7)	(2.6)	5.7
Non-Durable Goods	15.3	(0.1)	(2.1)	3.2	0.7	(9.0)	0.3	7.9	9.0

Source: CSO, MOFSL

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