Quickonomics

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Kindling consumption in the short term

Two out of three transitory factors have turned supportive

Private consumption is known to be more sensitive to factors that impact permanent, rather than transitory, income. Yet, in the short term, some factors do influence private consumption.

Last fiscal, India's private consumption growth (in real terms) hit a two-decade low of 4%. Though it recovered sharply to 7.3% this fiscal, this growth bears watching because part of the lift was from a low-base effect.

To be sure, private consumption had been slow to rebound because incomes haven't recovered fully from the impact of the Covid-19 pandemic.

Transitory factors had also weakened private consumption growth last fiscal.

We examine the role of three factors — the performance of the agriculture economy, food inflation and government spending — and the outlook for them next fiscal.

When these factors turn adverse, private consumption takes a material hit, as had happened last fiscal.

Agriculture performance and food inflation are weather-dependent.

When their growth is impacted, increased government spending — channelled appropriately — can cushion the impact on private consumption, as the national accounts data shows.

This fiscal has seen two of these factors turn supportive. An improvement in the third remains elusive.

- Normal monsoon and healthy kharif incomes bolstered consumption, especially in hinterland
- Increased government spending on employment schemes (detailed later) aided consumption
- But food inflation remained high and unsupportive. High inflation kept monetary policy and lending conditions tight, denting urban consumption

Outlook for fiscal 2026

Next fiscal, healthy farm incomes (assumptions detailed later) should provide support to rural incomes. Lower inflation (assumptions detailed later) and scope for reduced interest rates should improve purchasing power for discretionary spending.

But for private consumption to remain strong, government spending must focus on employment-generating schemes that put incomes in the hands of those with a higher propensity to consume.

A combination of such spending on asset-creating schemes (rural roads, affordable housing and National Rural Employment Guarantee Act, or NREGA, works) and furthering government capital expenditure or capex on infrastructure (railways, highways and ports) could moderate the inflation impact of such spending.

If the supporting factors kick in, the pick-up in private consumption growth could be preserved next fiscal.

However, for a self-sustaining lift to private consumption over the medium run, employment opportunities and household permanent incomes need to increase durably.

Inclement weather affecting agriculture incomes, persistently high food inflation, slower government revenue spending after the surge during the pandemic, and sluggish urban employment opportunities due to lagged service sector recovery have held back a complete recovery in private consumption.

This fiscal, real private consumption growth revived to 7.3% from 4% last fiscal, the slowest in two decades (excluding the pandemic year).

So, will the ongoing pick-up sustain? To reiterate, part of it was due to a low base. What's salutary is that some factors that support consumption recovery in the short term have also turned supportive.

What drives consumption?

Government spending is a key influencer of private consumption in the short term. We looked at 14 years of national accounts data to ascertain this.

In the years governmtent consumption expenditure slowed, private consumption dipped in tandem. The exceptions were fiscals 2014 and 2020, when the agriculture economy outperformed and consumption bounced back after the pandemic lockdowns, respectively.

However, when an agriculture shock and food inflation spike pile on to slower government consumption, the impact to consumption is amplified.

Last fiscal was when this triad of factors hammered hard — agriculture gross value added (GVA) fell to 1.4%, compared with a decadal average of 4.1%, food inflation soared to 7.5% and government consumption spending growth decelerated to 2.5% against a decadal average of 5.3%. Fiscal 2013 was another year when the three factors were unsupportive.

Table 1: Drivers of private consumption

(%, y-o-y)	Agriculture GVA	CPI food	Govt consumption exp.	Observations on private consumption		
				Growth	Extent of slowdown	Attributed to
FY12	6.4	6.3*	6.5	7.4	-	High food inflation
FY13	1.5	10.2	0.6	5.5	Sharp	Slower govt consumption spending + agriculture hit + high food inflation
FY14	5.6	12.1	0.6	7.3	-	-
FY15	-0.2	6.4	7.6	6.4	-	Agiculture hit + high food inflation
FY16	0.6	4.9	7.5	7.9	-	-
FY17	6.8	4.3	6.1	8.1	-	-
FY18	6.6	1.8	11.9	6.2	-	Unexplained by the three observed macros**
FY19	2.1	0.2	6.7	7.1	-	-
FY20	6.2	6.7	3.9	5.2	Sharp	Slower govt consumption spending + high food inflation
FY21	4.0	7.8	-0.8	-5.3	Sharp	Covid-19 hit + slower government consumption spending + high food inflation
FY22	4.6	3.8	0.0	11.7	-	-
FY23	4.7	6.8	9.0	6.8	-	-
FY24	1.4	7.5	2.5	4.0	Sharp	Slower govt consumption spending + agriculture hit + high food inflation
FY25	3.8	8.4**	4.1	7.3	-	-

