

13 September 2023

India | Economy

Economy

Industrial output accelerates, but still-elevated non-core CPI inflation is set to moderate

Industrial output accelerated in Jul'23 to 5.7% YoY growth, and is likely to strengthen further as infrastructure goods stay strong, and capital goods output rebounds from a brief hiatus in growth momentum. Other pockets of strength included basic metals (+12.8% YoY, with steel output up 21% YoY) and pharmaceuticals (+12% YoY) in Jul'23. Mining is likely to continue benefitting from strengthening metals output, in response to the broadening of the investment recovery. Consumer non-durables output was up 7% YoY in Nov'22-Jul'23, evidence of a clear recovery, while consumer durables contracted because garments (-22% YoY) offset the rebound in vehicles (+8.9% YoY). We expect 6% manufacturing growth in FY24, aided by a low base in Aug-Dec'23.

CPI inflation moderated to 6.83% YoY in Aug'23 (from the shock surge to 7.44% YoY the previous month) as vegetable inflation moderated to 26.1% YoY in Aug'23 (from 37.4% YoY in Jul'23). Importantly, core CPI inflation moderated to 4.79% YoY, a reassuring signal that underlying inflation was continuing to respond to the tightening of monetary policy over the past 16 months. We expect CPI inflation to moderate below 6% YoY no later than Nov'23.

Core inflation below 5% YoY, and energy inflation too set to fall

Core CPI inflation was below 5% YoY for the second consecutive month in Aug'23, and all components of food inflation moderated, helping to lower the headline CPI inflation rate to a still-lofty 6.83% YoY. Energy (fuel and light) inflation edged up slightly to 4.3% YoY in Aug'23 (from 3.7% YoY in Jul'23). Vegetable prices have moderated substantially further in Sep'23, and the cut in LPG prices at the end of Aug'23 should enable CPI inflation to moderate to 6.3% YoY in Sep'23, and to durably below 6% YoY no later than Nov'23. The monsoon was 11% below normal until 6th Sep'23, but both major weather forecasters expect normal rainfall in Sep'23 (as evident in the past week), so reservoirs are likely to be replenished to within 'normal' levels (less than 10% below the long-period average) by the end of Sep'23.

No more policy rate changes in FY24, but a cut likely in Q1FY25

The I-CRR hike is to be withdrawn in phases over four weeks ending 9th Oct'23, and this continuing period of slightly tight liquidity will also contribute to reining-in inflation. Once headline CPI inflation moderates below 6% YoY by Nov'23 (and likely below 5% YoY by Jan'24), there will be no need for any change in policy interest rates during the rest of FY24. However, we continue to expect a rate cut in Q1FY25.

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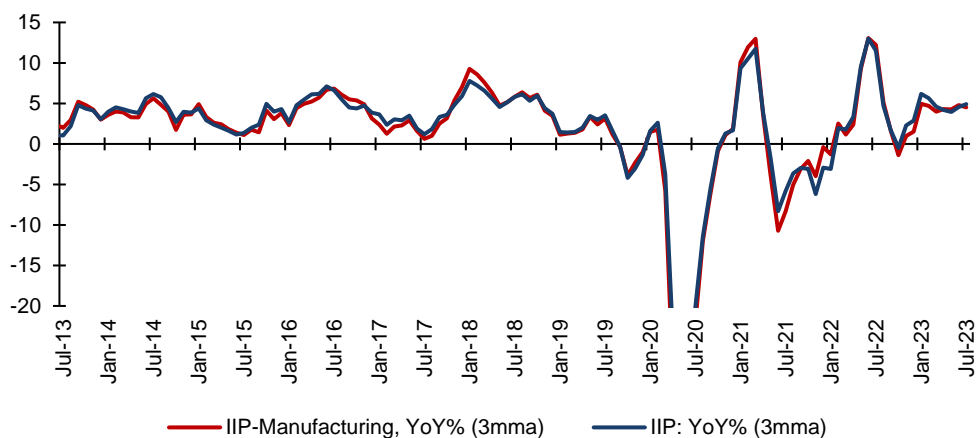
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Mining and electricity bolster the industrial acceleration

