Macroeconomics | First cut

Inflation inches up, IIP slides

January 2024

Food drives up headline inflation; core dips below 4%

Inflation based on the Consumer Price Index (CPI) edged up to 5.7% in December from 5.6% in November. Food inflation, accentuated by low-base effect rose to 9.5% from 8.7%. The drivers were vegetables and fruits, and pulses and sugar. Inflation in cereals and spices continues to be elevated.

The data for December reveals two interesting facets.

One, although food inflation rose to a 4-month high, sequentially and on a seasonally adjusted basis there has been a softening. The good part is, despite being elevated, foodgrain inflation (cereals *plus* pulses) at 12.1% is marginally lower for the second month in a row. Much of this could be attributed to government measures to ramp up supplies along with the impact of kharif harvest entering the markets.

Two, core inflation not only fell below 4% (printing 3.8%) but dropped to its lowest since January 2020. Falling fuel inflation, supported by government measures to reduce cooking gas prices has helped but so has easing global raw material prices.

In the coming months, some more softening in food inflation could be expected supported by government interventions and kharif harvest supplies. But lower rabi sowing is a worry. Besides, the increased frequency of climate events and their impact on India's agriculture output bears watching.

With this background, CRISIL expects the Reserve Bank of India (RBI) to hold rates steady at its February meeting. On average, we expect the CPI inflation this fiscal to average 5.5% and see some further softening in the next. Easing input cost pressures on manufacturers and moderating domestic demand are expected to keep core inflation in check. That said, several risks to our forecast remain. Tight global food supplies, low rabi sowing and climate risks threaten food inflation. Any further escalation in the Middle East conflict could lift oil, commodity and other logistics costs for manufacturers.

Key data points in December

- CPI inflation inched up to 5.7% from 5.6% previous month
- Food inflation accelerated to 9.5% from 8.7% driven by base effect in vegetables
- Fuel[1] inflation declined to -1% from -0.8%
- Core CPI[2] inflation eased to 3.8% from 4.1%

[1] Refers to CPI fuel and light.
[2] CPI excluding food and beverages, and fuel and light.

Food inflation accelerates partly on account of a low base

- Vegetable inflation accelerated to 27.6% in December from 17.7% in November on account of a low-base effect even as vegetable prices cooled on-month. Inflation in TOP (tomato, onion, potato) vegetables saw a smaller increase compared to non-TOP vegetable inflation. The former rose to 28.3% from 24% because of tomatoes (33.5% vs 11.3%) and potatoes (-8.8% vs -15.6%). Inflation in onions eased to 74.2% from 86.3% in November owing to fresh arrivals in the market and government action. Inflation in non-TOP vegetables surged to 27.2% from 13.6% in November. Inflation accelerated in several vegetables such as garlic, leafy vegetables, brinjal, cauliflower and green chillies
- Inflation in cereals hit a 16-month low of 9.9% from 10.3% in November. While the reading accelerated for rice from non-PDS sources (12.3% vs 11.8%), it slowed for non-PDS wheat (4.7% vs 6.4%)
- Pulses inflation remained high at 20.7%, hardening marginally from 20.3% in November. The gauge remained high and unchanged in arhar (42.4%) while it eased marginally in moong (13.1% vs 13.3%). While urad saw an acceleration (13.3% vs 11.8%), other major protein categories saw a deceleration — milk 5.1% vs 5.7%, meat and fish 1.1% vs 2.2% and eggs 4.4% vs 5.9%
- Inflation in spices eased to 19.7% from 21.5%, falling below 20% for the first time since June. The easing was led by jeera (114.3% vs 122.6%), dry chillies (8.2% vs 10.5%) and dhania (-4.4% vs -3.7%)
- Sugar inflation quickened for the ninth consecutive month to a three-year high of 7.1% from 6.6% in November. Global prices also remained high

Fuel inflation enter a deeper negative zone

- Fuel inflation remained negative for the third straight month in December, declining to -1% from -0.8% in November. LPG prices fell 13% on-year compared with 12.8% on-year in November
- Inflation in kerosene eased in both PDS (-19.5% vs -15.3%) and non-PDS sources (14.7% vs 17.6%)
- Electricity inflation was unchanged at a high 10.5%

Core inflation cools

- Core inflation continued to decline, easing to 3.8% in December (vs 4.1%), the lowest since January 2020
- Inflation cooled in some essential categories including health (5.1% vs 5.5%) and education (4.8% vs 5%) while it was unchanged in housing (3.6%)
- Other items that saw deceleration were clothing and footwear (3.6% vs 3.9%), personal care and effects (7.3% vs 7.8%), and transport and communication (2% vs 2.1%)
- Services inflation softened to 3.7% from 3.9% led by easing of inflation in rent (3.5% vs 3.6%) and school and college fees (5% vs 5.2%)

Inflation more burdensome for the poorest in urban and rural areas, in December

The effect of inflation varies with income groups as the share of spending on food, fuel and core categories differs across classes. Essential items, such as food and fuel, occupy a greater share in the consumption basket of lower income classes.

