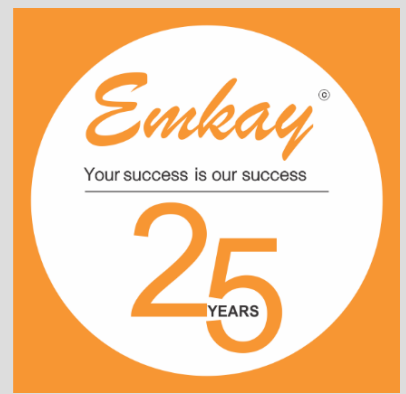


Refer to important disclosures at the end of this report

Inflation slumps even as industrial activity improves



- **Headline CPI inflation surprised positively in Jan'21, easing to 4.06% on account of a slump in food prices, while core inflation budged marginally. The food inflation owed its fall to meaningful sequential easing in vegetables, cereals, and protein complex, with current trends hinting at further easing, albeit at a slower pace. Core inflation moderation has been milder at 5.16% from 5.24%, with health, recreation, education and transport costs showing a sequential uptick.**
- **While demand conditions overall remain patchy, gradual recovery in economic activity, possibly improving producers' pricing power at the margin and rising input costs are weighing on underlying inflation. The improving momentum in economic activity is also validated by a pick-up in Dec'20 industrial activity (1% yoy), which was led by manufacturing, with consumer demand driving the expansion.**
- **The healthy inflation print, nonetheless, could put significant downward pressure to the RBI's Q4FY21 and H1FY22 forecasts and will also help reinforce an accommodative stance in CY21. We think headline inflation may average below 4.5% in FY22E as against ~6.2% in FY21E, assuming food inflation normalizes. We, however, remain watchful of risks in the form of cost push pressure in non-food and non-perishable goods, seasonal upside in food prices in summers and demand-led better pricing power.**

Key highlights:

- **Headline CPI inflation at 4.06% ; food inflation eases to 1.9%; core eases marginally at 5.16%**
- **Healthy Inflation print likely to put significant downward pressure to RBI's Q4FY21 forecast**
- **December IIP gains 1%, led by manufacturing, with consumer demand driving the improvement.**
- **RBI to maintain status quo on rates; liquidity withdrawal to be a calibrated process**

CPI inflation surprises again led by slump in food prices

Inflation continued to surprise on the downside for the third consecutive month, printing 4.06% (Emkay: 4.25%, Consensus: 4.4%) in Jan'21 after 4.59% in Dec'20. This is the lowest inflation recorded in the last 16 months. The sharp correction was led by easing of food inflation, while core inflation budged marginally – pretty much the same theme as seen in Dec'20. Food inflation slumped to 1.9% on an annualized basis after 3.4% prior and average of ~10% in Apr-Nov'20, owing to sequential contraction in vegetables, cereals and protein complex. On an annualized basis, vegetable inflation contracted 15.8% (-14.6% mom) with fall seen across the board. High frequency mandi prices suggest perishables prices are falling further, albeit at a lesser pace, while eggs, meat and fish prices may continue to ease through Feb'21, given avian flu fears. However, the unfavorable base may lead to some rise in headline print in the coming months. Energy inflation rose 3.87% amid a sequential rise, driven by higher oil prices.

Core inflation nudges down albeit marginally

Core inflation (ex food, fuel and intoxicants) moderation has been much milder to 5.16% from 5.24% earlier, with health, recreation, education, and transport costs printing higher sequentially. Personal Care and Effects also rose sequentially despite correction in gold and silver prices to print close to 10.6% yoy. Overall, a gradual albeit patchy recovery in economic activity, possibly improving producers' pricing power at the margin, rising input costs, higher administrative fuel costs etc. could weigh on core inflation. However, easing disruptive supply logistics and wide output gap should ensure that the upside is capped on underlying inflation dynamics.

Dec'20 IIP rises 1.0% led by manufacturing

Dec'20 IIP came in better than expected at 1.0% (Emkay: -1.3%, Consensus: -0.1%), implying 1% growth in Q3FY21 -- the first positive quarterly growth in six quarters, reflective of improving capacity utilization and improving economic activity. Industry-wise, pick-up in production activity was led by manufacturing, which reverted to positive growth of 1% (-2.0% earlier) and continued gains in electricity (5.1%), while mining continued to contract, printing -4.8%. Sector-wise, consumer durables grew 4.9%, while non-durables rose 2.0%. Capital goods production rose modestly by 0.6%, while intermediate goods production was up 0.4%.