India's industrial growth strengthened to 5.7% YoY in Jul'23, the fastest pace since Feb'23 (+6% YoY) and Jan'23 (5.8% YoY). Manufacturing (+4.6% YoY) was a relative growth laggard in Jul'23 – having grown faster in three of the past six months – but industrial output was bolstered by the strength of mining (+10.7% YoY) and electricity (+8% YoY). The strength of mining was underpinned by the 9.8% YoY growth in coal output and 12.2% YoY growth in basic metals output.

Exhibit 1: Industrial (including manufacturing) growth is gently re-accelerating

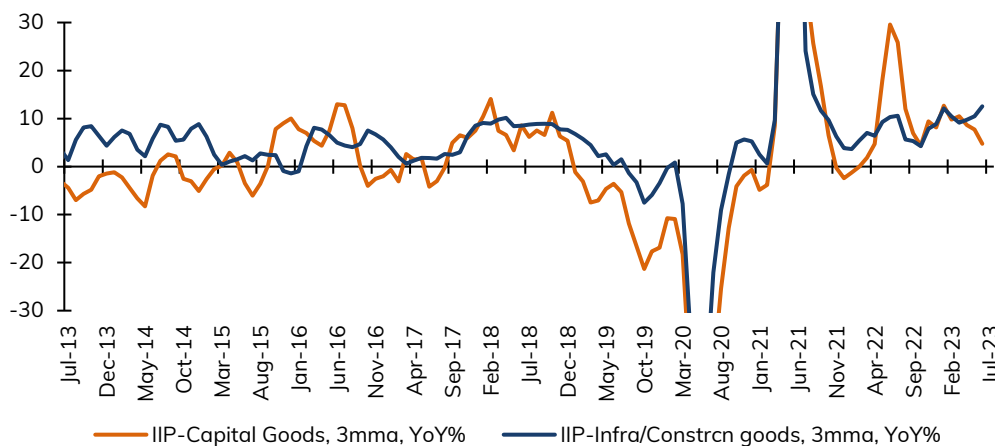


Source: I-Sec, based on data from MOSPI and CEIC

Strength of infrastructure goods output shows public investment still robust

Fixed investment spending has grown 8% YoY or more in each of the past 5 quarters, contributing crucially to the strength of real GDP growth over the period. However, capital goods output has decelerated in the last two months, growing just 4.6% YoY in Jul'23 and 3.3% YoY in Jun-Jul'23 – after growing more than 8% YoY in five of the previous six months, with growth averaging 10.4% YoY in Nov'22-May'23. By contrast, infrastructure and construction goods output grew 11.4% YoY, and has re-accelerated to 12.2% YoY growth in Apr-Jul'23.

Exhibit 2: Infrastructure goods output strengthens further, capital goods decelerate

