Macroeconomics | First cut

Food inflation scorches, IIP slackens

August 2023

Dramatic lift from food inflation amid material comfort from non-food inflation

Consumer Price Index (CPI) based inflation surged to 7.4% in July from 4.9% in June. Though a sharp rise in inflation was expected, its extent came as a surprise. It was led by a 11.5% inflation in food items.

- Though likely to be transient, food price pressures are expected to stay for a couple of months more. July data not only highlights the surge in prices of vegetables (37.3%), but also the double-digit inflation in cereals, pulses (~13% each), spices (21.6%), and high inflation in milk (8.3%) — all of which is pinching the average consumer's pocket. Monsoons turning normal provide limited comfort to prices in the immediate term
- Meanwhile, there is relief on the non-food front, where inflation has been steadily softening, led by falling input cost pressures. This has reduced the need to raise retail prices for several commodities. In July, goods inflation (excluding food) slid 20 basis points (bps) on-month to 5.1%, while services inflation softened 20 bps to 4.5%. Excluding vegetables, CPI inflation was up only 10 bps on-month, at 5.5%, while excluding the entire food category, CPI inflation was down 25 bps, at 4.8%
- Yet, for now, the pressure from food prices remains the big worry and can cause the headline inflation to run red hot for another 2-3 months, after which government intervention (releasing food stocks, facilitating imports and restrictions on hoarding) and fresh crop arrivals should provide some relief

With the sharp surge in the July CPI print, and early signs that August would see minimum relief on food prices, the upside risks to our inflation forecast have materialised. We have, therefore, revised upwards our inflation forecast for this fiscal to 5.5% on average, from our earlier estimate of 5%. Notably, this forecast too faces upside risks from high global food prices and the prediction of a possible setback from evolving El Niño conditions. Persistently high food inflation also threatens to constrain a further downside to non-food inflation if high food prices transmit to other inflation components.

The higher-than-expected inflation reading and continued food price pressure, despite a softening core, puts monetary policy in a dilemma. Though monetary policy typically overlooks supply-side shocks such as this, a sustained price rise is difficult to ignore. While we expect the Monetary Policy Committee of the Reserve Bank of India to hold policy rates in its October meeting, the evolving inflation dynamics suggest that policy is likely to remain tight for longer with the first rate cut seen only in the early part of next fiscal.

Key data points in July

- CPI inflation rose to a 10-month high of 7.4% in July from a revised 4.9% in June, driven by surging food prices
- Food inflation accelerated sharply to 11.5% from 4.5%, led by vegetables inflation, which jumped to 37.3% from -0.7%
- Fuel[1] inflation eased to 3.7% from 3.9% as the base effect continued to support
- Core CPI[2] inflation softened to 4.9% from 5.2%. Core inflation has fallen 130 bps from its peak in January

Food inflation is raging, mainly in vegetables

The steep rise in food inflation to 11.5% in July from 4.5% in June and 3% in May is due to accelerating inflation in vegetables, cereals, pulses, spices, and milk. This is the highest rate of food inflation since April 2020. Sequentially, food prices rose 5.6% on-month on a seasonally adjusted basis, with an uptick seen across most food items. Inflation is edible oils remained in the deflation zone (-16.8%) providing some offset.

- Vegetables inflation, which was in the deflation zone for eight straight months, surged to 37.3% in July from -0.7% in June led by a sharp increase in tomato prices. On a seasonally adjusted basis, vegetable prices shot up 28% on-month (vs 5.2% in June). Tomato inflation zoomed to 201.5% (vs -34.1%). Sequentially, too, tomato prices increased 195.3% on a seasonally adjusted basis. Inflation also accelerated in onions to 11.7% (vs 1.7%). Other vegetables such green chillies, garlic, carrot, radish, brinjal, cauliflower, ladyfinger also saw double-digit inflation. Deflation in vegetables prices was helping keep the headline food number low over the past few months despite high inflation in other major food categories such as cereals, pulses, and milk
- Inflation in cereals rose to 13% in July from 12.8% in June led by accelerating inflation in rice (14% in non-PDS rice) which has the highest weight among cereals. On the other hand, inflation in wheat from non-PDS sources eased to 11.9% from 12.4%, led by arrival of rabi stocks
- Inflation in pulses rose to 13.3% from 10.6% in the previous month as inflation picked up in tur (34.1% vs 27.5%) and moong (9.1% vs 7.5%). Prices of pulses rose 2.7% on-month (seasonally adjusted). Among other proteins categories, inflation eased in eggs (3.8% vs 7%), stayed high in milk (at 8.3% vs 8.6%) but hardened in the meat and fish category (2.3% vs 1.5%)
- Inflation in spices accelerated to 21.6% in July from 19.2% in June, as inflation picked up in jeera, black pepper, and tamarind

