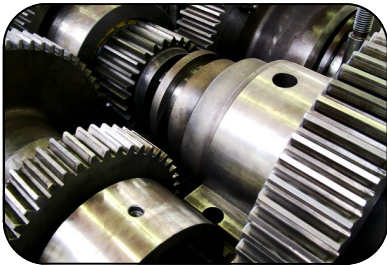


Event Updates

IIP & CPI



July 13, 2018

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Index of Industrial Production (IIP) grew by 3.2% YoY in May 2018 (slowest in last 7 months) against a revised 4.8% YoY growth in April.

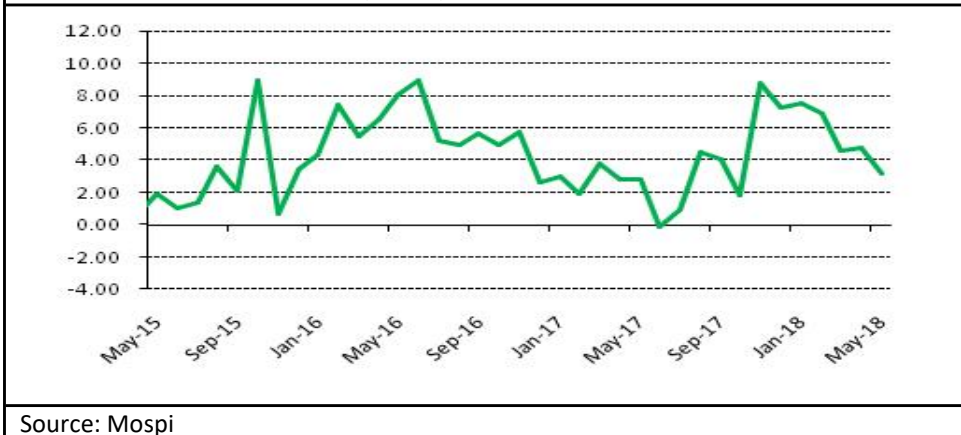
The Index of Industrial Production (IIP) grew by 3.2% YoY in May 2018 (slowest in last 7 months) against a revised 4.8% YoY growth in April. IIP growth for the month of May was also below the market expectations of 4.2% YoY. Disappointed growth in Manufacturing sector dragged the overall IIP growth number. Manufacturing sector grew 2.8% YoY in May compared with a 5.3% YoY rise in April. Most significant slowdown were witnessed in pharmaceuticals and labour intensive sectors like textiles, leather products, wearing apparel and rubber products. However, Mining activity and Electricity generation remained strong in May. Mining activity rose 5.7% YoY, where as Electricity generation grew 4.2% YoY.

Among the use based industries, Intermediate Goods and Consumer Non-durables witnessed significant decline in growth. Growth in Intermediate Goods sector slowed to 0.9% YoY from 1.7% YoY in the previous month. Within Intermediate Goods, naptha, cotton yarn, copper bars and rods and industrial valves have shown de-growth. Consumer Non-durables growth too declined by 2.6% YoY in May against a growth of 7.9% YoY registered in April on account of negative growth in detergent & washing soap, antibiotics, medical & surgical accessories, anti-malarial drugs and paper. Other than that, Capital Goods, a barometer of investments, showed a slowdown in output by 7.6% YoY in May against 11.9% YoY in April.

Key Highlights

- ◆ Low growth in Manufacturing sector dragged the IIP growth for May 2018.
- ◆ Manufacturing sector grew 2.8% YoY in May compared with a 5.3% YoY rise in April.
- ◆ Among the use based industries, Intermediate Goods and Consumer Non-durables witnessed significant decline in growth.

Exhibit 1: IIP Growth Trend (YoY%)



Source: Mospi

In Intermediate Goods, naptha, cotton yarn, copper bars and rods and industrial valves have shown de-growth during the month. In Consumer Non-durables, detergent & washing soap, antibiotics, medical & surgical accessories, anti-malarial drugs and paper have witnessed de-growth.

Manufacturing Sector

In manufacturing sector, 13 out of 23 industry groups have shown positive growth during the month of May. The industry group 'Manufacture of computer, electronic and optical products' has shown the highest positive growth of 27.0% YoY, followed by 21.1% YoY in 'Manufacture of motor vehicles, trailers and semi-trailers' and 13.2% YoY in 'Manufacture of furniture'.

