CPI up again, sniffs 5%; IIP logs a rebound

CRISIL First Cut I June 2018

CPI inches closer to 5% mostly led by fuel

Consumer price index (CPI)-based inflation marched higher to 4.9% in May from 4.6% in April. Fuel was the main driver of overall inflation in May, jumping up over 100 basis points (bps), while core inflation, which had added to the central bank's woes last month, crept 20 bps north, nearly touching 6%. The pick-up was also led by food inflation, which rose 30 bps after having declined for 4 months in a row.

The pick-up in fuel inflation was inevitable with global crude oil prices rising 7% on-month and over 50% on-year in May. Meanwhile, the other shock to imported inflation also came from the fall in rupee, which fell on 3% on-month against the dollar during the month.

The discomforting aspect is the sustained increase in core inflation categories since March, which suggests manufacturers are perhaps taking advantage of improving demand conditions and passing on higher input costs (from oil, rupee and metals) to consumers.

Even after excluding the impact of house rent allowance revisions on housing inflation, core inflation was up 20 bps in May. It is this sustained increase in core inflation that led the Monetary Policy Committee (MPC) to raise the policy repo rate by 25 bps to 6.25% in its June 6 policy meet – the first hike in over four years. The MPC was also worried about core inflation rate staying higher than the committee's inflation rate target of 4%.

Going forward, inflationary conditions are likely to firm up. With improving domestic demand conditions, manufacturers will pass on higher input costs to consumers, which will show up in core inflation. On an upward trajectory, crude prices were nearly 18.6% higher on-year in fiscal 2018. CRISIL expects another 23% average increase in average crude oil prices this fiscal. Also, metal prices are also firming up.

Similarly, food inflation will have a softening bias this year, it may stay relatively low given the expectation of a normal monsoon. However, aggressive implementation of the announced minimum support price measures could offset the impact of good monsoons numbers.

For fiscal 2019, therefore, CRISIL expects CPI inflation to perk up to 4.6% from 3.6% a year before. We believe there is a possibility of another rate hike if crude oil prices stay at current levels. While monetary policy will stay vigilant, further policy rate action will most likely only be effected if the rise is perceived as being sustainable, with pressures suggesting seepage into generalised inflation through stronger domestic demand.

Data snapshot

- Food inflation rose in May, after having eased for four months in a row. It stood at 3.1% compared with 2.8% in April. The rise was led by a sharp spike in inflation in fruits, some rise in vegetables inflation and continued pick-up in cereals inflation. Meanwhile, key protein-related items – eggs, meat and fish and pulses – recorded a dip. Inflation in pulses continued to fall, but at a slower pace (-11.6% from -12.3%).
- Fuel inflation, calculated by adding petrol, diesel, fuel and light components, jumped to 6.9% in May, from 5.8% in April. In fuel and light inflation rose to 5.8% from 5.2%, while in petrol and diesel inflation rose much higher to 10.8% from 8.3% in April. Within the fuel and light category, inflation in liquefied petroleum gas (LPG) and firewood and chips saw the steepest climb.
- Core inflation (CPI excluding food, fuel and light, petrol and diesel) rose to 5.9% in May, from 5.7% in April. Housing inflation, which had been reasonably rigid for the last 10 months, recorded a marginal decline, falling to 8.4% in May, from 8.5% in April. Excluding housing (to remove the impact of house rent allowance revisions), core inflation saw a 20 bps increase to 5.3% in May from 5.1% in April. There was a near broad-based increase in core inflation components in May and inflation was especially higher in personal care and effects, clothing and footwear, health and education.

IIP trying to pick up lost momentum

After the sudden deceleration in March, the Index of Industrial Production (IIP) grew in April, albeit at a slow pace, supported by a low base. According to the data released by Central Statistics Office today, IIP grew 4.9% on-year, marginally up from 4.4% in March.

That said, the output of India's eight major industries supported overall IIP growth, accelerating to 4.7% in April from 4.4% in March. Improvement in exports growth also helped. Non-oil exports growth rose to 6.5% in April, from 1.2% in March. IIP growth had settled at 4.3% in fiscal 2018.

Data readings

- Industrial activity tried to gather some lost steam in April, after having shown sharp decline in the previous month. IIP growth improved modestly to 4.9% in April, from 4.4% in March. That's still lower than the 7% plus growth achieved in the preceding four months. Growth in April was supported by manufacturing, which rose 5.2% (compared with 4.4% in March) and a 5.1% growth (2.8% in March) in mining. Electricity sector growth, on the other hand, slowed down to 2.1% from 5.9%. It is to be noted that manufacturing is the largest contributor to IIP, with 77.63% weight, followed by mining (14.37% weight) and electricity (7.99% weight).
- Within manufacturing, 16 out of 23 industry groups showed positive growth on an annual basis, with some new entrants in both the high and low growth zone. Sectors which displayed high positive growth were, 'computer, electronic and optical products', growing by 27.5%, followed by 'motor vehicles, trailers and semi-trailers', which was up 21.9%, and 'food products', which clocked a growth rate of 15.7%. Sectors that displayed high negative growth were, 'other manufacturing' (-30.7%), followed by 'wearing apparel' (-13.4%) and 'Printing and reproduction of recorded media' (-10.3%). From the end-use perspective, the industrial and investment-oriented manufacturing sectors saw growth improving to 2.6% in April (from 1.6% in March) while the consumer-oriented sectors (accounting for 37% of the manufacturing sector IIP) registered a slower rate of growth (1.8% in April compared with 2.0% in March) .
- According to the use-based classification, capital goods sector registered the highest growth at 35.1%, though mostly helped by a weak base. Infrastructure and construction goods continued their growth momentum, registering 7.5% growth in April. Consumer durables and non-durables too, continued their positive growth trajectory, growing by 1.5% and 9%, respectively. That said, it is noteworthy that while non-durables have managed to catch up pace, growth in consumer durables continues to remain weak. Intermediate goods, however, slumped (-16.0% growth), after having grown positively in previous seven months.

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