

## August CPI Inflation/ July IIP

14 September 2018

### CPI Inflation Moderates To 3.69% YoY; IIP Growth Slows To 6.6% YoY

Consumer Price Index or CPI inflation stood at 3.69% in August 2018, below Bloomberg consensus estimate of 3.8% but above our estimate of 3.55%. Core inflation at 5.87% was in line with our estimate of 5.9%. Muted food prices were responsible for keeping inflation under check. The inflation trajectory is likely to be benign over the next couple of months, although it may touch 5% by March 2019. Given the inflation trajectory, our base case was a rate hike in 1QFY20, but taking into account the recent movement in the Indian rupee or INR, we now believe that another 25bps rate hike is possible at the October 2018 meeting of the Reserve Bank of India's monetary policy committee. Nevertheless, in our view, we believe that aggressive rate hikes to stem the INR's depreciation is not the ideal solution for India. Moreover, pockets of sluggishness are already seen in the economy. Index of Industrial Production or IIP growth in July 2018 came in at 6.6%, down from 6.9% in the previous month. It was a tad above Bloomberg consensus estimate of 6.5%, but below our estimate of 7.5%. The manufacturing sector grew 7% YoY, up from 6.7% in the previous month. In addition, 20 out of 23 manufacturing segments registered positive growth, up from 19 in the previous month. Export-oriented sectors such as textiles and pharmaceuticals are also witnessing signs of a recovery, possibly helped by a weak INR. Consumer durables also grew by a robust 14.4%. Capital goods production, however, slowed to 3% YoY, below the 12-month average of 7.8%. The capex recovery is likely to witness temporary sluggishness as the country approaches the elections. With the recent sharp depreciation of the INR and interest rates moving up, we expect some slowdown in the economy going forward. Therefore, IIP growth will also be slow. Mining grew 3.7% YoY, while electricity production was up 6.7%YoY but both moderated from the previous month.

**CPI inflation eases to 3.69% YoY:** CPI inflation stood at 3.69% in August 2018, down from 4.2% in the previous month. Core inflation stood at 5.87%, down from 6.3% in the previous month. Muted food prices were responsible for keeping inflation under check. However, food and beverage inflation at 0.85% was above our estimate, mainly on account of higher vegetable prices. Vegetables prices rose 0.5% MoM, far below the seasonal normal, but above our estimate. We note that prices of cereals and pulses have been inching up after the announcement of a hike in minimum support price or MSP in July 2018. The kharif or summer harvest is also likely to be below last year's level, which implies that food prices may witness some uptick going forward. However, the inflation trajectory is likely to be benign over the next couple of months, although it may touch 5% by March 2019.

**IIP growth slows to 6.6% YoY:** IIP growth in July 2018 came in at 6.6% in July 2018, down from 6.9% in the previous month. It was a tad above Bloomberg consensus estimate of 6.5%, but below our estimate of 7.5%. The manufacturing sector grew 7% YoY, up from 6.7% in the previous month (Exhibit 2). In addition, 20 out of 23 manufacturing segments registered positive growth, up from 19 in the previous month (Exhibit 3). Export-oriented sectors such as textiles and pharmaceuticals also witnessed signs of a recovery, possibly helped by a weak INR. Consumer durables also grew by a robust 14.4%. Capital goods production, however, slowed to 3% YoY, below the 12-month average of 7.8%. The capex recovery is likely to witness temporary sluggishness as the country approaches the elections. With the recent sharp depreciation of the INR and interest rates moving up, we expect some slowdown in the economy going forward. Therefore, IIP growth will also slow. Mining grew 3.7% YoY, while electricity production was up 6.7%YoY, both moderating from the previous month but on strong bases.

