

Macroeconomics | **First cut**

Cooling CPI, surging IIP

October 2023

Inflation relief for now, risks aplenty

Consumer price index (CPI) inflation cooled to 5% in September from 6.8% in August and its 7.4% peak in July. The elevated inflation since July — and also the relief in September — were led by volatility in vegetable inflation, which rose to 37.4% in July and fell to 3.4% in September. Some softness in milk inflation and continued deflation in edible oils also aided the decline in headline inflation.

There was comfort from non-food inflation components, which have stayed benign so far, supported by a high base of 6.2% in September 2022 and lower raw material costs.

That said, some risks still loom large.

First, not all the components of food inflation provided comfort. Inflation in pulses¹ surged to 16.4% and in cereals, was uncomfortably high at ~11%, reflecting adverse impact from weather shocks. Further, inflation in pulses, eggs, meat and fish rose to 8.3% in September from 6.8% in August a low of 0.8% in March.

Second, rising oil prices — fuelled by the Middle East conflict — can pressure, or at least limit, the easing in non-food inflation components, which played a crucial role in lowering headline inflation. Government intervention (such as the recent cuts in liquefied petroleum gas (LPG) prices), however, can cushion the impact.

Inflation for the September quarter rose to 6.4% — as predicted by the Reserve Bank of India (RBI) — from 4.6% in the June quarter. For the December quarter, we expect food inflation to soften, helped by the kharif harvest entering the market and government intervention in food prices. However, inflation in pulses and cereals could see limited respite; further, oil could play spoilsport if the Middle East conflict escalates.

We expect the RBI to look through the September quarter hump, but stay vigilant since headline inflation remains much above its Monetary Policy Committee's (MPC's) 4% target and risks are on the upside due to oil prices. For fiscal 2024, in the base case, we expect inflation to average 5.5% and MPC to maintain the policy rate and stance.

Key data points in September

- CPI inflation dropped to 5% in September from 6.8% the previous month, led by food and fuel
 - Food inflation eased to 6.6% from 9.9%, led by a plunge in vegetable inflation
 - Fuel² inflation turned negative at -0.1% from 4.3% a month ago
 - Core CPI³ inflation cooled to 4.5% from 4.9%
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¹ Read CRISIL Quickonomics titled, 'Taking the pulse: Moving from volatility to stability' where we have highlighted factors that would drive the pulses inflation pick-up this year.

² Refers to CPI fuel and light.

³ CPI excluding food and beverages, and fuel and light.

Food inflation plummets, led by vegetables

- Food inflation eased to 6.6% from 9.9% a month prior, led by vegetables and cereals
- Vegetable inflation, the main driver of food inflation over the past few months, nosedived to 3.4% from 26.1%. Inflation in tomato prices, which was in triple digits in July and August, turned negative in September at -21.5%, and in potatoes, carrots, leafy vegetables, brinjal, and cauliflower, decelerated. In contrast, in onions, it accelerated to 35.8% from 23.3%
- Inflation in cereals eased to 10.9% from 11.9% as inflation eased in both rice (11.9% vs 12.5%) and wheat (7.9% vs 9.3%) from non-PDS sources
- Inflation in proteins hardened to 8.3% from 6.8% and rose across major categories, including pulses (16.4% vs 13%) — led by higher inflation in arhar (37.3% vs 32.3%) and moong (11.2% vs 9.3%) — meat and fish (4.1% vs 3.7%), and eggs (6.4% vs 4.3%)
- Inflation in milk eased to 6.9% from 7.8%
- Inflation in spices remained high, easing nominally to 23.1% from 23.2%

Fuel inflation turns negative

- Despite the rise in international crude oil prices, domestic fuel inflation eased sharply in September, moving into the deflation zone, to -0.1% in September from 4.3% in August
- The moderation in fuel inflation was backed by a sharp fall in LPG inflation (-12.7 vs 4.2%), due to the central government cutting LPG prices by Rs.200 per cylinder effective August 30
- Electricity inflation, which has emerged as a major pressure point for fuel inflation this fiscal, also cooled in September to 11.2% from 13.5% the previous month
- Inflation hardened in kerosene from both PDS (-17.3% vs -25.1%) and non-PDS sources (19.1% vs 17.3%)

Core inflation eases

- Core inflation cooled to 4.5% from 4.9% in August
- Inflation in essential categories such as health (5.9% vs 6.2%), education (5.3% vs 5.5%) and housing (4% vs 4.4%) eased compared with July
- Inflation also eased in the transport and communication category (2.3% vs 2.5%) and clothing and footwear (4.6% vs 5.2%)
- Inflation in the personal care and effects category hardened to 8.5% from 8.1% as inflation accelerated in gold (17.6% vs 15.1%) and silver (24.7% vs 20.8%)

Urban poor saw largest reprieve in inflation from August to September

The burden of inflation varies by income group, as the share of spending on food, fuel and core categories differs. Essential items such as food and fuel have a greater share in the consumption basket of the lower income classes.