The MPC to draw comfort, but further conventional easing looks elusive

The Jan'21 CPI inflation surprise would imply that the revised Q4FY21 estimate of RBI at 5.2% could see further downside of 40-50bps. If food inflation normalizes next year to below 3% (from 8%+ in FY21E), the headline inflation could average comfortably below 4.5% in FY22E (vs. ~6.2% in FY21E). However, risks of increasing input costs, higher commodity prices and seasonal upside in food prices and better pricing power remain key risks to inflation. We see core inflation outdoing headline inflation through most part of FY22. While this could worry the policymakers, the policy stance will likely remain accommodative both on rates and liquidity front in CY21.

Please see our model portfolio (Emkay Alpha Portfolio): [Nifty \(Page 5\)](#)

This report is solely produced by Emkay Global. The following person(s) are responsible for the production of the recommendation:

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Exhibit 1: Breakup of CPI and its components

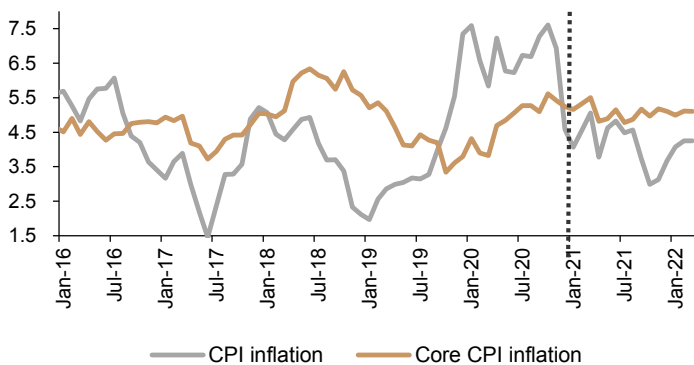
YoY (%)	Wt	Jan-21	Dec-20	Nov-20	Oct-20	Sep-20	Jan-20
Food & Beverages	45.9	2.60	3.87	8.89	10.09	9.80	11.79
Pan, Tobacco and Intoxicants	2.4	10.94	10.68	10.42	10.59	10.69	3.62
Fuel & light	6.8	3.87	2.92	1.62	2.13	2.80	3.66
Housing	10.1	3.25	3.21	3.19	3.27	2.83	4.20
Clothing, Bedding footwear	6.5	2.86	3.49	3.36	3.10	3.04	2.87
Miscellaneous	28.3	6.49	6.60	7.01	6.88	6.89	4.75
CPI	100.0	4.06	4.59	6.93	7.61	7.27	7.59
Core CPI	47.3	5.23	5.24	5.42	5.61	5.09	4.25
CPI ex vegetables	93.1	5.74	6.05	6.25	6.32	6.34	5.08

Source: MOSPI, Emkay Research

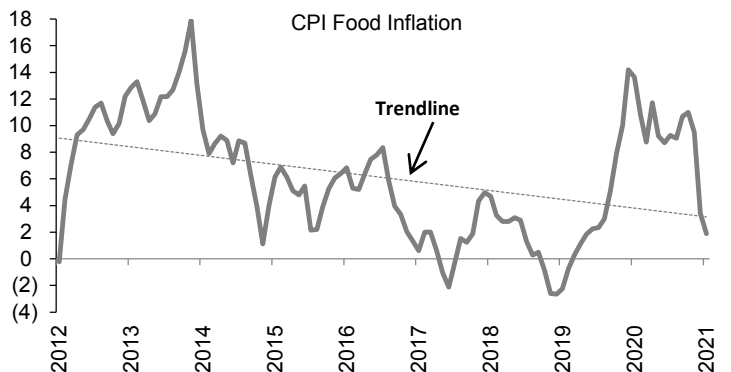
Exhibit 2: Break-up of Food items in CPI