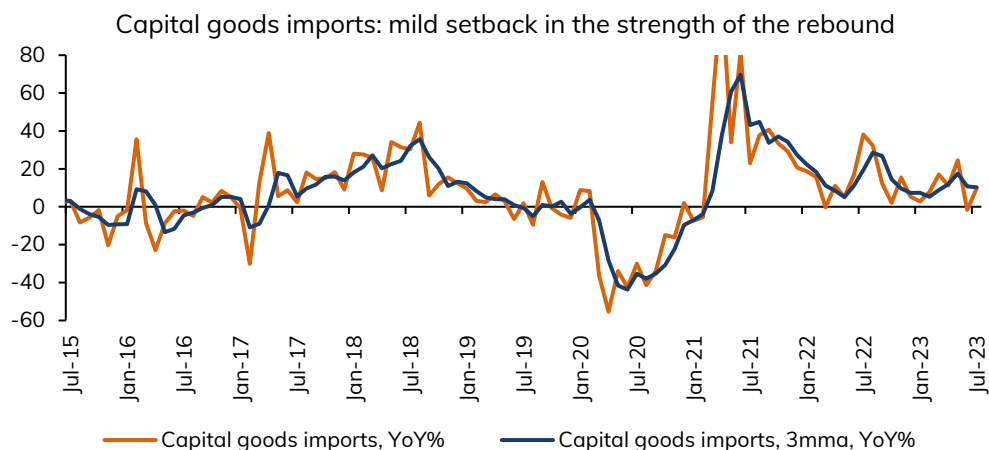


Source: I-Sec, based on data from MOSPI and CEIC

Private investment recovery still remains tenuous

Capital goods imports are a secondary indicator we use to corroborate the strength of investment spending. Capital goods imports, too, decelerated in Jun-Jul'23, declining YoY in Jun'23 before rebounding to 9.7% YoY growth in Jul'23. The rebound in private investment appears to have received a clear setback in Jun-Jul'23, although infrastructure/construction goods output continued to grow in double digits YoY – indicating that the investment rebound still remains very dependent on public (government) investment, while private investment is rebounding fitfully.

Exhibit 3: Capital goods imports too decelerate in Jun-Jul'23

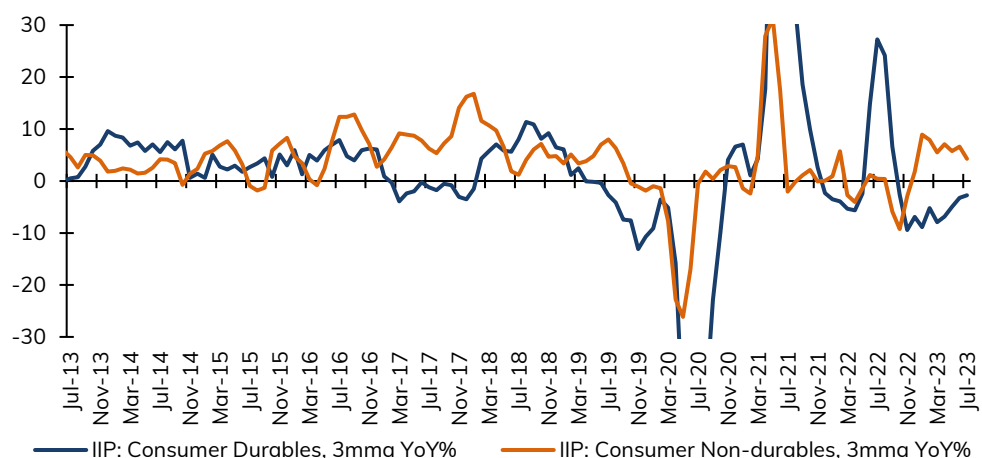


Source: I-Sec, based on data from PIB-Gol

Evidence of a clear, if modest, rebound in rural consumption

Consumer non-durables output was up 7.4% YoY in Jul'23, the seventh month of the past nine in which consumer non-durables output grew 6.5% YoY or more. For the past nine months (Nov'22-Jul'23) consumer non-durables output grew 7% YoY, suggesting a clear recovery after an 18-month post-covid slump. Consumer durables output still declined 2.7% YoY in Jul'23, as the 8.9% YoY growth in vehicles production was offset by the 22% YoY decline in apparel (garment) output.

Exhibit 4: Consumer goods output suggests PCE growth is sluggish



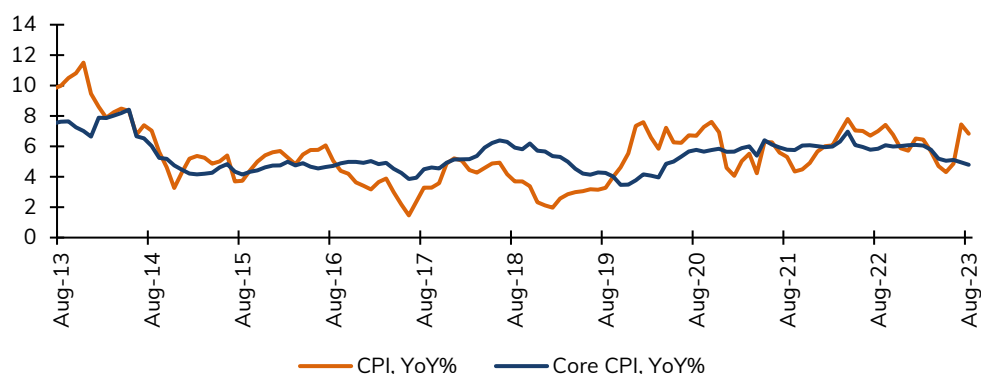
Source: I-Sec, based on data from MOSPI and CEIC

