Macroeconomics | First cut

Inflation soars, IIP rebounds

November 2024

Gauge pierces past 6%, may push back rate cut

Continuing rise in food prices driven by vegetables and edible oils lifted the Consumer Price Inflation (CPI)-based index to a 14-month high of 6.2%, a touch above the Reserve Bank of India's tolerance band of 4-6%.

Food inflation rose to 10.9%, its highest since July 2023. On the positive side, core inflation stayed below 4% for the 11th consecutive month, while fuel inflation was negative for the 14th month in a row.

Inflation in vegetables surged to 42.2% due to excess rains in pockets.

The surge in edible oil inflation in October (from 2.5% to 9.5%) was driven by global prices that saw a steep (27% on-year) rise because of supply disruptions in Southeast Asia.

Though benign, non-food inflation inched up to 3.1% from 3% as core inflation rose to a 10-month high of 3.8% driven by higher gold and silver prices. Discounting the bullion prices, the uptick in core was marginal.

Though non-food inflation remains benign, the recurring flare-up in food inflation has kept headline inflation elevated and creates an upside risk to the inflation trajectory — restricting the monetary policy easing.

We expect the Monetary Policy Committee (MPC) to hold rates steady in December, given the sharper-than-expected rise in food inflation in September and October.

That said, in our base case, we expect food inflation to be lower this fiscal compared with the last, as kharif sowing has been healthy. Food prices can see some correction when fresh stocks enter the market. Data for November suggests some moderation in vegetable prices. This, in addition to a favourable base, can lend some downside to vegetable inflation this month.

Accordingly, we expect the MPC to maintain status quo in December and cut rates towards the end of this fiscal.

Key data points in October

- CPI inflation accelerated to a 14-month high of 6.2% in October from 5.5% in September
- Food inflation rose to 10.9% from 9.2%
- Fuel[1] inflation fell further to -1.6% from -1.3%
- Core CPI[2] inflation accelerated to 3.8% from 3.5%

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

Food inflation accelerates

- Food inflation rose to 10.9% in October from 9.2% in September led by higher inflation in vegetables and edible oils.
- Edible oil inflation picked up sharply to 9.5% (vs 2.5%), its highest value since May 2022. Sequentially, prices of edible oils rose by a seasonally adjusted 6.2%. Higher global prices and the recent increase in import duty are driving the rise. According to the Food and Agriculture Organization of the United Nations, global vegetable oil prices were up 7.3% on-month in October to a two year high.
- Vegetable inflation rose to a 57-month high of 42.2% due to the impact of excess rains in many states. Tomato inflation jumped to a 14-month high of 161.3% (vs 42.9% in September). Garlic also saw a sharp rise to 82.5% from 71%. Meanwhile, inflation remained high but eased in onions (51.8% vs 66.1%) and potatoes (64.9% vs 65.2%).
- Fruits inflation rose to 8.4% from 7.6% driven by higher inflation in coconuts (25.4% vs 11.9%). This was partly offset by lower inflation in apples (1.2% vs 8.2%), which have the highest weight among fruits.
- Foodgrain inflation continued to slide, hitting a 27-month low of 7% (vs 7.5%) due to lower inflation in pulses (7.4% vs 9.8%). On the other hand, cereals inflation inched up marginally to 6.9% from 6.8% as inflation rose in non-PDS wheat (7.5% vs 6.7%).
- Spices inflation hit a new record low -7% (vs -6.1%).

Fuel inflation eases marginally

- Fuel prices fell 1.6% on-year in October compared with 1.3% in September, mainly due to lower inflation in kerosene.
- Kerosene saw inflation ease in both the non-PDS (-1.5% vs -0.1%) and PDS segments (-13.3% vs -7.1%).
- Inflation was broadly steady in other major categories namely electricity (5.5% vs 5.4%) and liquefied petroleum gas (-10.1%).

Core inflation rises

- Core inflation rose to 3.8% from 3.5% due to rising goods inflation. Core goods[3] inflation rose to 3.7% from 3.5%, while inflation was steady in services at 3.6%.
- Personal care and effects was the main mover of core inflation. Inflation in this category rose to its highest value since January 2021 (11% vs 9%) due to accelerating inflation in precious metals. Inflation in gold rose to 29% (vs 23%) while that in silver rose to 28.4% (vs 18.9%).
- Inflation inched up in education (4% vs 3.8%) and household goods and services (2.7% vs 2.5%) too.

[3] *CPI excluding services, food, fuel and light*

The rural poor faced the highest inflation

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

Rural inflation (6.7%) continues to outpace urban inflation (5.9%), since food has a higher weight in the rural basket. Plus, core inflation is lower in urban areas (3.6%) compared with rural (3.9%).

The poorest segment in rural areas faced the highest inflation rate since food has the highest weight in their consumption basket. Benign core inflation benefited the richest segment (top 20%) since core items comprise most of their consumption.