Fuel inflation eases marginally

- Fuel inflation eased marginally to 3.7% from 3.9% despite an on-month rise in global energy prices as the base effect continued to be supportive. While global energy prices increased on-month, they fell 41.3% on-year
- Inflation cooled in kerosene from both PDS (-32.3% vs -26.8%) and non-PDS sources (21.3% vs 29.1%) Inflation also slowed marginally in the wood and fire chips category (4.6% vs 4.8%)
- Inflation in electricity rose to 13.4% from 8.7%

Core inflation slows

- Core inflation slowed to 4.9% in July from 5.2% in June driven by softening inflation in clothing and footwear (5.6% vs 6.1%) and housing (4.5% vs 4.6%)
- Inflation remained fairly stable but high in personal care and effects at 9%, health at 6.2%, and gold at 16.7%; it and surged for silver (at 19.9% vs 12.9%)
- Inflation in education cooled to 5.5% from 6.0% with softening inflation in educational fees (5.7% vs 6.4%)
- Core goods inflation (excluding food) eased to 5.1% from 5.3%, while services inflation cooled to 4.5% from 4.7%

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

Poorest segment in urban areas faced highest inflation rate in July

The burden of inflation varies across 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.

The poorest segment in both urban and rural areas faced a higher inflation burden than their high-income counterparts as food inflation accelerated sharply. Moreover, the poorest segment in urban areas faced a higher burden than their counterparts in rural areas, as both food (12.3% in urban vs 11% in rural) and fuel inflation (4.4% vs 3.3%) was higher in the former than the latter. The high-income segment in urban areas faced the lowest inflation burden, as food has a relatively low share in their consumption basket.

CPI inflation across income classes (% on-year)

Income segment	July 2023		June 2023	
	Rural	Urban	Rural	Urban
Top 20%	7.3	7.1	4.9	5.0
Middle 60%	7.8	8.0	4.7	4.9
Bottom 20%	7.9	8.5	4.7	4.9

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

Industrial recovery weakens in June

Industrial output measured by the Index of Industrial Production (IIP) rose 3.7% on-year in June, compared with 5.3% previous month. Steady growth in mining and rise in electricity output was pulled down by a slowdown in the manufacturing sector.

Consumer-oriented sectors showed weakness in June after improving in the past two months. Exports continued to be a drag on industrial activity. Monsoon, agricultural performance and inflation will influence consumer demand in the coming months. In this respect, monsoon turning deficit in past few days is concerning. Overall, we expect India's real gross domestic product (GDP) to slow to 6% this fiscal from 7.2% in the previous fiscal.

Data highlights

- IIP rose only 3.7% on-year in June compared with 5.3% previous month
- Mining (7.6% in June vs 6.4% in May) and electricity (4.2% vs 0.9%) recorded an improvement, whereas manufacturing decelerated (3.1% vs 5.8%)
- Within manufacturing, growth was led by infrastructure and construction goods (11.3%), followed by primary goods (5.2%), intermediate goods (4.5%), capital goods (2.2%), consumer non-durables (1.2%) and consumer durables (-6.9%)

Consumer-oriented sectors take a beating

- The consumer non-durables sector showed feeble growth (1.2% in June vs 8.4% in May)
- Consumer durables growth turned negative (-6.9% vs 1.2%), driven by waning support from automobiles (7.9% vs 13.4%). IIP declined further for wearing apparel (-23.3% vs -20.9%) and electronics (-32.0% vs -5.7%)

- Looking at export-linked sectors such as textiles (-0.3% vs -3.7%) and chemical products (-2.2% vs -2.1%), growth remains deficient. Growth in pharmaceuticals slowed too (6.7% vs 20.9%).
- Capital goods slowed significantly (2.2% vs 8.1%), reflecting the drag from falling exports of engineering goods
- However, growth in commodity-linked sectors such as basic metals (13.6% vs 9.6%) and petroleum products (3.1% vs 2.5%) remains resilient.
- Infrastructure and construction goods IIP stayed steady (11.3% vs 11.3%). Primary goods (5.2% vs 3.6%) and intermediate goods (4.5% vs 3.0%) showed sharp revival

Outlook

In the first quarter of this fiscal, IIP growth averaged 4.5% on-year, same as in the previous quarter. Consumer-oriented sectors, and infrastructure and construction were the main drivers of growth.

Overall manufacturing activity remains healthy, as evident in S&P's Purchasing Managers' Index being in expansionary zone (above 50) till date. It stood at 57.7 in July, similar to 57.8 in June.

That said, two factors could affect the direction of industrial performance in coming months. First, a global economic slowdown — if not a recession — remains on the cards under the weight of rising interest rates. S&P Global expects this to lead to a shallow but more protracted slowdown from the second half of 2023. Due to this, exports may remain a drag on industrial activity.

Second, the monsoon's performance will critically influence industrial prospects through impact on inflation and rural demand. The monsoon has weakened again, with all-India rainfall turning deficient at 5% below long period average (LPA) as on August 15. The El Nino has set in as expected, and its timing and intensity will determine rainfall patterns this year.

Overall, we expect GDP to grow 6.0% this fiscal compared with 7.2% the previous fiscal.

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