Core inflation below 5% YoY in Jul-Aug'23 should keep policy on hold for the rest of FY24

CPI inflation moderated to 6.83% YoY in Aug'23, easing from the surge to 7.44% YoY in Jul'23. Importantly, core inflation continued to moderate, staying below 5% YoY for the second consecutive month (4.79% YoY). Although the RBI's monetary policy is determined by the trajectory of headline inflation, the Monetary Policy Committee (MPC) pays attention to core CPI inflation too as a gauge of underlying inflationary pressure. The MPC will be reassured by the further moderation in core inflation, and we expect that its action on the policy rate will remain on hold for the rest of FY24.

Exhibit 5: CPI inflation at 6.83% YoY, core CPI inflation at 4.79% YoY in Aug'23

Headline inflation elevated, but core inflation continues to recede



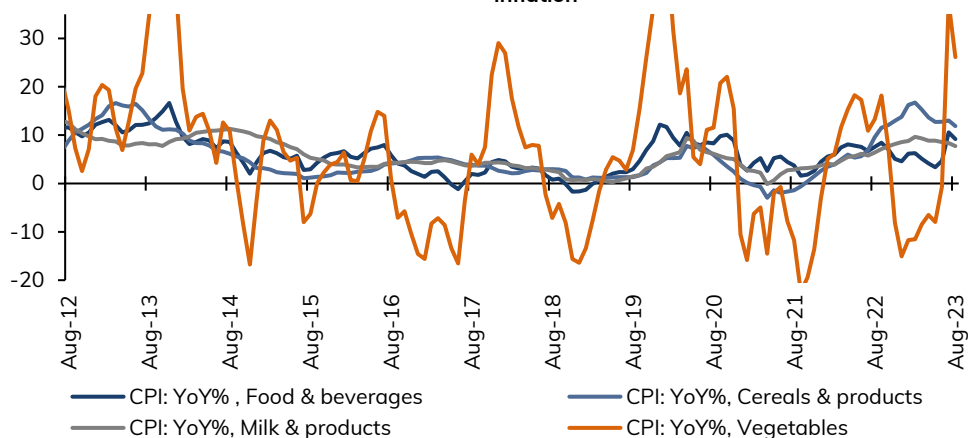
Source: I-Sec, based on data from data from MOSPI and CEIC

Food inflation receded across the board in Aug'23

Food and beverages inflation moderated to 9.2% YoY in Aug'23 (from 10.6% YoY in Jul'23, itself a marked surge from 3.3% YoY in May'23 and 4.7% YoY in Jun'23), with all the key components of food inflation receding. Vegetables inflation (comprising 6% of the CPI) had soared in Jul'23 to 37.4% YoY (from -0.7% YoY in Jun'23), as tomato and other vegetable prices surged amid distributional challenges. In Aug'23, vegetable inflation moderated to 26.1% YoY, while inflation in cereals (+11.9% YoY), milk (+7.7% YoY), and prepared food (5.3% YoY) all moderated relative to Jul'23 inflation levels.