Food Items	Wt	Jan-21	Dec-20	Nov-20	Oct-20	Sep-20	Jan-20
Food	39.1	1.89	3.48	9.50	11.00	10.68	13.63
Cereals	9.7	0.07	0.98	2.46	3.53	4.68	5.25
Meat and Fish	3.6	12.61	15.21	17.03	18.63	17.60	10.50
Egg	0.4	12.92	16.09	20.40	21.74	15.47	10.41
Milk & Products	6.6	2.73	4.05	5.04	5.20	5.64	5.63
Oils and Fats	3.6	19.71	19.95	17.94	15.17	13.44	6.65
Fruits	2.9	4.96	2.75	0.14	0.27	3.21	5.76
Vegetables	6.0	(15.92)	(10.41)	15.54	22.08	20.73	50.19
Pulses	2.4	13.39	15.98	18.05	18.34	14.67	16.71
Sugar	1.4	(0.26)	0.53	0.96	1.49	2.47	4.58
Spices	2.5	9.01	10.29	10.88	11.28	11.73	8.25

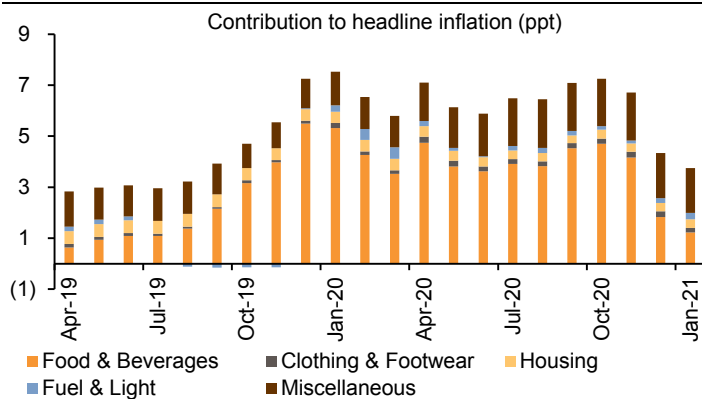
Source: MOSPI, Emkay Research

Exhibit 3: CPI inflation likely to ease further in Q4FY21

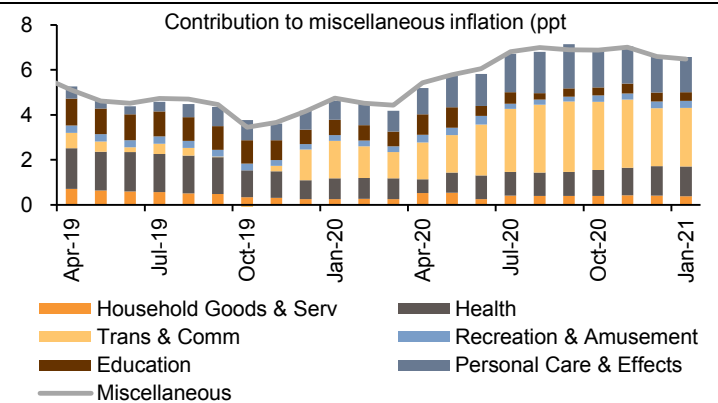
Source: MOSPI, Emkay Research estimates

Exhibit 4: Food inflation on an easing trend

Source: MOSPI, Emkay Research

Exhibit 5: Further easing in inflation in Food & Beverages contributed largely to the decline in headline inflation

Source: MOSPI, Emkay Research

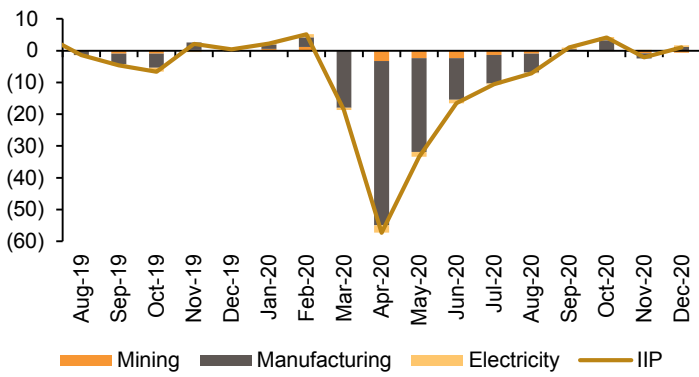
Exhibit 6: Miscellaneous inflation eased in Jan, on account of easing across categories

