

# **CPI eases a tad, IIP keeps the revs up**

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## CPI moderates to 5.1% on lower food inflation

Consumer price index (CPI)-based inflation marginally slowed to 5.1% in January from 5.2% in December, mildly pulling back the northward trajectory seen since July 2017. A 30 basis points (bps) fall in food inflation on-month, aided by a 60 bps decline in fuel inflation, brought overall CPI inflation lower. Inflation, however, continued to firm up in large parts of the services sectors such as housing (driven by the revision in house rent allowance payments), education and in recreation, amusement and personal care and effects (reflective of both, return of pent up demand in the economy and impact of higher taxes on services due to goods and service tax implementation). Yet, core inflation, stayed broadly unchanged from the previous month, at around 5.1% in January.

Despite the recent rise in core inflation, the Reserve Bank of India's (RBI) Monetary Policy Committee (MPC) refrained from raising the policy repo rate in its meeting on February 7 since it believes that the economy's recovery is nascent and requires nurturing. Also, several factors driving the uptick in inflation (return of pent up demand and impact of goods and services tax, or GST on services prices) are expected to smoothen off over time.

**For fiscal 2018, CRISIL expects CPI inflation to come below 4% average and rise to 4.6% in fiscal 2019. The pick-up will be due to rising consumption demand, impact of house rent allowance revisions on housing inflation, and higher global crude oil prices. The risk of fiscal slippage and higher MSP can also translate into upside risks to inflation. Food inflation is likely to stay benign given a normal monsoon. As per the MPC, inflation is expected to rise in the first half of fiscal 2019 but moderate significantly in the second half. In light of this, CRISIL expects the repo rate to remain unchanged over the next six months unless significant upside risks to the MPC's inflation forecast materialise.**

So far, inflation has stayed within the projected trajectory despite an upside from the prices of oil, fruits and vegetables, and higher housing inflation. Yet, inflationary risks could mount if risks materialise. First, higher minimum support prices (MSP) as well as increase in coverage of procured crops as per these MSPs could flare up prices of certain crops and exert an influence on food inflation. Second, firmer input costs can push manufacturers to raise prices in a scenario of stronger demand. On the downside, items of mass consumption could see softer prices if the latest downward revision in the GST rates on some items is passed on to consumers. The interplay among factors will therefore determine the pressures on inflation.

## Data snapshot

- Food inflation fell to 4.7% in January from 5% in December. The fall was led by a decline in inflation in cereals (at 2.3% from 2.6%), milk and products (4.2% from 4.4%), vegetables (27% from 29.1%) and continuing deflation in pulses (at -20.2% from -23.5%). Inflation in vegetables has been rising sharply since September and the decline in January is a welcome relief.
- Fuel inflation, calculated by adding petrol, diesel, fuel and light components, fell to 6.4% from 7% in December. In fuel and light, inflation slipped to 7.7% from 7.9%, while inflation in petrol and diesel it was sharply down to 1.6% from 3.6%. During January, prices for the Indian crude oil basket rose 24% on-year and 7.7% on-month, but a slightly stronger rupee capped the upside to imported fuel inflation. Broadly, softer inflation in petrol, liquefied petroleum gas, kerosene and coal brought inflation in this category down.
- Core inflation (CPI excluding food, fuel and light, petrol and diesel) climb stayed broadly unchanged at around 5.1% - same as in the previous month. Housing inflation continued to rise higher (to 8.3% from 8.2%) due the impact of revision of house rent allowance paid to government employees. But other than housing, inflation in recreation and amusement and personal care and effects also continued to rise reflecting the impact of pent-up demand and impact of higher taxes on services due to goods and service tax implementation.

## IIP registered high growth for the second consecutive month

The Index of Industrial Production (IIP) registered second consecutive month of high growth, on the back of robust manufacturing activity. IIP grew 7.1% on-year in December, after having clocked 8.8% (revised up from 8.4% earlier) growth in November. Consistent high growth in the manufacturing activity is the key. The industry seems to be shedding away the weight of GST-related glitches behind and trying to get back lost momentum, as both domestic and global growth surge. December growth showed not only a robust year on year growth but also a strong sequential improvement in the industrial activity.

With this, Q3 (October-December) IIP and manufacturing growth at 5.95% and 7.12% are now higher than 3.86% and 3.16% growth respectively in the same period an year ago.

- Industrial activity improved for the second consecutive month in December. Index of industrial production (IIP) growth stood at to 7.1% on-year in December compared with an upwardly revised 8.8% (from 8.4% earlier) growth in November. Manufacturing sector (the largest contributor to IIP, having 77.6% weight) was once again the key contributor to this growth. It grew 8.4% in December, only slightly lower than 10.7% growth in the previous month. Mining and electricity – the other two components of IIP – continued their slow pace of growth. While mining growth in December came in at 1.23%, compared with 1.13% in November, electricity registered a growth of 4.43% compared with 3.85%.
- Within manufacturing, 16 out of 23 industry groups showed positive growth on an annual basis. Sectors which displayed high positive growth were, 'other transport equipment', growing by 38.3%, followed by 'pharmaceuticals, medicinal chemical and botanical products', which was up 33.6%, and 'computer, electronic and optical products', which clocked a growth rate of 29.8%. Sectors that displayed high negative growth were, 'tobacco products' (-28.2%), followed by 'other manufacturing' (-22.3%) and 'electrical equipment' (-14.9%). Looking from the end use lens, growth in the consumer-oriented sectors (accounting for 37% of the manufacturing sector IIP) at 3.69% outpaced that in the industrial & investment-oriented manufacturing sectors that grew 2.95%.
- According to the use-based classification, *infrastructure and construction goods* displayed strong buoyancy, growing by a healthy 6.7%. While *capital goods* grew by a strong 16.4%, it was mostly on account of a low base of last year. As for the consumer goods, while the durables displayed a muted growth (0.86%), non-durables maintained their high pace of growth (16.45%).
- This in conjunction with other short-term indicators such as exports and credit decisively point towards a better second half for the current fiscal.

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