Exhibit 6: Food and beverages inflation receded across all categories in Aug'23

Volatile vegetable inflation abates slightly, as do all components of food inflation

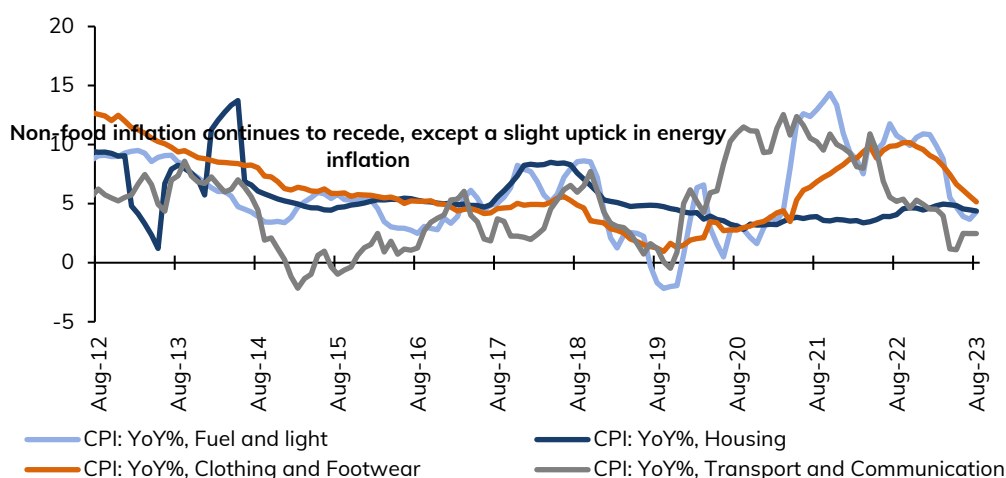


Source: I-Sec, based on data from MOSPI and CEIC

I-CRR hike to be withdrawn in phases ending 9th Oct'23

Energy (fuel & light) inflation edged higher to 4.3% YoY (from 3.7% YoY in Jul'23), but all other categories of non-food inflation receded in Aug'23 – contributing collectively to the further moderation in core inflation. As we had expected, the Reserve Bank of India (RBI) chose not to entirely eliminate the I-CRR (incremental cash reserve ratio) hike imposed last month, but to do it in phases – cutting it to 7.5% (from 10%) on 9th Sep'23, 5% two weeks later and zero on 9th Oct'23. The implementation of the higher I-CRR had already played its part in tightening liquidity conditions over the past month: for the first time in 3 years, the RBI had to inject liquidity during its daily open market operations between 21st and 23rd Aug'23. Excess liquidity conditions should be restored by Oct'23.

Exhibit 7: Energy inflation edged up in Aug'23, all other non-food inflation receded



