

Macroeconomics | **First cut**

Inflation rises anew, IIP trudges up, too

February 2022

CPI inflation reaches RBI's tolerance limit, WPI stays in double-digits

Inflation based on consumer price index (CPI) rose for the fourth consecutive month to 6% in January compared with 5.7% previous month. Headline inflation is now at the upper limit of Reserve Bank of India's target range of 2-6%. A 'base effect driven' sharp rise in food inflation drove the rise in CPI, even as core¹ inflation remained elevated. Meanwhile, wholesale price index-linked (WPI) inflation, while remaining in double digits for 10th consecutive month, moderated slightly to 13% in January compared with 13.6% previous month.

Food CPI inflation has risen significantly over the past three months as impact from the favourable base has worn off. Meanwhile, core CPI inflation remains sticky at 6%. With producers facing double-digit WPI inflation, we expect it to get passed on to retail prices. The pass-through can increase in the next fiscal as domestic demand strengthens. In addition, surging crude oil prices have added to the upside risks. Due to these factors, we expect CPI inflation to moderate only slightly to 5.2% in fiscal 2023 compared with an expected 5.5% in the current fiscal.

Inflation trends in January: highlights

- CPI inflation rose to 6.0% on-year in January from 5.7% previous month and 4.1% in January 2021
 - Sequentially, CPI grew 0.5% on-month² in January, similar to the rate seen in past 2 months
 - Food CPI inflation rose to 5.4% on-year from 4% previous month and 2% in January 2021
 - Fuel CPI³ inflation moderated to 9.3% from 11% previous month, but higher than 3.9% in January 2021
 - Core CPI inflation was slightly lower at 6% compared with 6.1% previous month, but higher than 5.5% in January 2021
 - Rural CPI inflation was higher at 6.1% in January compared with 5.4% previous month. Urban CPI inflation was stable at 5.9% as previous month
 - WPI inflation moderated to 13% in January from 13.6% previous month, but higher than 2.5% in January 2021
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¹ CPI excluding food and beverages and fuel and light

² All on-month growth numbers are seasonally adjusted

³ CPI fuel and light

How key items saw inflation move

- **Food and beverages** surged to 5.6% in January, compared with 4.5% previous month
 - Inflation rose for major food items such as cereals (3.4% in January versus 2.6%), and vegetables (5.2% vs -3%)
 - Protein items also saw a rise, such as pulses (3% vs 2.5%), milk products (4.1% vs 3.8%), and eggs, meat and fish (5.1% vs 4.3%)
 - Inflation moderated for edible oils (18.7% vs 24.3%), fruits (2.3% vs 3.5%), sugar and confectionery (5.4% vs 5.6%), prepared meals, snacks and sweets (6.4% vs 6.6%) and non-alcoholic beverages (6.6% vs 8.2%)
- **Fuel inflation** fell below 10% for the first time in nine months Declining electricity prices, coupled with slowing growth in liquefied petroleum gas (LPG) and kerosene prices, contributed to the moderation.
- **Core inflation** stayed little changed 6% compared with 6.1% previous month.
 - Moderation was driven by health services (6.9% vs 7.1%) and pan, tobacco and intoxicants (2.5% vs 3.2%)
 - Transport and communication inflation reduced slightly (9.4% vs 9.7%). While Brent crude oil prices surged 15% on-month to \$85.5 per barrel average in January, this was partially offset by lower excise duties on petrol and diesel in force since November
 - Other items that saw a slight decline in inflation were personal care and effects (3.5% vs 3.7%), housing (3.5% vs 3.6%), and recreation and amusement (7% vs 7.4%). Education inflation was stable at 3.3%
 - However, inflation surged for clothing and footwear (8.8% vs 8.3%) and household goods and services (7.1% vs 6.8%). Both these categories have seen consistent rise in inflation in the past few months, indicating producers passing through cost pressures

Urban poor remain worst affected

The burden of inflation varies across different income groups, as the share of spending on food, fuel and core categories differs across classes. Using the National Sample Survey Organisation data, we estimated the average expenditure patterns across three broad income groups (bottom 20%, middle 60%, and upper 20% of population) and map them with the inflation trends⁴.

Based on this, we find that urban poor (bottom 20%) faced highest inflation in January. The effective inflation rate for urban poor rose to 6.3% in January from 6.2% previous month. For urban rich (top 20%) it stayed stable at 5.9% as previous month.