Note: 1. Cells are highlighted when the values are worse off than the decadal average
*2. Data as per *Consumer Price Inflation Index for Industrial Workers (CPI-IW)*
*3. ***As per the Reserve Bank of India's annual report, "The loss of speed in private consumption reflected a combination of factors – the overhang of demonetisation, especially in respect of the unorganised sector; the initial disruptions associated with the implementation of goods and services tax and some deceleration in rural wage growth."*
4. Data is for April-November
Source: National Statistical Office (NSO), CEIC, CRISIL

Two factors turn supportive, one remains elusive

1. Government consumption spending

This fiscal, growth in government consumption expenditure rebounded to 4.1% from 2.5% last fiscal, supporting private consumption growth recovery.

Over the past few fiscals, government revenue spending on welfare schemes, such as NREGA, rural roads and housing construction, generated employment and bolstered rural demand in the immediate term.

In the rural areas, in addition to agriculture, the bulk of the households are also employed in non-agriculture and allied activities, with many engaged in construction activity resulting from the welfare schemes mentioned above. Spending on such rural employment-generating, asset-creating rural schemes surged during the pandemic as the government provided support to alleviate the impact of income loss and unemployment caused by the lockdown.

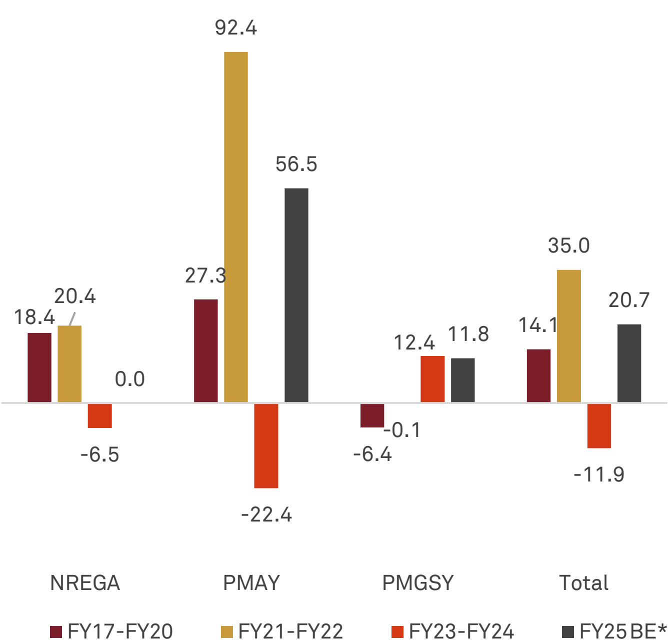
However, as the economy recovered, some of these spends were normalised to make way for capex and/or to curtail the fiscal deficit.

Compared with an average 14% growth in central allocation to NREGA, Pradhan Mantri Gram Sadak Yojana (PMGSY) and Pradhan Mantri Awas Yojana (PMAY) between fiscals 2017 and 2020, spending grew 35% in fiscals 2021 and 2022, tapering thereafter (Chart 1). Softer consumption demand in fiscal 2024 could be linked to this.

Typically, dependence on these schemes tends to rise in years when the agriculture economy underperforms. Last fiscal, in addition to the impact on agriculture and high food inflation, lower spending on these schemes could have exacerbated the effect on rural incomes and hence, demand.

With rural incomes and demand sluggish, some government support was restored in the budget for this fiscal and the spending allocation was increased 20% on welfare schemes.

Chart 1: Normalisation of pandemic-era revenue spends



Source: Budget documents, CRISIL
** Budget estimates*

Our view

For private consumption to remain strong, government spending must focus on employment-generating schemes that put incomes in the hands of those with a higher propensity to consume. A combination of spending on asset-creating schemes (rural roads, affordable housing and NREGA works) and furthering government capex on infrastructure (railways, highways and ports) could moderate the inflation impact of such spending.