Rural residents faced a higher inflation burden in September compared to their counterparts in urban areas across income classes. While food and fuel inflation cooled in both rural and urban areas, the drop in inflation rates was more pronounced in urban areas and hence the urban poor saw the largest reprieve in inflation between August and September. As core inflation remained lower than food inflation, the urban rich faced a lower inflation burden than their counterparts in other income groups.

CPI inflation across income classes (% on-year)

Income segment	September 2023		August 2023	
	Rural	Urban	Rural	Urban
Top 20%	5.3	4.6	6.7	6.5
Middle 60%	5.3	4.7	7.1	7.2
Bottom 20%	5.3	4.7	7.2	7.6

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

Source: NSSO, National Statistical Office, CEIC, CRISIL

Industrial activity sees a broad-based revival

Industrial output measured by the Index of Industrial Production (IIP) surged to 10.3% on-year in August from 6% previous month. This was the strongest growth in 14 months, helped by a low base as well as stronger sequential momentum. It ties up with S&P Global Purchasing Managers Index (PMI) for manufacturing rising to 58.6 in August, versus 57.7 previous month.

Strong IIP growth in August was the result of revival in export-oriented sectors, apart from healthy domestic demand and strong government capex.

But exports are expected to weaken given the slowing advanced economies in the west. The impact of uneven monsoon on rural demand remains to be seen. The lagged impact of repo rate hikes may play out on domestic demand in the second half of this fiscal. Rising crude oil prices and geopolitical tensions are a risk to input cost pressures for manufacturers. All these factors could cap buoyancy in industrial activity in the coming months.

Data highlights

- IIP rose 10.3% on-year in August compared with 6.0% previous month, and -0.7% in August last year
 - All major sectors recorded an improvement: mining (12.3% in August versus 10.7% previous month) manufacturing (9.3% vs 5.0%) and electricity (15.3% vs 8.0%)
 - Within manufacturing, growth was once again the strongest infrastructure and construction goods (14.9% vs 12.4%), followed by capital goods (12.6%), primary goods (12.4%) intermediate goods (6.5%), and consumer durables (5.7%)
 - Sequentially, IIP grew 1.4% on-month on a seasonally adjusted basis. Electricity saw the strongest sequential growth, followed by mining and manufacturing
 - Overall, IIP growth has been higher in second quarter so far (8.2% in July-August 2023), compared with 4.7% in the first quarter
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Infrastructure activity remains the driving force

- IIP growth in infrastructure and construction goods was the strongest and rose to 14.9% on-year in August from 12.4% previous month
- Government capex remained strong: 29.9% higher on-year for centre and 27.6% for 16 major states in August

Improvement in both essential and discretionary consumption goods

- Consumer non-durables IIP showed persistent growth: to 9.0% in August from 7.9% previous month. This was driven by beverages (9.4% vs 3.9%). However, food products slowed (2.9% vs 5.2%)
- Consumer durables showed a turnaround to 5.7% from -2.6% in July. The improvement was driven by automobiles (12% vs 8.9%), rubber and plastic products (4% vs 0.2%), and leather products (3.9% vs -4.0%). This indicates a recovery in both high and low-ticket items.
- Decline narrowed in wearing apparels (-17.1% vs -22.5%) and electronics (-8.7% vs -16.8%)

Narrowing export decline helps IIP growth

- IIP growth revived for export-oriented sectors in August. Merchandise exports declined lesser at -6.9% on-year in August compared with -10.1% previous month, partly driven by rising prices in some commodities. Decline narrowed for oil exports with sequential improvement in crude oil prices. Non-oil exports grew (0.2% vs -1%), driven by engineering goods, iron ore, and pharmaceuticals
- IIP grew for pharmaceutical products (16.8% vs 12.0%), basic metals (15.7% vs 12.8%), machinery and equipment (12.4% vs 4.7%), coke and refined petroleum products (10.2% vs 4.2%), and textiles (1.6% vs 0.9%).
- However, IIP remained weak for chemical products (-4.3% vs -7.4%) in line with its declining exports

Outlook

Industrial activity is expected to slow in the coming months. S&P Global's Purchasing Managers Index (PMI) for manufacturing moderated to 57.5 in September from 58.6 previous month. Among other high frequency indicators, E-way bills slowed in September, but railway freight and auto sales recorded higher growth.