**RBI may hike rates in October 2018:** Given the inflation trajectory our base case was a rate hike in 1QFY20, but taking into account the recent movement in the INR, we now believe another 25bps rate hike is possible at the October 2018 meeting. Nevertheless, in our view, we believe aggressive rate hikes to stem the INR's depreciation is not the ideal solution for India. Unlike most other emerging markets where FPI flows are primarily into debt, flows into India are concentrated in equities. Therefore not only will aggressive rate hikes hurt domestic growth, it may also lead to FPI outflow from equities. We believe a sovereign bond or NRI deposit scheme is likely to be a better line of defence for India.

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## Exhibit 1: CPI inflation eases to 3.69%YoY supported by low food prices

%YoY	Weight (%)	Aug-17	Jul-18	Aug-18
<b>CPI</b>	<b>100</b>	<b>3.3</b>	<b>4.2</b>	<b>3.7</b>
<b>Food and beverage</b>	<b>45.86</b>	<b>2.0</b>	<b>1.7</b>	<b>0.9</b>
<i>Cereals and products</i>	9.7	3.9	2.9	3.0
<i>Milk and milk products</i>	6.6	3.7	2.9	2.7
<i>Vegetables</i>	6.0	6.0	(2.3)	(7.0)
<i>Prepared meals and snacks</i>	5.6	5.2	4.5	4.2
Pan, tobacco and intoxicants	2.38	6.8	6.3	5.3
Clothing and footwear	6.53	4.6	5.3	4.9
Housing	10.07	5.6	8.3	7.6
Fuel and light	6.84	5.0	8.0	8.5
Miscellaneous	28.32	3.8	5.8	5.5
<i>Transport and communication</i>	8.59	3.7	6.6	6.0
<b>Core CPI</b>	<b>47.3</b>	<b>4.9</b>	<b>6.3</b>	<b>5.9</b>

Source: Central Statistical Organisation or CSO, Nirmal Bang Institutional Equities Research

## Exhibit 2: IIP slows to 6.6% YoY

% YoY	Jul-17	Jun-18	Jul-18
<b>IIP</b>	<b>1.03</b>	<b>6.87</b>	<b>6.61</b>
<b>Mining</b>	4.52	6.60	3.68
<b>Manufacturing</b>	(0.08)	6.65	6.96
<b>Electricity</b>	6.60	8.48	6.71
<b>Goods-based classification</b>			
Primary goods	2.21	9.28	6.91
Capital goods	(1.13)	9.82	3.01
Intermediate goods	(2.76)	1.50	1.17
Infrastructure and construction goods	4.27	8.22	8.43
Consumer durables	(2.42)	13.35	14.36
Consumer non-durables	4.06	0.16	5.61

