Macroeconomics | First cut

Non-food inflation to the rescue; IIP uneven

May 2024

Retail inflation dodges pressure from food, traces softening in fuel and core

Consumer price index (CPI) inflation eased marginally to 4.8% in April from 4.9% in March. Food inflation, however, edged up to 8.7% from 8.5%, driven by costlier cereals and meat; vegetables, which have been sticky at elevated levels, softened a touch. Prices of edible oils fell at a softer pace on-year.

Despite the uptick in food, non-food components helped curtail headline inflation. Fuel prices deflated at a faster pace while core inflation eased to a record low of 3.2%.

Food inflation, which has a 39.1% weight in the CPI gauge, has remained well above 8% for six months now. Pressure on food prices continues, with the ongoing heatwaves being one factor.

Our base case is the upcoming monsoon rains can offer respite, assuming they are they are well distributed in terms of time and geography.

Fuel and light, with a 6.8% weight, has been reducing the pressure on the headline for eight months, led by the government's retail fuel price relaxations. But if crude oil prices surge and stay elevated in the wake of geopolitical concerns, inflation could trend upwards again.

Meanwhile, core inflation, with a weight of 47.3%, has been low for most of this period. However, the expected rise in commodity prices with a low base effect can put upward pressure on core inflation in the current fiscal.

Net-net, we expect CPI inflation to broadly ease to 4.5% on-year this fiscal from 5.4%. Softer headline inflation forecast is primarily premised on lower food inflation assuming a normal monsoon and on the back of the high base of fiscal 2024.

Key data points in April

- CPI inflation eased to an eleven-month low of 4.8% from 4.9%
- Food inflation picked up to 8.7% from 8.5%
- Fuel[1] inflation declined to -4.2% from -3.4%
- Core CPI[2] inflation eased to 3.2% from 3.3%

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

Food inflation inches up

- Although prices of cereals fell on-month, inflation in cereals hardened to 8.6% (8.4% in March) due to an adverse base. Inflation hardened in non-PDS (Public Distribution System) wheat (6% vs 4.7%) while it eased a tad in non-PDS rice (12.5% vs 12.7%)
- Inflation in pulses continued to ease to 16.8% in April from 17.8% in March. This was led by cooling inflation in arhar (31.4% vs 33.6%) and moong (10% vs 11.6%)
- Vegetables inflation softened a touch to 27.8% from 28.3%. TOP (tomatoes, onions, potatoes) and non-TOP inflation moved in opposite directions. While TOP inflation accelerated to 44.9% from 37.4%, driven by tomatoes (41.8% vs 32.6%) and potatoes (53.6% vs 40.9%), non-TOP inflation eased to 20.4% from 24.4%
- Inflation in meat and fish accelerated for the third straight month to 8.2% from 6.4% driven by chicken (13.9% vs 8.6%)
- Prices of edible oils declined 9.4% on-year in April compared with a 11.7% fall in the previous month
- Spices inflation softened to 7.8% from 11.4%. This is the first time since May 2022 that spices have seen single-digit inflation
- Inflation in sugar softened sharply to 5.9% from 7.3%

Fuel inflation declines

- Fuel inflation remained negative for the eight straight month, slipping to -4.2% in April from -3.4% in the previous month
- Liquefied petroleum gas prices deflated 24.9% on-year in April compared to a deflation rate of 22.7% in March
- Inflation also eased in non-PDS kerosene (8.5% vs 9.5%) and fire and woodchips (2.8% vs 3.3%)
- Inflation in electricity remained sticky, but edged down to 10.2% from 10.4%

Core inflation eases to record low

- Core inflation inched down to 3.2% from 3.3% the previous month, the slowest pace on record
- Inflation eased in education (4.2% vs 4.7%) while it was unchanged in health (4.3%) and housing (2.7%)
- The personal care and effects care and effects category saw inflation harden for the second straight month to 7.4% from 6%, as inflation in precious metals such as gold (17.7% vs 12.9%) and silver (11.3% vs 10.8%) accelerated

Rural poor face the highest burden

The effect of inflation varies across income groups since the share of spending on food, fuel and core categories differs according to classes. Items such as food and fuel, being essential, occupy a greater share in the consumption basket of those with a lower income.

Rural residents faced a higher inflation burden than their urban counterparts across income segments in April. This was due to two factors. One, rural inflation was higher than urban inflation in all three major subcategories. Two, food, which was the pain point for inflation this month, occupies a much larger share in the consumption basket of rural residents. Hence, the poorest segment in rural areas faced the highest inflation burden as food and beverages comprise 60% of their consumption basket.

Rural inflation continues to outpace urban inflation across categories

Category	Rural	Urban
Headline	5.4	4.1
Food	8.8	8.6
Fuel	-1.3	-9.1
Core	3.3	3.1

Source: National Statistical Office, CEIC, CRISIL

CPI inflation across income classes (% on-year)

Income segment	April		March	
	Rural	Urban	Rural	Urban
Top 20%	5.1	4.1	5.2	4.1
Middle 60%	5.5	4.4	5.6	4.4
Bottom 20%	5.6	4.5	5.6	4.5

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 April inflation trends. The table above presents the average inflation faced by each income class.