On the other hand, the industry group 'Other manufacturing' has shown the highest negative growth of -31.9% YoY, followed by -15.6% YoY in 'Manufacture of tobacco products' and -12.8% YoY in 'Manufacture of wearing apparel'.

Use-Based Sector

Among the use-based classification, in Intermediate Goods, naptha, cotton yarn, copper bars and rods and industrial valves have shown de-growth during the month. In Consumer Non-durables, detergent & washing soap, antibiotics, medical & surgical accessories, anti-malarial drugs and paper have witnessed highest negative growth. However production of sugar, rice, vaccine for veterinary medicine, Anti-pyretic, analgesic/anti-inflammatory API & formulations registered positive growth. In Consumer Durables, growth of readymade garments (not knitted), gold jewelry, electrical apparatus, footwear has declined over the past few months, indicating strict credit norms and delayed GST returns continue to put the sector under pressure.

Exhibit 2: Sectoral Growth Trend (YoY%)

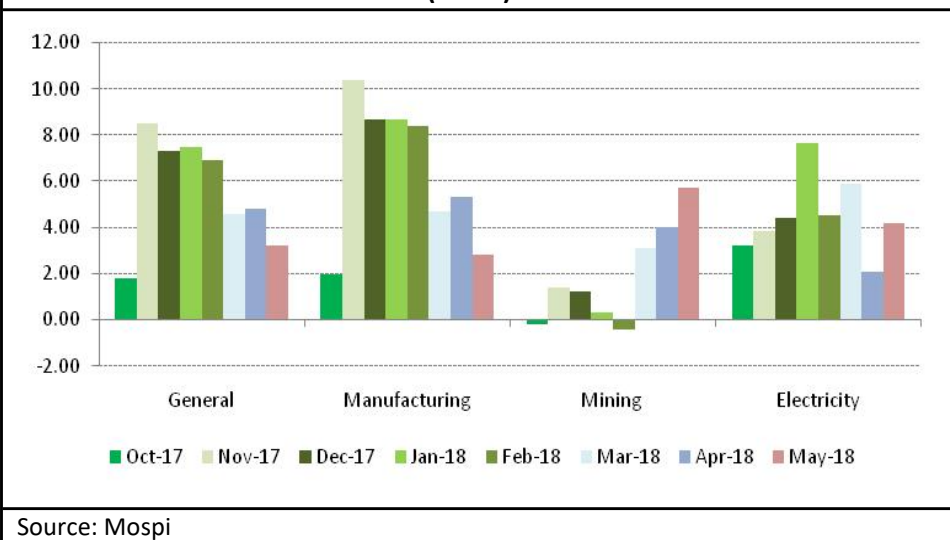
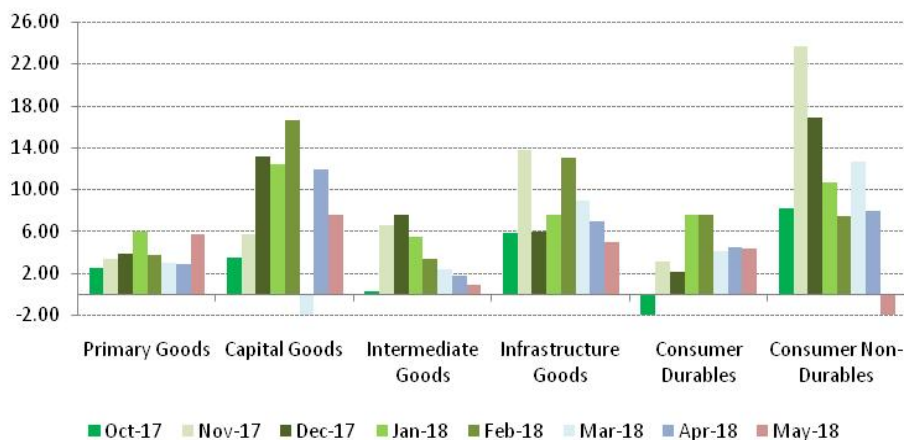


Exhibit 3: Sectoral Growth Trend (YoY%)



