Research

Growth-inflation math turns healthier

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CPI down further to 4.3% as food inflation continues to dip, core ticks up

Consumer price index (CPI)-based inflation came in at 4.3% in March, after a 60 basis points (bps) fall to 4.4% in February. Although food inflation rate fell more – by 40 bps over February – and overall fuel inflation decelerated by 100 bps, core inflation edged up.

Inflation in housing, the category that had rapidly been pushing up core inflation in the recent past, stood steady for the third month in a row even as other core inflation categories ticked up.

For full fiscal 2018, CPI inflation averaged 90 bps lower at 3.6% compared with 4.5% in fiscal 2017. Most of the fall was on account of food inflation, which fell 240 bps, while fuel inflation rose 260 bps. Core inflation was also moderately lower, falling 30 bps.

However, inflation pressures are beginning to rear up. Global crude oil prices have continued to rise and were nearly 24% higher on-year in March.

In fiscal 2019, CRISIL expects crude oil prices to rise another 13% on average. Similarly, metal prices are also firmer. Given improving domestic demand conditions, manufacturers are likely to pass on higher input prices to consumers, which will show up in core inflation.

Similarly, there could also be pressure on food inflation if elements of the minimum support price (MSP) announcement, such as setting it at 1.5 times the cost of production, extension of MSP to all kharif crops, and assuring at least MSP is paid to all farmers, together with rise in import duties are implemented.

For next fiscal, CRISIL expects CPI inflation to perk up but stay benign overall and within the Monetary Policy Committee's (MPC) projected trajectory. The MPC expects inflation to average ~4.7% in fiscal 2019 with the expectation that it will significantly moderate in the second half. Yet, given upside pressures, the MPC will stay vigilant on the evolving inflation scenario.

CRISIL expects the repo rate to remain unchanged over the next six months unless upside risks to the MPC's inflation forecast materialise. We foresee CPI inflation averaging 4.6% next fiscal. The pick-up will be due to rising consumption demand, impact of house rent allowance revisions on housing inflation, and higher global crude oil prices. Food inflation will have a softening bias and is likely to stay relatively soft given the expectation of a normal monsoon. But aggressive implementation of announced MSP measures could create an upside.

Data snapshot

- Food inflation declined to 2.8% from 3.3%. The fall was led by a continued decline in inflation in milk and products (3.5% from 3.8%), vegetables (11.7% from 17.6%), meat and fish (3.2% from 3.4%), and continuing deflation in pulses (at -13.4% from -17.6%). Inflation in cereals reversed its declining trend and rose after nearly a year (to 2.2% from 2.1%).
- Fuel inflation, calculated by adding petrol, diesel, fuel and light components, eased to 5% from 6%. In fuel and light, inflation continued to fall sharply, declining to 5.7% from 6.9%, while inflation in petrol and diesel eased to 2.3% after having risen to 2.7% in February. During March, prices for the Indian crude oil basket were fairly stable compared to the previous month, at an average $63.8 per barrel. Within the fuel and light category, inflation in liquefied petroleum gas (LPG) saw a steep decline.
- Core inflation (CPI excluding food, fuel and light, petrol and diesel) saw a small uptick to 5.2% from 5.1%. Housing inflation, which had been rising since July, stood unchanged for the third month in a row, at 8.3%. But, excluding the housing index, the rest of the core index rose to 4.5% in March from 4.3% in the previous month. Inflation rose in nearly all core sectors and was especially higher in education, personal care and effects and transport (in part reflecting pass-through of higher fuel prices).

IIP shows healthy growth, helped by low base

The Index of Industrial Production (IIP) delivered a healthy 7.1% on-year in February, just a tad below 7.4% growth (revised up from 7.1% earlier) in January. Low-base effect of last year also helped here. That said, the fourth straight month of 7% plus growth was supported largely by the manufacturing sector as the electricity sector growth slowed and mining sector growth declined.

- Industrial activity maintained positive momentum for the fourth consecutive month in February. IIP growth stood at 7.1% on-year in February compared with 7.4% in January. Manufacturing sector (the largest contributor to IIP, having 77.6% weight) supported the overall growth. It grew 8.7% in February, versus 8.6% in January. Electricity growth plummeted to 4.5% (from 7.6%). Mining sector, after having displayed weak growth in past few months, turned into negative territory (-0.3%).
- Within manufacturing, 15 out of 23 industry groups showed positive growth on an annual basis. Sectors which displayed high positive growth were, 'other transport equipment', growing by 32.0%, followed by 'machinery and equipment', which was up 26.9%, and 'motor vehicles, trailers and semi-trailers', which clocked a growth rate of 19.9%. Sectors that displayed high negative growth were, 'other manufacturing' (-27.3%), followed by ''Printing and reproduction of recorded media' (-9.4%) and 'rubber and plastics products' (-8.2%). From the end-use perspective, growth in the industrial and investment-oriented manufacturing sectors, at 4.5%, outpaced the consumer-oriented sectors (accounting for 37% of the manufacturing sector IIP) growth, which came in at 2.5%.

According to the use-based classification, infrastructure and construction goods, growing at 12.6% continued its healthy pace. Capital goods grew by a strong 20.0%, albeit on a negative base (-2.4%) of last year. Still a double digit growth indicates some pick-up in the investment activity. Within consumer goods category, the non-durables registered an impressive 7.4% growth, despite a high base of last year. Durables held steady, growing by 7.9%.

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