Inflation is also catching up fast in rural areas. Here it is the rich that face highest inflation (6.2% in January vs 5.5% previous month), while inflation for poorest 20% is slightly lower (6.1% vs 5.3%).

Food inflation was higher in urban areas at 5.9% in January compared with 5.2% in rural. Given food occupies the highest weight in consumption basket of the poorest 20%, urban poor are suffering to a greater extent than their rural counterparts.

CPI inflation across different income classes* (on-year, in %)

Income segment	January 2022	
	Rural	Urban
Top 20%	6.2	5.9
Middle 60%	6.1	6.1
Bottom 20%	6.1	6.3

* With share of commodity groups in expenditure basket of respective income class as weights
Source: NSSO, National Statistics Office (NSO), CEIC, CRISIL

⁴ For detailed methodology and findings, refer to CRISIL Quickenomics: *Same inflation, different burdens by income* (October 2021)

Outlook

In this fiscal so far (April 2021-January 2022), CPI inflation has averaged 5.3%, compared with 6.4% in same period last year. We expect the headline number to stay around these levels next fiscal, too.

While lower excise duties on petrol and diesel relative to last year will help cap the rise in fuel inflation, the outlook on international crude prices has worsened considerably on account of rising geopolitical tensions. CRISIL Research expects Brent crude prices to average \$80-85 per barrel in calendar 2022, compared with \$70.4 per barrel in 2021.

The second upside risk might build on core CPI inflation. This fiscal has seen input cost pressures rising significantly for producers — as evident in WPI inflation staying in double digits throughout this fiscal. While firms were unable to fully pass on cost pressures as demand recovery was weak and uneven, we believe it can increase next fiscal as recovery in domestic demand strengthens and becomes more broad-based.

Due to these factors, we expect CPI inflation to moderate only slightly to 5.2% in fiscal 2023 compared with an expected 5.5% in the current fiscal.

Industrial production struggles in December

The Index of Industrial Production (IIP) printed at 138.0 in December, representing 0.4% on-year growth, down from 1.3% growth in November.

While there was an improvement in the momentum i.e., sequential or on-month movement of industrial activity in December — likely reflecting some easing of raw material supply disruption — it was not very robust. Softness in both consumption and investment demand kept industrial, especially manufacturing, growth subdued.

Highlights

- The slowdown in on-year IIP growth to 0.4% in December, from 1.3% in November, reflected weaker manufacturing activity which, at 77.6%, is the largest component of IIP. To be sure, the slowdown is also the result of a high base (as IIP had risen in Dec 20 over Nov 20).
 - While manufacturing IIP declined 0.1% on-year in December, mining (14.4% weight) and electricity (7.9% weight) grew 2.6% and 2.8%, respectively, containing the decline in overall IIP growth. The weakness in manufacturing growth was in sync with the Purchasing Manager's Index, which eased to 55.5 in December from November's 57.6. That said, strong export performance did some counter-balancing.
 - Of the twenty three manufacturing categories, 10 saw an annual decline in activity; together these represent 42.5% of the manufacturing group. The five biggest declines were observed in *electrical equipment* (-15.6% on-year), followed by *machinery and equipment* (-13.0%), *other transport equipment* (-11.3%), *rubber and plastic products* (-9.7%) and *wood products* (-9.3%).
 - The use-based classification of IIP suggests weakness in both investment and consumption demand. Declining 4.6% on-year in December, *capital goods* registered negative growth for the third consecutive month. At the same time, *consumer durable* and *non-durables* registered -2.7% and -0.6% on-year growth respectively. Growth in *infrastructure and construction goods*, while positive, declined for the fourth consecutive month to 1.7% on-year in December, likely reflecting slower government capex activity in the third quarter.
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Outlook

Industrial growth fell in January due to rising omicron cases. This could also have slowed demand a bit, and caused some logistical disruptions. Beyond that, going ahead, industrial activity is expected to gather pace for two reasons. One, raw material shortages are slowly getting addressed, and consumption and investment demand are expected to gradually pick up. Two, the government is expected to step up capex, which should give a lift to the manufacturing of infrastructure-related products and services. That said, high commodity prices and their impact on manufacturing activity will remain the monitorables in the road ahead.

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