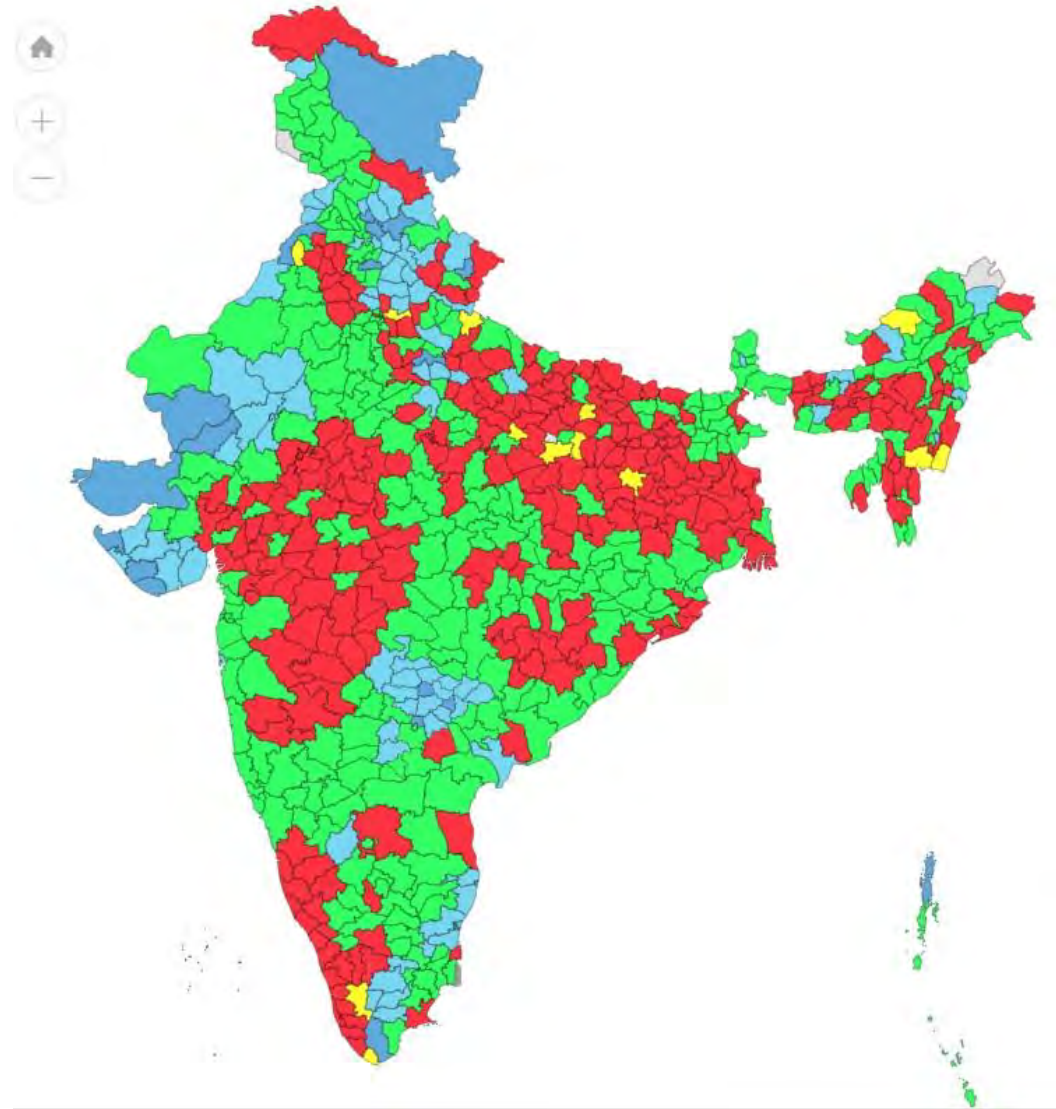
Source: I-Sec, based on data from MOSPI and CEIC

We expect CPI inflation to durably return below 6% YoY by Nov'23

Vegetables inflation has moderated further in recent weeks (with tomato prices, in particular, normalising across the country). The cut in cooking-gas (LPG) prices by INR200/cylinder at the end of Aug'23 will also contribute toward a moderation in energy inflation in Sep'23. While headline inflation is likely to moderate to 6.3% YoY in Sep'23, it should ease below 6% YoY by Nov'23. Until 6th Sep'23, this year's monsoon rain was 11% below the long-period average, with the rain-fed rice growing states of Bihar, eastern UP and gangetic West Bengal suffering deficient rain. IMD (India Meteorological Department) predicts good rainfall in Sep'23, but expects this year's to be the first below-normal monsoon since 2015. Private forecaster Skymet expects it to be a normal monsoon. (The first week of Sep'23 was one of the driest weeks of the monsoon nation-wide, but the current week is witnessing substantial rain across the country, including in New Delhi during the G20 summit). While the kharif rice crop could be hit by the poor distribution of the monsoon, there are ample excess stockpiles of rice and wheat to stabilise those prices. So inflation should durably fall below 6% YoY no later than Nov'23, requiring no further rate hikes in FY23.

The rain deficit from mid-Aug'23 to 6th Sep'23 has caused water in reservoirs across the country to be at 14% below the long-period average levels as of 6th Sep'23. If, as predicted by both IMD and Skymet, rainfall in the rest of Sep'23 is normal, then the reservoir levels too are likely to be restored to within 10% of the long-period average level of water. We are, therefore, not yet worried about the rabi sowing season, and the impact on the rabi crop (harvested in Mar-Apr'24).