Source: CSO, Nirmal Bang Institutional Equities Research

## Exhibit 3: 20 out of 23 manufacturing segments register positive growth

Industry / %YoY	Weights	Jul-17	Aug-17	Sep-17	Oct-17	Nov-17	Dec-17	Jan-18	Feb-18	Mar-18	Apr-18	May-18	Jun-18	Jul-18
Food products	5.30	0.32	7.30	1.95	1.04	17.73	12.01	12.47	19.15	20.59	18.80	10.45	6.16	1.06
Beverages	0.80	(0.73)	(1.94)	1.12	2.45	5.60	7.56	11.99	12.46	2.60	3.92	6.13	10.53	15.64
Tobacco products	1.04	(43.67)	(13.44)	(20.99)	(20.73)	(5.83)	(28.13)	(46.48)	(1.62)	(20.57)	3.80	(15.63)	(31.69)	28.36
Textiles	3.29	(2.01)	(2.93)	(3.27)	(2.67)	3.16	7.37	2.71	0.80	(1.99)	(0.78)	(0.51)	(0.77)	2.92
Wearing apparel	1.32	(4.01)	(17.69)	(10.47)	(24.29)	(7.95)	(13.41)	(10.69)	(10.06)	(18.64)	(13.31)	(12.76)	4.41	9.76
Leather and related products	0.50	(2.21)	(5.11)	(5.49)	(1.64)	7.06	17.63	7.69	0.40	(2.76)	(1.83)	(1.54)	2.02	9.27
Wood and wood products	0.19	2.19	1.61	(6.65)	(1.93)	9.30	2.15	1.71	(0.43)	(4.89)	4.41	2.15	9.62	6.31
Paper and paper products	0.87	(5.86)	(4.29)	(8.83)	(3.38)	(0.85)	(2.33)	(3.32)	(3.81)	(3.74)	(2.71)	(4.99)	3.27	(2.67)
Printing & reproduction of recorded media	0.68	(8.51)	4.71	(3.09)	(2.55)	(6.70)	(14.05)	(13.23)	(9.44)	(3.40)	(11.16)	(5.05)	0.95	(2.73)
Coke & refined petroleum products	11.77	(4.14)	2.97	8.59	4.11	4.95	5.79	11.54	6.83	(0.85)	1.20	4.85	11.91	10.74
Pharma, medicinal chemical & botanical products	7.87	18.78	16.78	26.52	22.59	40.85	33.37	22.34	7.41	16.60	7.79	(8.17)	(0.47)	7.14
Chemicals and chemical products	4.98	(6.38)	(2.01)	1.37	0.09	6.66	5.50	3.61	(2.54)	1.52	3.87	5.46	5.72	4.03
Rubber and plastic products	2.42	(4.83)	(5.43)	(13.13)	(16.28)	(7.62)	(7.32)	(2.43)	(8.09)	(12.52)	(10.10)	(7.81)	2.65	0.28
Other non-metallic mineral products	4.09	(2.73)	(1.68)	(4.35)	(2.50)	9.90	14.55	15.45	13.48	8.75	10.85	4.47	10.94	5.40
Basic metals	12.80	3.55	1.87	2.77	6.12	13.09	4.80	4.01	10.69	9.73	3.28	3.18	4.29	3.19
Fabricated metal products ex-machinery and equipment	1.57	(6.00)	9.74	4.68	9.45	9.63	3.59	6.64	16.40	9.44	9.79	12.92	11.93	10.36
Computer, electronic& optical products	3.00	4.65	34.92	22.51	10.45	28.97	32.58	22.14	17.69	12.18	28.07	26.97	44.11	30.77
Electrical equipment	2.65	(12.74)	(7.74)	(18.72)	(18.96)	(9.98)	(14.93)	(2.02)	(2.31)	(8.97)	3.77	(0.56)	15.06	7.89
Machinery and equipment N.E.C.	4.77	(1.45)	9.33	9.93	2.04	5.87	11.01	14.92	26.95	(4.24)	8.61	1.77	7.75	(0.92)
Motor vehicles, trailers & semi-trailers	4.86	6.96	13.43	13.92	13.18	17.94	26.51	26.59	20.49	17.15	22.27	21.11	20.47	14.08
Other manufacturing	1.78	(21.48)	(3.91)	(26.15)	(36.75)	(15.37)	(22.84)	(32.41)	(28.96)	(30.65)	(32.76)	(31.89)	(40.23)	3.56
furniture; manufacturing N.E.C.	0.13	(8.24)	(7.00)	0.00	(7.09)	6.21	33.63	27.81	22.36	41.52	9.68	13.16	10.65	42.70
Other transport equipment	0.94	10.49	11.72	4.33	0.69	22.37	26.67	33.07	32.04	15.86	13.22	8.11	15.63	18.90
<b>Number of industries showing positive growth</b>		<b>8.00</b>	<b>11.00</b>	<b>12.00</b>	<b>11.00</b>	<b>16.00</b>	<b>16.00</b>	<b>16.00</b>	<b>14.00</b>	<b>11.00</b>	<b>16.00</b>	<b>13.00</b>	<b>19.00</b>	<b>20.00</b>

Source: CSO, Nirmal Bang Institutional Equities Research

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