Source: MOSPI, Emkay Research

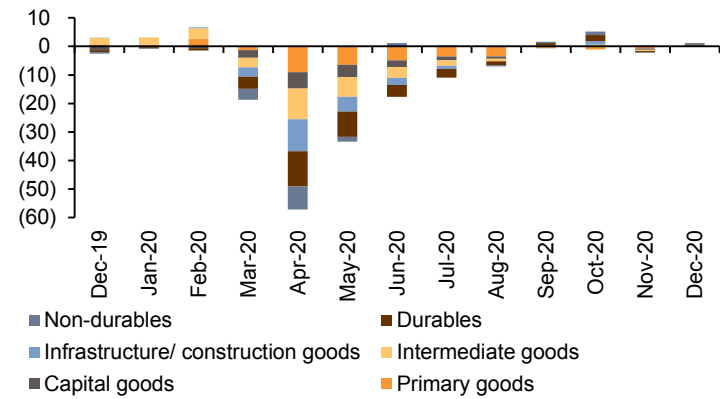
Exhibit 7: Industry and Use-based classification of IIP

YoY (%)	Wt	Dec-20	Nov-20	Dec-19	FY21*	FY20*
Industry based classification						
Mining	14.4	(4.80)	(6.65)	5.68	(11.4)	0.62
Electricity	8.0	5.12	3.50	(0.07)	(3.6)	0.71
Manufacturing	77.6	1.55	(1.99)	(0.29)	(15.1)	0.28
IIP	100.0	1.04	(2.10)	0.45	(13.53)	0.36
Use-based classification						
Primary goods	34.0	(0.31)	(2.33)	2.37	(10.10)	0.37
Capital goods	8.2	0.64	(7.35)	(18.31)	(27.57)	(12.47)
Intermediate goods	17.2	0.41	(2.56)	13.09	(14.97)	10.69
Infrastructure/ construction goods	12.3	0.89	1.71	0.21	(15.20)	(2.12)
Durables	12.8	4.86	(3.43)	(5.56)	(24.69)	(6.46)
Non-durables	15.3	1.96	(1.33)	(3.24)	(24.69)	2.64

Source: MOSPI, Emkay Research | Note * Apr-Dec

Exhibit 8: IIP expanded 1.04% in Dec'20, Manufacturing and Electricity sector contributed positively

Source: MOSPI, Emkay Research

Exhibit 9: Except Primary goods, all other use-based sectors fueled the IIP

Source: MOSPI, Emkay Research

Exhibit 10: Details of manufacturing side of IIP

Items	Wts (%)	YoY (%)				
		Dec-20	Nov-20	Dec-19	FY21*	FY20*
Food products	5.3	(1.4)	8.0	(1.7)	(4.6)	5.7
Beverages	1.0	(9.2)	(16.1)	(4.2)	(35.6)	0.3
Tobacco products	0.8	(2.0)	(13.8)	(6.0)	(20.3)	2.7
Textiles	3.3	(7.2)	(9.8)	2.6	(31.2)	(2.2)
Wearing apparel	1.3	(20.0)	(18.8)	(2.7)	(36.0)	7.5
Leather and related products	0.5	(5.0)	(9.4)	5.6	(24.2)	(0.5)
Wood and products of wood and cork, except furniture; manufacture of articles of straw and plaiting materials	0.2	(5.2)	0.8	19.2	(29.8)	13.3
Paper and paper products	0.9	(17.4)	(22.7)	(7.8)	(33.2)	(12.2)
Printing and reproduction of recorded media	0.7	(27.1)	(19.8)	(6.2)	(31.4)	(5.0)
Coke and refined petroleum products	11.8	(0.7)	(3.2)	1.2	(15.2)	(0.4)
Chemicals and chemical products	7.9	7.2	0.2	0.5	(5.8)	1.0
Pharmaceuticals, medicinal chemical and botanical products	5.0	6.8	(0.8)	(3.6)	2.2	2.6
Rubber and plastics products	2.4	6.3	6.8	(4.7)	(10.2)	(6.4)
Other non-metallic mineral products	4.1	(6.6)	(3.6)	2.1	(18.9)	(1.1)
Basic metals	12.8	4.2	1.2	16.7	(12.8)	13.7
Fabricated metal products, except machinery and equipment	2.7	1.9	2.1	(13.4)	(20.3)	(13.6)
Computer, electronic and optical products	1.6	18.9	(15.4)	(25.0)	(26.7)	(7.8)
Electrical equipment	3.0	8.1	0.1	(3.7)	(20.2)	(1.8)
Machinery and equipment n.e.c.	4.8	4.3	(5.4)	(21.7)	(23.7)	(11.6)
Motor vehicles, trailers and semi-trailers	4.9	5.4	0.9	(11.6)	(30.3)	(16.2)
Other transport equipment	1.8	(8.8)	0.4	7.0	(26.7)	(5.3)
Furniture	0.1	(10.9)	(26.1)	(5.9)	(31.2)	(7.5)
Other manufacturing	0.9	(4.3)	0.6	(1.1)	(33.6)	(9.6)
Manufacturing	77.63	1.6	(1.7)	(0.3)	(13.6)	0.4
Other Important Indicators						
% of manufacturing growing less than last year	100.0	60.9	56.5	65.2	91.3	60.9
% of manufacturing growing less than 5%	100.0	73.9	91.3	82.6	95.7	78.3

