Macroeconomics | First cut

Food inflation offsets core descent, IIP retracts a touch

March 2024

Pricey food leads to sticky headline inflation

Headline consumer price inflation (CPI) stayed put at 5.1% than decline in February as the food gauge surged higher. Core inflation — down to a 52-month low of 3.4% — could not entirely offset the pressure from food.

Food inflation accelerated to 8.7% from 8.3% in January. While the kharif harvest has been helpful in softening foodgrain inflation, vegetables continue to play the spoilsport. Pressure from them continues to be broad-based: inflation in the TOP (tomato, onion, potato) category rose to 22.7% from 18.1% last month, while the non-TOP category inflation rose to 34% from 32.2%. Thankfully, disinflation in the non-food component of CPI (at 2.9% in February from 3.1% previous month) prevented the headline print from rising.

Softer core and non-food inflation continue to offer relief as the food barometer edges up. This, along with the government's pursuit of fiscal consolidation, should comfort the Monetary Policy Committee (MPC) of the Reserve Bank of India and create grounds for rate cuts in the months to come.

But persistently high food inflation can delay the move till there is clarity on rabi output (harvested in April and May) and the signal on forthcoming southwest monsoons by June.

We expect CPI inflation to continue to soften next fiscal to 4.5% from an estimated 5.5% this fiscal, supported by the assumption of a normal monsoon, softer domestic demand, and benign global oil prices.

Given all this, the MPC might hold the repo rate steady till at least its June policy review.

Key data points in February

- CPI inflation remained steady at 5.1%
- Food inflation ticked up to 8.7% from 8.3%, driven by vegetables and meat
- Fuel[1] inflation declined slightly to -0.8% from -0.6%
- Core CPI[2] inflation eased to 3.4% from 3.5%

Food inflation rises

After just one month of easing, food inflation accelerated to 8.7% from 8.3%, and has remained above the 6% mark since July. The rise was driven by surging inflation vegetables and meat and fish, and the slower pace of deflation in edible oils. Pulses inflation remained high at ~19% but eased compared with the previous month.

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

- Inflation in vegetables rose to 30.2% in February from 27.1% in January, and hardened in several key vegetables including tomatoes (42% vs 38.3%), garlic (264.3% vs 223.6%), cabbage (30.4% vs 21.8%), and cauliflower (26% vs 22.3%). Potato inflation turned positive after 12 straight months of deflation, due to base effect (12.4% vs -1.9%). That said, inflation cooled in onion (22.1% vs 29.6%) and leafy vegetables (12.7% vs 14.2%).
- Foodgrain inflation eased 30 basis points (bps) to 9.8% in February, and moderated in both cereals (7.6% vs 7.8%) and pulses (18.9% vs 19.5%). Cooling inflation in *arhar* (36.8% vs 39.1%) and *moong* (12% vs 12.6%) led to the moderation in pulses inflation.
- Inflation surged in meat and fish to 5.2% from 1.2% previous month due to rising inflation in chicken (5.7% vs -4%). Inflation in eggs also rose sharply, almost doubling to 10.7% vs 5.6%.
- Edible oil prices continued to fall on-year (-14%), but the pace of the decline slowed compared to the previous month (-15%).
- Spices inflation decelerated to 13.5% from 16.3% in January and 19.7% in December.

Fuel inflation remains negative

- Fuel prices fell 0.8% on-year in February compared to a 0.6% fall in the previous month. Fuel inflation has been negative for the last six months due to the central government's subsidy on cooking gas. It is likely to come down further due to recent cut in cooking gas prices.
- The fast decline in fuel prices was due to softer inflation in dung cake (5.4% vs 6.2%) and kerosene by non-PDS sources (11.1% vs 11.5%).
- Inflation remained unchanged in electricity (10.4%) and LPG (-13.3%) while it hardened in fire and woodchips (3% vs 2.7%).

Broad-based easing in core inflation

- Core inflation inched down to 3.4% from 3.5% previous month as inflation eased in all major core inflation categories.
- Inflation eased a tad in education to 4.8% from 4.9% while other essentials categories such as health (4.5% vs 4.9%) and housing (2.9% vs 3.2%) saw a sharper fall in inflation rate.
- Core goods[3] and services inflation softened 20 bps each to 2.5% and 3.3%, respectively. Inflation moderated in rent (2.8% vs 3.1%) while it was unchanged in tuition at 5.1%.

[3] Refers to CPI excluding services and food

Urban residents across income segments saw their inflation burden ease mildly

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.

Rural inflation remained unchanged at 5.3% while urban inflation inched down to 4.8% from 4.9%. Urban core inflation eased to an all-time low of 3.3% and hence inflation burden eased across income classes in urban areas despite surging food inflation (9.2%). The rural poor saw a rise in their inflation burden as rural food inflation rose to 8.2% from 7.9%.