Exhibit 8: Monsoon map for rainfall from 1st Jun'23-6th Sep'23



Source: IMD. Blue depicts excess rainfall, green areas normal rainfall, red deficient, yellow extreme deficiency

Recent reports

Date	Report
12-09-2023	China's structural over-capacity triggers a widening financial crisis; but its banks are still liquid
01-09-2023	Economic momentum is robust despite some seeming fiscal deterioration
21-08-2023	'Bidenomics' delays recession; high core inflation and fiscal deficits to buoy bond yields all year
15-08-2023	Inflation surge in Jul'23 tempered by lower core inflation; industrial rebound moderates a tad
11-08-2023	RBI keeps policy rate unchanged but raises a red flag on vegetable inflation; rate cut likely only in Apr'24
02-08-2023	Twin Deficit Watch: Fiscal improvements slowed in Q1FY24, but CAD likely to vanish in FY24
27-07-2023	FOMC's 25bp hike restores a positive real Fed Funds rate; we think the hiking cycle is nearly done
17-07-2023	Goods exports and imports slump, but improving goods and services trade balances bode well for CAD
14-07-2023	China's tepid recovery reflects a slow-burning crisis of over-capacity in industry and real estate
13-07-2023	Industrial recovery gains traction; but with inflation edging higher, a rate cut is unlikely before Jan'24
29-06-2023	CAD set to shrink further as the dynamism of services is complemented by a likely rebound in goods exports
16-06-2023	Trade deficit shrinks faster in Apr-May'23; CAD likely to be minimal in Q1FY24 and all of FY24
15-06-2023	FOMC pauses, but dot plot suggests at least 2 more hikes likely; we still expect Fed Funds to peak at 5.5%
14-06-2023	Inflation abates to below the RBI's projection, making a rate cut by Oct'23 more likely; industrial growth is steady
01-06-2023	Real GDP likely to continue being buoyed by net exports and investment, as the government's borrowing declines
31-05-2023	Declining imports mainly reflect falling import prices, not declining domestic demand
24-05-2023	US default remains unlikely, but this is Round 1 of protracted negotiations to cut excessive public debt
17-05-2023	Trade deficit narrows, likely pushing the current account into surplus for another couple of quarters
16-05-2023	Inflation recedes enough to preclude more tightening; industrial fragility suggests room for rate cuts by Q3FY24
04-05-2023	Global growth prospects clouded, but India's 7%+ real GDP growth to be spurred by investment and net exports
13-04-2023	Goldilocks redux: Industrial output accelerates in Jan-Feb'23, inflation recedes in Mar'23
03-04-2023	Twin Deficit Watch: CAD on track to stay below 2% of GDP in FY23, fiscal deficit below 6% of GDP
23-03-2023	FOMC hikes 25bp (as expected); its dot plots suggest another 25bp hike in CY23 and mild recession ahead
22-03-2023	CA surplus likely in Q4FY23, and services to provide a fillip in FY24 too amid slowing goods trade
15-03-2023	Elevated core inflation requires further US tightening; banking woes to necessarily alter the mix of measures
13-03-2023	Industrial output accelerates in Jan'23, spurred by capex; labour-intensive manufacturing remains a drag
28-02-2023	US inflation shock implies more aggressive tightening ahead, while a recession remains imminent
16-02-2023	Trade deficit likely to narrow sharply in Jan-Sep'23, but labour-intensive export revival remains elusive
14-02-2023	Inflation spike illusory (distorted by food-grain weights), but could induce a hawkish policy response
10-02-2023	RBI stays hawkish; we expect inflation to recede faster than RBI projects, requiring no more hikes in CY23
08-02-2023	US Economy: Recession imminent, but more monetary tightening needed to tame inflation
02-02-2023	FY24 Budget: Balancing act achieves fiscal prudence while boosting capex further
31-01-2023	Twin Deficit Watch: Revenue strength provides room for manoeuvre on the Budget; CAD set to moderate
13-01-2023	Goldilocks economy? Industrial growth rebounds and inflation continues to abate
29-12-2022	Twin Deficit Watch: CAD likely peaked in Q2FY23; fiscal improvement persists despite higher subsidies
15-12-2022	Recession inevitable amid Fed hawkishness; inflation will wane and rate cuts are likely in H2CY23
13-12-2022	A positive real rate is restored, as inflation abates and industrial output also wanes
13-12-2022	Foreign exchange reserves being rebuilt, as INR holds steady against a depreciating USD
07-12-2022	RBI tightens monetary policy as expected; no further rate hikes are likely in FY23, in our view
01-12-2022	Fixed investment spending is being crowded-in as government borrowing stays below target
24-11-2022	Period of surging USD over, but India likely to persist with mildly weaker NEER
12-11-2022	Crises of domestic overcapacity and external overlending loom as Xi Jinping reduces focus on the economy