Studies[1] find that government spending tends to have a reasonable short-term multiplier impact on the economy in the same year. The peak impact is smaller than that for capex during the year. But combining the two could give a bigger push to output. This suggests if the government pursues both, the push to growth will be considerable in the short term. In the long run, the capex multiplier impact is over three times that of the revenue expenditure.

[1] *32015, Goyal A., and Sharma B., 'Government Expenditure in India: Composition, Cyclicality and Multipliers, Indira Gandhi Institute of Development Research. http://www.igidr.ac.in/pdf/publication/WP-2015-032.pdf*

2. Weather and agriculture

Data shows a high correlation (coefficient of 0.7) between southwest monsoons and agriculture GVA, given 44% of cultivation in India is dependent on rain (chart 3).

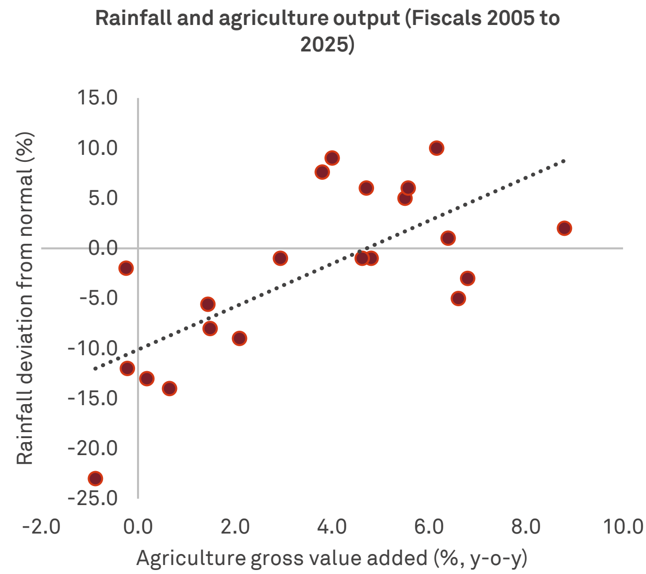
The National Sample Survey Office (NSSO)[2] data shows that ~98 million or 57% of rural households are engaged in agriculture — 40% self-employed in cultivation, 14% in casual labour in agriculture, less than 2% in regular wage labour in agricultural activity and rest self-employed in other agriculture activities (chart 2). These could face a direct impact on incomes, thereby affecting demand in case of weather disruption. Although the rural section is diversifying its income sources towards livestock rearing, fishing and construction, agriculture remains a large employer.

Last fiscal, agriculture GVA growth slowed to 1.4%, reflecting the blow dealt by ill-distributed rains and the impact on key crops. Weaker agriculture incomes pinched rural consumption.

But this fiscal, the agriculture economy did better with healthy southwest rains and robust kharif harvest. Good soil moisture and abundant reservoir levels are benefiting the rabi crop as well.

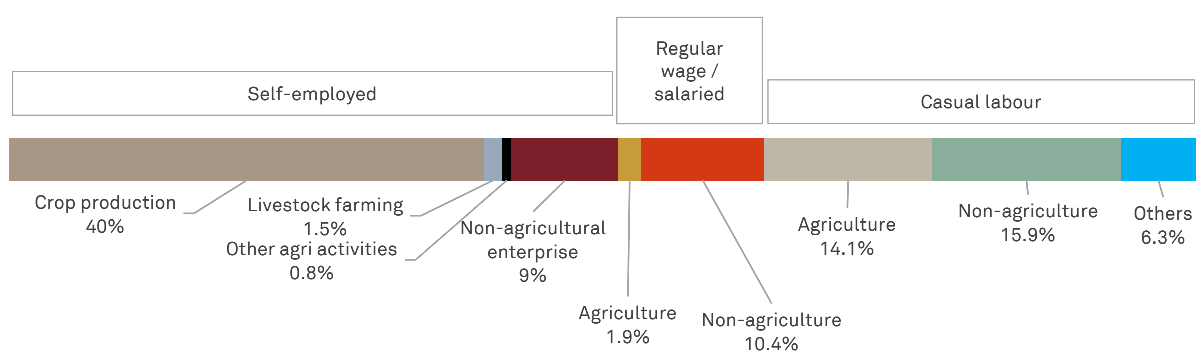
Though calendar 2024 was the warmest year recorded since 1901[3], there was no significant disruption to agriculture. The government's first advance estimates shows agriculture GVA growing 3.8% this fiscal, which will support rural incomes and demand.