Source: NSSO, National Statistical Office, CEIC, CRISIL

Uneven trends in subsectors moderate IIP

The Index of Industrial Production (IIP) rose 4.9% on-year in March, down from 5.6% in February. Meanwhile, February's reading was revised down marginally from the previous estimate of 5.7%. The slowdown was driven by mining, while manufacturing and electricity recorded an uptick.

IIP reflected uneven growth across major industrial sectors. While overall IIP growth moderated in March, manufacturing IIP rose. However, the increase in manufacturing was driven by merely two sectors – capital goods and consumer non-durables.

Infrastructure and construction goods, a major driver of IIP growth in the past fiscal, slowed. Consumer durables slackened, reflecting moderation in urban demand.

Manufacturing growth may wane next fiscal with moderating government capital spending unless the private sector steps up. The lagged impact of the Reserve Bank of India's (RBI) rate hikes and regulatory tightening of

credit is also expected to have a bearing, particularly for urban consumption of high-value items. However, a good monsoon and reviving rural demand is expected to augur well for consumption.

Net-net, lower fiscal support and tighter financial conditions are expected to weigh on industrial activity this fiscal. We expect overall gross domestic product (GDP) growth to moderate to 6.8% this fiscal from an estimated 7.6[3]% in fiscal 2024.

Data highlights

- IIP growth decreased to 4.9% on-year in March from 5.6% the previous month. The index contracted 1.0% on-month after seasonal adjustments
- Growth in mining slowed sharply (1.2% on-year versus 8.1%) on account of a sharply unfavorable base while that in electricity (8.6% vs 7.5%) and manufacturing (5.2% vs 4.9%) picked up
- Manufacturing growth was buoyed by a sharp pickup in capital goods (6.1% on-year versus 1.0%) and consumer non-durables (4.9% vs -3.5%). Meanwhile, growth in infrastructure and construction goods (6.9% vs 8.5%), intermediate goods (5.1% vs 8.7%) and primary goods (2.5% vs 5.9%) decreased

Manufacturing picks up marginally

- The manufacturing pickup was on the back of rising growth in capital goods and consumer non-durables. Within capital good, growth was higher in fabricated metals (20.3% vs 14.9%) and electrical equipment (14.0% vs 10.0%)
- However, the overall performance of export-oriented sectors deteriorated in March, with output contracting for coke and refined petroleum products, chemicals and computer and electronic products. Output growth in basic metals moderated as well. This reflects the deteriorating performance of merchandise exports in March, which contracted 0.7% on-year after rising 11.8% in February. However, pharmaceuticals growth rose (16.7% vs -10.6%)

Mixed performance in consumer goods

- Consumer durables recorded moderating on-year output growth (9.5% in March versus 12.4% in February), led by slowing output growth of automobiles (6.6% vs 11.6%) as well as a contraction of output in computer and electronic products (-1.0% vs 1.9%) and textiles (-0.8% vs 3.7%)
- While on-year growth in consumer non-durables rebounded (4.9% vs -3.5%), sequentially, output continued to decline (on a seasonally adjusted basis). The rise in on-year growth was driven by pharmaceutical products. However, food products continued to decline (-3.9% vs 2.0%)
- Consumer durables (9.5%) continued to record higher on-year growth than non-durables (4.9%)

[3] *NSO's second advance estimate*

Performance of industrial goods moderates

- Output growth moderated in infrastructure and construction goods (6.9% vs 8.5%), reflecting lower government capex growth in March. Output growth in primary and intermediate goods also moderated
- Electricity IIP growth picked up to 8.6% in March from 7.5% in the previous month

Outlook

The IIP data points to slowing GDP growth ahead. On average, IIP grew slower at 4.9% in the fourth quarter, compared with 6.2% in the third, which is likely to contribute to lower manufacturing GDP growth this quarter.

That said, industrial activity remains healthy, as indicated by the manufacturing Purchasing Managers' Index staying consistently in expansionary zone. As in April, manufacturing PMI stood at 58.8, the second-best reading in three-and-a-half years.

Rural demand – which was a key drag on consumption in the previous fiscal – could revive this fiscal. Early weather forecasts predict an above normal monsoon. However, the lagged impact of the RBI's rate hikes and regulatory tightening of credit could have a moderating impact, especially for urban consumption.

Fiscal support to industrial activity is expected to wane in fiscal 2025 as the government targets lowering the fiscal deficit to 5.1% of GDP from 5.8% of GDP in the previous fiscal. A pickup in private capex is critical to sustain the investment momentum.

Exports continue to face risks from geopolitical tensions. Uneven growth in India's major trading partners could restrict India's export recovery. S&P Global expects the United States to grow 2.5% in 2024; growth may be weaker in the Eurozone at 0.7%. Unfavourable crude prices are a risk to domestic industrial activity.

Net-net, we expect these factors to contribute to a moderation in GDP growth to 6.8% in the current fiscal from an estimated 7.6% past year.

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