Date	Report
05-11-2022	Holding up half the sky: Developed economies head to recession, but emerging economies remain resilient
19-10-2022	Twin Deficit Watch: Sep'22 saw a positive shift in goods trade, while surging direct taxes buoyed the fiscal position
13-10-2022	Dismal industrial performance amid high food-driven inflation
03-10-2022	RBI raises repo rate as expected; external balances to improve as inflation differentials begin favouring INR
28-09-2022	Low external debt is underpinned by large voluntary capital inflows
22-09-2022	FOMC implicitly acknowledges its policy error; to front-load further rate hikes
21-09-2022	Supply-side measures sacrifice growth to slay inflation
01-09-2022	Investment-led recovery to buoy the economy amid global slowdown
30-08-2022	US Economy: Far from recession now, but clearly headed toward one by Q1CY24
22-08-2022	Growth will be marginally less robust as India sacrifices external strength to tackle inflation
28-07-2022	The global investment drought & China's quarter-century of over-investment
28-07-2022	FOMC surprises (a bit) positively, with another 75bps hike; suggests smaller hikes in future
15-07-2022	Twin Deficit Watch: Both deficits remain on a stable path, despite the noise
13-07-2022	Growth gains ground, but inflation remains troubling
16-06-2022	Tight labour market obliges the Fed to quickly reverse its policy error
08-06-2022	RBI hikes 50bp as expected; policy to focus on bringing inflation into line
01-06-2022	China faces the perfect storm: global tightening, capital flight, over-capacity
01-06-2022	Rebounding GFCF a positive in Q4FY22; will take the growth baton from exports in FY23
31-05-2022	IPEF and new FTAs to add medium-term dynamism to India's export engines
24-05-2022	Growth was under-estimated in CY21, but reforms will spur strong growth in CY22 and CY23
05-05-2022	MPC's inter-meeting rate hike: countering commodity inflation, and containing fallout from USD strength
30-04-2022	US Economy: Weak GDP print for Q1 ironically reflects ample evidence of an overheating economy
13-04-2022	Twin Deficit Watch: BoP current account to improve; revenue surge provides fiscal leeway for FY23
09-04-2022	Monetary policy remains accommodative, but with a subtly hawkish twist
07-04-2022	Monetary Policy errors have raised the risk of recession by 2024
30-03-2022	Firing on all monetary cylinders, China's "selection-year" rebound is being derailed by covid
25-03-2022	Global GDP to decelerate as FOMC tightens faster; robust external balances bolster India's monetary autonomy
16-03-2022	Binary risks from revival of the JCPOA (Iran nuclear deal) and the wider impact of financial sanctions on Russia
11-03-2022	A pro-incumbent win for BJP in 4 states, but longer-term challenger rises in Punjab
03-03-2022	Higher oil prices in H1CY22 (and lower in H2) to bring forward India's rate hikes
23-02-2022	The Risks from a Russia-Ukraine war: Higher oil prices, European recession
11-02-2022	RBI is in calm seas despite the storm of imminent US tightening
10-02-2022	A credible path toward crowding-in private investment
31-01-2022	Budget Preview: Robust fiscal health opens numerous policy options
25-01-2022	US Economy: Inflation is a monetary phenomenon; FF rate at 1.25% by end-2022 to contain it
21-01-2022	Re-globalisation to drive growth momentum in 2022

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