Chart 2: Rainfall performance influences agriculture output



Source: NSO, CEIC, CRISIL

Chart 3: Employment in rural households, 2019



Source: NSSO, CRISIL

Our view

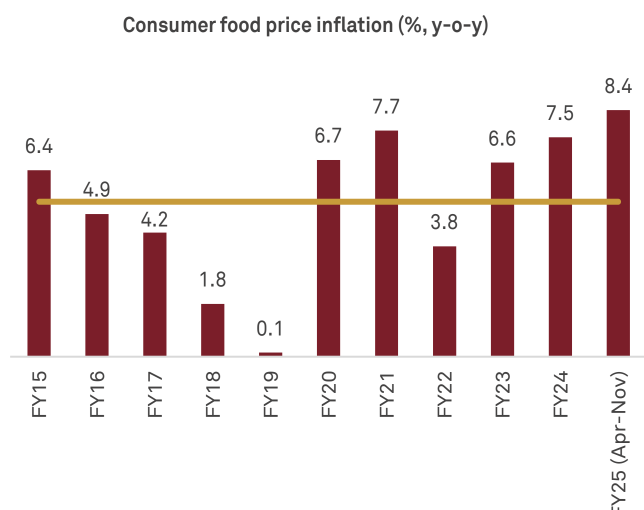
Next fiscal, assuming the recent La Niña effect that has just set in[4] positively impacts the southwest monsoon, and there are fewer, less-disruptive weather disturbances, we expect agriculture output and incomes to remain healthy and continue aiding rural consumption. Inflation, which has been the harshest for the rural poor because of a higher weight of food in their consumption basket, should also turn supportive and bolster discretionary consumption.

[2] *1Situation Assessment of Agricultural Households and Land and Livestock Holdings of Households in Rural India, 2019*
[3] *https://www.hindustantimes.com/india-news/2024-warmest-year-on-record-for-india-imd-101735756100108.html*
[4] *January 1, 2025, Indian Meteorological Department https://internal.imd.gov.in/press_release/20250101_pr_3517.pdf Computed using the NSSO survey on Consumption Expenditure*

3. Food inflation and discretionary spending

- Food constitutes ~40% of India's consumption basket. Persistent high food inflation can bite into the discretionary spending of households that may defer consumption or not consume at all
- The contribution of food inflation to the headline CPI steadily rose to 55% in fiscal 2024 from ~27% in fiscal 2022 and 67% in April-November 2024
- The impact of inflation is greater on lower income segments[5] that spend more than half of their monthly income on food. Last fiscal, the rural and urban poor (the bottom 20% income segment of the population) faced an inflation rate of 5.6%. In contrast, the rich (or top 20%) faced a lower inflation rate of 5.4% in rural areas and 5.1% in urban areas
- This fiscal, the inflation rate faced by the rich dropped sharply, while that of the poor eased only marginally. Consequently, the gap in inflation rates of the lowest income segments (rural poor) and the highest (urban rich), widened to 120 basis points (bps) from 20 bps last fiscal.
- The Pradhan Mantri Garib Kalyan Anna Yojana (PMGKAY) is expected to have provided some cushion to the poor against high inflation. But for households not covered under the PMGKAY scheme and for the other unavoidable food purchases such as vegetables, spices and milk, soaring prices are expected to have hurt. Last fiscal, the inflation rates of all categories, except meat and fish, and edible oils, were significantly above their respective decadal averages. This fiscal, inflation eased for some but for foodgrains remained high at 9.1%, while that for vegetables surged to 26.2%, the highest in the fiscal so far (April to November).

Chart 4: High food inflation biting into purchasing power



Source: NSO, CEIC, CRISIL

Our view

Food inflation is the only influencer of private consumption that hasn't turned supportive yet — it has in fact imposed more pressure this year. Average food inflation between April and November this fiscal rose to 8.4% vs 7.5% for full last fiscal. Persistently high food inflation is eating into discretionary purchases and has kept the headline inflation high, constraining monetary policy rate cuts.

In our base case forecast, we expect food inflation to cool down in the coming months as healthy food supplies enter the market. Lower food inflation should make way for improved discretionary consumption. Lower inflation will also make way for monetary policy rate cuts. Rigidity and repeated resurgence in vegetable prices, and the surge in edible oil prices, however, are risks to be monitored.

[5] *Computed using the NSSO survey on Consumption Expenditure*

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