That said, India's industrial activity has been stronger than other major economies. S&P Global PMI manufacturing was lower for the United States (US) at 49.8 in September, Eurozone at 43.4, and China at 50.6.

The external environment will be a bigger drag on industrial growth, as western advanced economies slow in the second half of this fiscal. Interest rates are expected to stay higher for longer, with no rate cut expected in US and Europe before the second half 2024.

Rising crude oil prices amid new geopolitical flare-ups have added fresh risks for inflationary pressures. It also add risks for input cost pressures for manufacturers.

Domestic demand may remain supportive of growth. The latest RBI's surveys show consumer confidence reaching a 4-month high in September. Manufacturers remain highly optimistic on demand conditions, while bankers expect further improvement in loan demand in the second half of this fiscal.

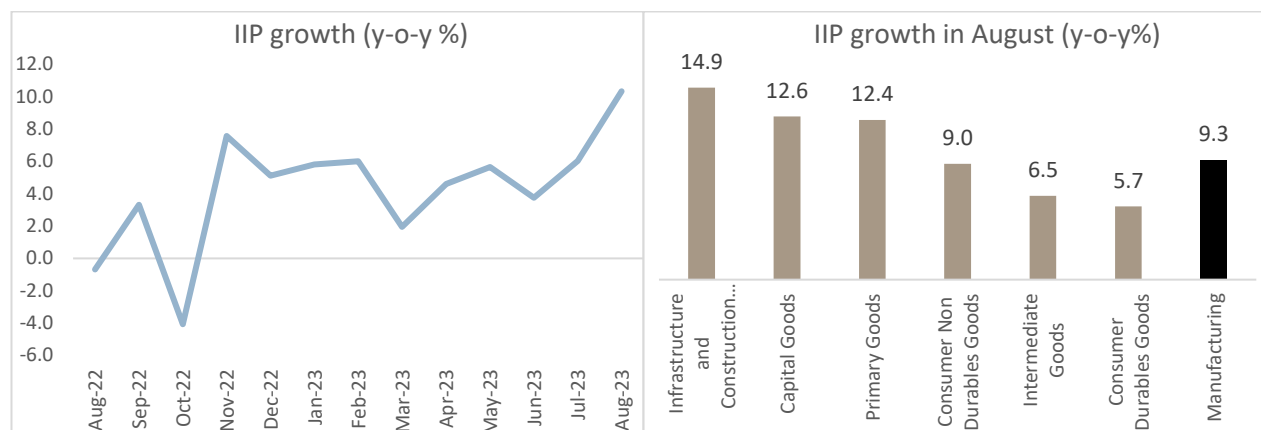
However, monsoon remains a risk to rural demand. With the monsoon highly uneven this year, ending 6% below the long period average, kharif sowing has been mixed across crops, with rice, sugarcane and coarse cereals higher and pulses and oilseeds lower. Rabi output also faces risks from low reservoir levels.

Also, the lagged impact of Reserve Bank of India's rate hikes will likely play out in the second half this year.

Due to these factors, we expect GDP growth to slow after the peak of 7.8% reached in the first quarter. Overall, we expect GDP growth at 6.0% this fiscal compared with 7.2% the previous year.

Chart 1: IIP growth on a rising trend in the first half this fiscal

Chart 2: Industrial goods clock highest growth



Source: National Statistics Office (NSO), CEIC, CRISIL

Analytical contacts

Dharmakirti Joshi

Chief Economist, CRISIL Limited
dharmakirti.joshi@crisil.com

Dipti Deshpande

Principal Economist
dipti.deshpande@crisil.com

Pankhuri Tandon

Senior Economist
pankhuri.tandon@crisil.com

Sharvari Rajadhyaksha

Economic Analyst
sharvari.rajadhyaksha@crisil.com

Meera Mohan

Economic Analyst
meera.mohan@crisil.com

Media contacts

Aveek Datta

Media Relations
CRISIL Limited
M: +91 99204 93912
aveek.datta@crisil.com

Riddhi Savla

Media Relations
CRISIL Limited
M: +91 98199 57423
riddhi.savla1@crisil.com

Roma Gurnani

Media Relations
CRISIL Limited
M: +91 78754 32131
roma.gurnani@ext-crisil.com

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