Source: MOSPI, Emkay Research | Note*: Apr-Dec

Emkay Alpha Portfolio – Nifty

EAP-Nifty (25 stocks)

Company Name	Nifty Weight	Nifty EAP Weight	OW/UW (%)	OW/UW (bps)
Agri Input & Chemicals	0.46	0.00	-100%	-46
UPL	0.46	0.00	-100%	-46
Auto & Auto Ancillaries	5.92	9.59	62%	366
Bajaj Auto	0.83	1.78	114%	95
Eicher Motors	0.60	1.30	116%	69
Hero Motocorp	0.70	0.95	35%	24
Mahindra & Mahindra	1.34	0.00	-100%	-134
Maruti Suzuki India	1.56	2.77	78%	121
Tata Motors	0.89	2.79	214%	190
BFSI-Banks	27.49	36.93	34%	944
Axis Bank	2.81	6.70	139%	390
Bandhan Bank	0.00	2.41	NA	241
HDFC Bank	10.46	8.99	-14%	-147
ICICI Bank	6.66	8.59	29%	193
Indusind Bank	0.89	3.84	333%	296
Kotak Mahindra Bank	4.39	0.00	-100%	-439
State Bank of India	2.29	6.39	179%	411
BFSI-Insurance	1.40	2.00	42%	59
HDFC Life	0.86	0.00	-100%	-86
SBI Life	0.54	2.00	269%	145
BFSI-NBFCs	10.79	9.47	-12%	-131
Bajaj Finserv	0.94	0.00	-100%	-94
Bajaj Finance	2.26	0.00	-100%	-226
Cholamandalam Investment	0.00	1.93	NA	193
HDFC	7.59	7.54	-1%	-4
Cement & Building Materials	2.45	4.46	82%	201
Grasim Industries	0.73	2.27	210%	154
Shree Cements	0.58	0.00	-100%	-58
Ultratech Cement	1.13	2.18	92%	105
Consumer Goods & Retail	10.39	6.18	-41%	-421
Asian Paints	1.73	0.00	-100%	-173
Britannia Industries	0.62	0.39	-37%	-23
Hindustan Unilever	3.09	0.00	-100%	-309
ITC	3.02	1.54	-49%	-149
Nestle India	0.95	0.00	-100%	-95
Titan Company	0.97	2.40	146%	142
United Breweries	0.00	1.85	NA	185
Engineering & Capital Goods	2.83	1.24	-56%	-159
Larsen & Toubro	2.83	1.24	-56%	-159
Information Technology	16.01	12.28	-23%	-373
HCL Tech	1.61	3.07	91%	146
Infosys	7.32	6.81	-7%	-51
TCS	5.15	0.00	-100%	-515
Tech Mahindra	0.93	2.40	158%	147
Wipro	0.99	0.00	-100%	-99
Metals & Mining	2.50	3.23	29%	72
Coal India	0.44	0.69	56%	25
Hindalco	0.66	1.23	87%	57
JSW Steel	0.60	0.00	-100%	-60
Tata Steel	0.80	1.31	63%	51
Oil & Gas	11.99	3.08	-74%	-891
BPCL	0.52	2.53	389%	201
GAIL	0.39	0.00	-100%	-39
Indian Oil	0.38	0.00	-100%	-38
ONGC	0.55	0.55	0%	0
Reliance Industries	10.16	0.00	-100%	-1016
Pharmaceuticals	3.36	6.57	96%	322
Cadila Healthcare	0.00	1.94	NA	194
Cipla	0.67	1.92	187%	125
Divi's Lab	0.73	0.00	-100%	-73
Dr. Reddy's Lab	0.90	1.91	114%	102
Sun Pharma	1.06	0.80	-24%	-26
Ports & Logistics	0.66	0.00	-100%	-66
Adani Ports	0.66	0.00	-100%	-66
Power	1.56	1.82	17%	26
NTPC	0.72	0.72	0%	0
Power Grid Corporation	0.84	1.10	31%	26
Telecommunications	2.20	3.16	44%	96
Bharti Airtel	2.20	3.16	44%	96
Cash		0.00		
Nifty	100.00	100.00		