CPI inflation across income classes (% on-year)

Income segment	February 2024		January 2024	
	Rural	Urban	Rural	Urban
Top 20%	5.1	4.7	5.1	4.9
Middle 60%	5.4	5.3	5.4	5.4
Bottom 20%	5.5	5.5	5.4	5.6

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 February inflation trends. The table above presents the average inflation faced by each income class.
Source: NSSO, National Statistical Office, CEIC, CRISIL

IIP slows on waning capex support

The Index of Industrial Production (IIP) decreased to 3.8% on-year in January from 4.2% in December, driven by mixed performance in both consumption and industrial sectors. Meanwhile, December reading was revised up from the previous estimate of 3.8%. Growth in manufacturing IIP slowed down, while that in electricity and mining IIP picked up.

IIP has been quite volatile, displaying mixed performances across consumption, industrial and export-oriented sectors. In January, consumer essentials and infrastructure and construction goods drove the slowdown.

On average, IIP growth has slowed down in the second half of this fiscal. This is consistent with official second advance estimates that bake in slower gross value added (GVA) growth in the second half of this fiscal.

While investments have driven the surge in GDP growth in major part of this fiscal, they could lose some steam as the government pursues fiscal consolidation next year. The full transmission of the rate hikes and regulatory measures of the MPC on credit growth are expected to moderate domestic demand. Uneven global growth could also restrict export recovery, with risks persisting for trade around the Middle East.

Consequently, we expect GDP growth to slow to 6.8% next fiscal from 7.6% in this fiscal.

Data highlights

- IIP growth slowed to 3.8% on-year in January from 4.2% previous month. The index grew 0.6% on-month after seasonal adjustments.
- Growth in manufacturing slowed (3.2% on-year in January vs 4.5% previous month), while that in electricity (5.6% vs 1.2%) and mining (5.9% vs 5.2%) accelerated.
- Manufacturing slowdown was driven by consumer non-durables (-0.3% vs 2.4%), primary goods (2.9% vs 4.8%) and infrastructure and construction goods (4.6% vs 5.1%). On the other hand, growth in consumer durables (10.9% vs 5.3%), intermediate goods (4.8% vs 3.9%) and capital goods (4.1% vs 3.6%) picked up.

Manufacturing slows

- The slowdown in manufacturing IIP (3.2% on-year in January vs 4.5% previous month) was led by computer and electronic products (-11.9% vs -5.2%), petroleum products (-2.2% vs 6.9%), chemicals (-1.5% vs-0.2%) and pharmaceutical products (0.0% vs 3.0%).
- The performance of export-oriented sectors was mixed, with contraction in output of petroleum products and chemicals; while output growth picked up for machinery and textiles.
- Output of petroleum products contracted In January even as exports of the same rebounded on an on-year basis. This was a result of the price effect due to a sequential uptick in crude oil prices in January.

Consumer and industrial goods record mixed performance

- As was the case in December, on-year growth picked up sharply for consumer durables, whose output grew at 10.9% in January (versus 5.3% in December). This was driven by a sharp acceleration in automobile (18.0% in January compared with 9.2% in the previous month) and furniture (15.1% vs -1.0%) output.
- However, output in the consumer non-durables segment contracted (-0.3% in January against 2.4% previous month), led by food products (-0.6% vs 1.2%).

- Industrial goods also recorded a mixed performance. Output growth picked up in intermediate goods (4.8% in January vs 3.9% previous month) and capital goods (4.1% vs 3.6%), while growth declined for primary goods (2.9% vs 4.8%) and infrastructure and construction goods (4.6% vs 5.1%).
- Electricity IIP growth increased to 5.6% in January from 1.2% in December.

Outlook

On average, IIP growth has been lower in the second half so far (5.6% between October 2023 and January 2024) compared with 6.3% in the first half. This is consistent with the National Statistics Office second advance estimate that expects GVA growth at ~5.8% in the second half compared with 8% in the first half of this fiscal.

Infrastructure and construction goods contributed to the slowdown in the second half, reflecting the waning support from government capital expenditure (capex). We expect government support to weaken further next fiscal as it pursues the path to fiscal consolidation. A pickup in private capex is critical to sustaining the investment momentum.

Private consumption has been the weak link, estimated to grow just 3% in fiscal 2024, much below the 7.6% GDP growth. Weak growth in consumer non-durables has driven the fall in IIP growth as well; and may be reflecting weak consumption at the bottom income segment of the population, particularly in rural areas.

A normal monsoon and easing inflation could support rural demand next fiscal. However, transmission of the past rate hikes of the Reserve Bank of India to lending rates, along with its regulatory measures to clamp risky consumer credit are expected to drag domestic demand next fiscal.

Growth in India’s major trading partners is expected to be uneven in 2024, with the European Union expected show tepid growth while the US retains its strong momentum. Global trade flows could revive on a low base of previous year, but tensions in the Middle Sea remain a risk. These factors could restrict a broad-based export recovery.

We expect these factors to moderate GDP growth to 6.8% in fiscal 2025 from 7.6% this fiscal.

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