CPI inflation across income classes (% on-year)

Income segment	October		September		FY24	
	Rural	Urban	Rural	Urban	Rural	Urban
Top 20%	6.3	5.5	5.6	5.0	5.4	5.1
Middle 60%	6.8	6.3	6.0	5.6	5.6	5.4
Bottom 20%	6.9	6.7	6.0	5.9	5.6	5.6

Note: With data from the National Sample Survey Organisation (NSSO), CRISIL has mapped the expenditure baskets of three broad income groups — bottom 20%, middle 60% and upper 20% of the population — with October inflation trends. The table presents the average inflation faced by each income class.

Source: NSSO, National Statistical Office, CEIC, CRISIL

IIP rebounds well from August contraction

The Index of Industrial Production (IIP) grew 3.1% in September, after contracting 0.1% in August. This was led by recovery across all industrial, infrastructure and consumption goods.

Industrial production saw a broad-based improvement across use-based sectors.

Consumer durables saw the highest growth in September, as their production was ramped up before the festival season. Consumer non-durables also grew after three months of decline. Additionally, infrastructure- and construction-related goods output picked up as rains ebbed.

Industrial activity may rise in the coming months as the festival season boosts consumption demand. The impact of healthy monsoon on rural demand is also expected to kick in in the second half, which would support consumption.

However, the impact of elevated borrowing costs and high inflation would also weigh on discretionary spending. A lower fiscal impulse from the government is further expected to have a moderating impact on the GDP growth.

Overall, we expect the GDP growth at 6.8% on-year this fiscal compared with 8.2% last year.

Data highlights

- IIP picked up 3.1% on-year in September, reversing the 0.1% contraction in August. The index grew 1.1% on-month after seasonal adjustments.
- The pick-up in output was mainly driven by manufacturing (3.9% vs 1.1% in August). Also, growth returned, though marginally, in both mining (0.2% vs -4.3%) and electricity output (0.5% vs -3.7%).
- The recovery was broad-based. Consumer durables saw the sharpest growth (6.5%), followed by intermediate goods (4.2%), infrastructure and construction goods (3.3%), capital goods (2.8%), consumer non-durables (2.0%) and primary goods(1.8%).

Consumption goods perform better across the board

- Consumer durables output picked up as well (6.5% on-year vs 5.3%), driven by output growth in furniture (32.9% vs 19.3%) and automobiles (2.1% vs 0.5%).
- Consumer non-durables output registered growth after three months of sustained contraction (2.0% vs -4.5%), driven by a revival in output growth in food products (4.4% vs -1.6%), tobacco products (1.7% vs -4.1%) and pharmaceuticals (1.5% vs -5.8%) and a slower pace of contraction in beverages output (-0.1% vs -3.3%).

Broad-based growth in industrial goods

- Intermediate goods saw the highest growth among industrial goods (4.2% vs 3.0%), led by better performance in rubber and plastic products (9.9% vs 6.4%) and chemicals (4.9% vs 2.6%).
- Investment-related goods also grew during the month:
  - Infrastructure and construction goods output rose (3.3% vs 2.2%), with a significant increase in cement output as the monsoon receded.
  - Capital goods saw a broad-based output growth (2.8% vs 0.5%), led by increased production of other transport equipment (13.9% vs 7.2%), machinery and equipment (2.8% vs -2.5%) and fabricated metals (2.7% vs -6.5%).
- Primary goods reversed previous month's contraction to grow 1.8% (vs -2.6%) led by coke and refined petroleum products (5.3% vs -0.7%), mining and electricity.
- Improving export earnings drove better output in major export-oriented sectors, such as coke and refined petroleum, chemicals, machinery and equipment, and pharmaceuticals. Merchandise exports grew once again in September after a sharp contraction in August (0.5% on-year vs -9.3%).

Outlook

Industrial activity may accelerate further in the coming months as the festival season is expected to boost consumption demand. Rural demand is expected to lead the consumption recovery this fiscal.

After a healthy monsoon, things are looking upbeat for the rural economy. Latest data has shown a rise in average rural wage growth and falling distress demand under the NREGA. The impact of healthy monsoon on rural demand is expected to reflect in the second half of this fiscal, which would support consumption.

However, the impact of higher borrowing costs would also weigh, especially in urban areas. This is evident in slowing bank credit growth in the past four months.

Additionally, stubbornly high inflation may be weighing on households' discretionary expenditure. Inflation being the highest in food, it will inevitably impact the purchasing power, particularly of the lower income segments. That said, easing food inflation by the end of this fiscal should offer relief.

A lower fiscal impulse from the government is further expected to have a moderating impact on the GDP growth. Government capital expenditure has moderated relative to last fiscal. A revival in private investment is critical to sustain the investment momentum.

Global trade is expected to improve and support export growth this year. However, geopolitical tensions, particularly in the Middle East, remain a risk for trade flows and supply-chain pressures for industry.

Overall, we expect the GDP growth at 6.8% on-year this fiscal compared with 8.2% last fiscal.

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