Source: Mospi

Exhibit 4: IIP Growth Table

	May-18 yoy (%)	Apr-18 yoy (%)	Apr-May FY19 yoy(%)	Apr-May FY18 yoy (%)
Industrial Production	3.2	4.8	4.0	3.0
Manufacturing	2.8	5.3	4.0	2.7
Mining	5.7	4.0	4.9	1.6
Primary Goods	5.7	2.8	4.3	3.4
Intermediate Goods	0.9	1.7	1.3	2.1
Consumer Durable	4.3	4.5	4.4	0.0
Consumer Non Durable	-2.6	7.9	2.3	9.3
Infrastructure Goods	4.9	7.0	5.9	2.2
Capital Goods	7.6	11.9	9.7	-3.1

Source: Mospi

Outlook

Slowdown in growth momentum over the last two months was disappointing. Main concern is the sustained sluggishness in labour intensive sectors like Readymade Garments, paper, tobacco products, gold Jewellery etc. These have been contracting for more than 15 months now. However, IIP is likely to remain on higher side in the next month owing to the base effect. Moreover, an expected recovery in Capital Goods sector in the second half of FY19 along with a normal monsoon, healthy vehicle sales and sector specific programmes such as housing for all are likely to help Industrial Production to register a better growth number in FY19 than FY18.

India's Consumer Price Index (CPI) based inflation accelerated to 5-month high 5.0% YoY in June 2018 compared to 4.87% YoY in May 2018 and 1.46% YoY in June 2017.

India's Consumer Price Index (CPI) based inflation accelerated to 5-month high 5.0% YoY in June 2018 compared to 4.87% YoY in May 2018 and 1.46% YoY in June 2017. However, the print was below than the market expectations of 5.3% YoY mainly due to below-expected rise in food inflation. Inflation of food and beverages eased to 3.18% YoY in June 2018 from 3.29% YoY in May 2018. Within the food items, the inflation eased for Fruits to 10.13% YoY, Meat and fish 2.41% YoY, Milk and products 3.04% YoY, Prepared meals, snacks, sweets etc. 4.83% YoY and Cereals and products 2.70% YoY. On the other hand, the inflation rose for Pulses and products to -10.87% YoY, Spices 2.37% YoY, Vegetables 7.80% YoY. Unsurprisingly, fuel prices continue to thread higher path. On the other hand, fuel group inflation increased to 7.1% YoY in June against 5.8% YoY in previous month.

Core inflation, however, jumped more than expected suggesting that higher input costs are being passed on due to steady demand conditions. Core inflation increased to 6.35% YoY in June 2018. Inflation for housing rose marginally to 8.45% YoY, while that for miscellaneous items moved up to 5.74% YoY during June. Within the miscellaneous items, inflation for Transport and communication increased to 6.18% YoY, Education 5.83% YoY, Household goods and services 5.18% YoY, Health 6.07% YoY and Recreation and amusement 5.24% YoY.

Key Highlights

- ◆ CPI inflation rose at a slower than expected pace in June as food prices rose modestly.
- ◆ Food price inflation stood at 2.9% YoY in June compared with 3.1% YoY in May.
- ◆ Fuel and light inflation stood at 7.14% YoY in June compared with 5.8% YoY in May.

Exhibit 5: CPI Inflation Trend (YoY%)



Source: Mospi

Outlook

Along with existing upside risks from higher commodity prices and stronger demand, the increase in minimum support prices (MSP) for Kharif season crops will likely add to inflation pressures. Earlier this month, Cabinet Committee on Economic Affairs (CCEA) approved MSP of the Kharif season 2018-19 for 14 kharif crops. The move, which was the highest ever single-year raise, came close on the heels of general elections 2019. MSP increases were in line with the Union Budget 2018-19 announcement of giving farmers a price of 1.5 times of cost.

Our assessment shows that CPI inflation is likely to increase by 70 bps over a 12 month period (October-March FY19 till the end of April-September, FY20) due to this current MSP hike. Given that the impact of MSP hikes play out in the second half of the current fiscal year, the average impact on FY19 CPI inflation is likely to be around 30 bps. However, the impact of MSP on inflation will largely depend upon how the procurement will happen.

Against this background, we expect the Reserve Bank of India (RBI) will go for a wait and watch move. We expect RBI will hike rate in October meeting rather than in August to assess the full impact of MSP pass through, monsoons and fuel prices.

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Stock Recommendation	Expected absolute returns (%) over 12 months
Strong Buy	>20%
Buy	between 12% and 20%
Accumulate	between 6% and 12%
Hold	between 0% and 6%
Sell	0 to <-10%
Neutral	No Rating

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