Given below is the impact of inflation on different income groups in urban and rural areas in December:

- The inflation burden on the poorest segment in both urban and rural areas was heavier than their richer counterparts as food was the key component in the spiral during the month
- The top segment in urban areas faced the lowest burden since almost two-thirds of their consumption basket consist of non-food items

CPI inflation across income classes (% on-year)

Income segment	December 2023	
	Rural	Urban
Top 20%	5.7	5.4
Middle 60%	6.0	6.0
Bottom 20%	6.1	6.3

Note: Using data from the National Sample Survey Organisation (NSSO), CRISIL has mapped expenditure baskets of three broad income groups – bottom 20%, middle 60% and upper 20% of the population – with December inflation trends. The table above presents the average inflation faced by each income class.
Source: NSSO, National Statistical Office, CEIC, CRISIL

Industrial activity slows sharply

The Index of Industrial Production (IIP) slowed sharply to 2.4% on-year in November from 11.6% in October. Manufacturing IIP slid while electricity and mining orders slowed. As per the use-based classification, production declined on-year in consumer and capital goods, whereas slowed considerably in infrastructure and construction goods.

While a high-base effect pulled down the on-year headline IIP print, sequential, seasonally adjusted data was interesting. There was an on-month slowdown in mining and electricity sectors and from a use-based perspective in capital, intermediate and infrastructure/construction goods segment. But the manufacturing sector, and from a use-based angle, consumer goods and consumer non-durables goods segment saw mild upticks reflecting the positive impact of the festive season.

However, the months ahead are expected to see some sluggishness in industrial activity. The latest print of PMI for manufacturing points towards some deceleration in December, with the indicators down at 54.9 from 56 in November.

The National Statistical Office's 'first advance estimate' of GDP for this fiscal is a strong 7.3%, but this implies a slower 6.9% growth in the second half, compared with 7.7% in the first half. Manufacturing is expected to hard-brake to 3.8% vs 9.3% on-year.

So far, strong investment and construction activity have driven the growth. However, IIP data for November indicates these sectors are losing steam. How the government alters its capex to boost growth in the upcoming budget will be a key monitorable. As the government progresses on its fiscal consolidation path and moderates its capex spend, private investments will need to step up for sustaining investment momentum.

Rural demand may remain weak this fiscal with agriculture and allied growth estimated to have slowed sharply to 1.8% from 4.4% last fiscal. After the kharif crop was impacted by an uneven monsoon, rabi sowing is also lagging owing to lower reservoir levels and delayed sowing.

Lagged transmission of the RBI's rate hikes and the central bank's recent regulatory measures that clamped down on risky lending are expected to somewhat moderate credit growth and domestic demand going forward.

Slowing growth in India's major export markets, especially the United States, is likely to weigh on the export demand in the remainder of this fiscal.

S&P Global expects the US growth to slow to 1.5% in 2024 (vs a better-than-expected 2.4% in 2023) as monetary policy transmission picks up. A flareup in the Middle East conflict has revived risks of disruptions in global trade and raised concerns of a rise in shipping costs.

All these factors indicate slower industrial growth ahead.

Data highlights

- IIP growth slowed sharply to 2.4% on-year in November from 11.6% in the previous month; on-month the index shrank 0.6% after seasonal adjustments
- All major sectors witnessed a sharp decline in growth, with manufacturing recording the lowest growth (1.2% on-year in November vs 10.2% previous month), followed by electricity (5.8% vs 20.4%) and mining (6.8% vs 13.1%). The sharp extent of deceleration came on an elevated base from the previous year
- Among the sub-sectors of manufacturing, output shrank the most in consumer durables (-5.4% on-year), followed by consumer non-durables (-3.6%) and capital goods (-1.1%). Intermediate goods and infrastructure and construction goods recorded on-year growth in output (3.5% and 1.5%, respectively), albeit slower than October. Seasonally adjusted data, however, shows better on-month performance in consumer goods vs investment goods.

Festive demand provides some sequential uptick to manufacturing

- The growth in IIP for electricity IIP declined sharply to 5.8% on-year in November, from 20.4% in October. This is the slowest pace of expansion since June and somewhat reflective of sluggish industrial activity
- Interestingly, the IIP growth for both consumer durables and non-durables was negative on-year in November (at -5.4% and -3.6%, respectively), but sequentially there was a mild uptick when adjusted for seasonal factors. Festive demand in November would have supported this segment
  - From an on-year perspective, the dip in manufacturing growth was driven by heavy-weights like food products and textiles (-3.7% each), chemical products (-3.9%), base metals (7.2%) and automobiles (9.2%). Several export-oriented sectors recorded a decline in line with slowing exports. In November, India's merchandise exports fell by 2.8% on-year from 6.1% growth in October.
- Capital goods IIP turned negative in November (-1.1% vs 21.3%). Growth remained positive for primary goods (8.4%) and intermediate goods (3.5%) though the pace was slower than the previous month (11.4% and 9.4% respectively)
- Slower IIP in infrastructure and construction goods (1.5% vs 11.3%) and decline in the above industrial sectors suggest investment momentum could be decelerating

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