Source: Emkay Research; Note: *We have internally capped single stock exposure to 10% in our EAP

Sector portfolio NAV

	Base					Latest
	1-Apr-19	13-Feb-20	13-Aug-20	12-Nov-20	12-Jan-21	11-Feb-21
EAP - Nifty	100.0	104.1	94.4	102.3	119.1	125.0
Nifty50	100.0	104.3	96.8	108.8	124.8	130.0

*Performance measurement base date 1st April 2019

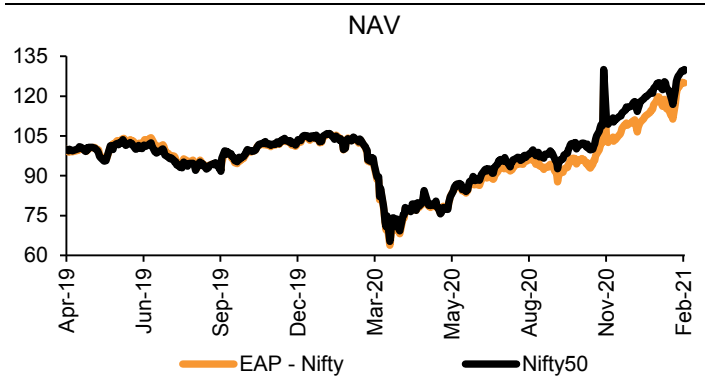
Source: Emkay Research

Price Performance (%)

	1m	3m	6m	12m
EAP - Nifty	5.0%	22.1%	32.4%	20.1%
Nifty50	4.2%	19.6%	34.3%	24.6%

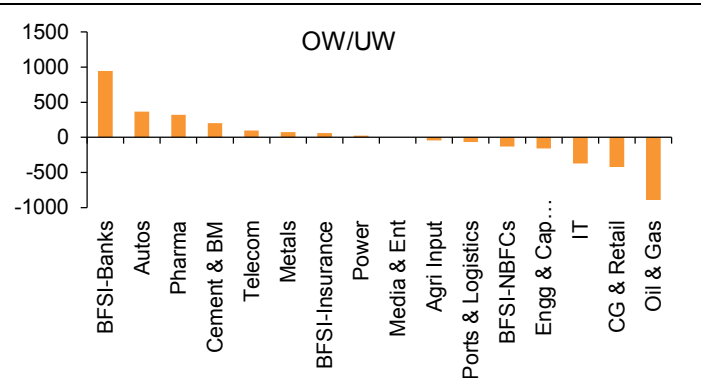
Source: Emkay Research

NAV chart



Source: Emkay Research

Sector OW/UW



Source: Emkay Research

Please see our model portfolio (Emkay Alpha Portfolio): [SMID](#)

“Emkay Alpha Portfolio – SMID and Nifty are a supporting document to the Emkay Alpha Portfolios Report and is updated on regular intervals”

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BUY	Over 15%
HOLD	Between -5% to 15%
SELL	Below -5%

Completed Date: 13 Feb 2021 02:17:54 (SGT)
Dissemination Date: 13 Feb 2021 02:18:54 (SGT)

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