Macroeconomics | First cut

Inflation, IIP a wee lower

June 2024

High food prices allow only a slight moderation in inflation

Consumer price index (CPI) inflation moderated slightly to 4.75% in May from 4.8% in April. Non-food categories drove down the headline number, but what's worrying is the relentless inching up of key food categories — cereals and pulses — and the rigidity in vegetables at elevated levels.

Food inflation has stayed above 8.5% for four months now. In May, seasonal pressures kept it at 8.7%, unchanged from April.

Non-food inflation continued to offer some respite, printing at a record low of 2.3%. Much of this was due to the core sliding to 3%, also a record.

The southwest monsoon has arrived on time; now, its progress will influence how food inflation moves over the next few months. From June, the high base would offer support, but a sharper easing in inflation, particularly food inflation, will depend on the advancement of the monsoon.

For this fiscal, we expect inflation to average 4.5%. Assuming a normal monsoon, we expect food inflation to soften. Non-food inflation could see a statistical uptick but is overall expected to remain soft on the back of benign commodity prices. Geopolitical developments need to be watched as escalations in ongoing tensions could push up commodity prices and constrain supply chains.

Key data points in May

- CPI inflation eased for the fourth straight month to 4.75% from 4.8%
- Food inflation was high and unchanged at 8.7%
- Fuel[1] prices fell 3.8% on-year compared with a decline of 4% in the previous month
- Core CPI[2] inflation eased to 3.0% from 3.2%

Rigid food inflation

- Food inflation stood unchanged from the previous month, at 8.7%. Foodgrain inflation inched up to 10.4% in May from 10.2% in the previous month since inflation in cereals and pulses rose. After four straight months of easing, pulses inflation unexpectedly rose 30 basis points (bps) to 17.1%, mainly due to an uptick in inflation in arhar (32.1% vs 31.4%). Cereals inflation was up 10 bps to 8.7%

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

- Vegetables inflation was also rigid at 27.3% compared with 27.8%. TOP (tomatoes, onions, potatoes) and non-TOP vegetables inflation continued to diverge for the third straight month. TOP inflation rose to 46.5% from 45% while non-TOP vegetables inflation eased to 18,8%. Inflation hardened on-month in potatoes (55.4% vs 53.6%) and onions (38.1% vs 36.7%)
- The pace of deflation in edible oils slowed for the fourth consecutive month. Inflation in edible oils stood at -6.7% in May compared with -9.4% in April. This was led by slowing deflation in mustard oil (-8.6% vs -12.2%) and refined oil (-10.8% vs -14.4%)
- Spices inflation eased sharply for the ninth straight month, to 4.3% from 7.8%. Jeera's inflation was in single digits for the first time since March 2022 (9.1% vs 29.3% in April). Inflation in dry chilies was negative at -3% compared with -0.5% in April
- Inflation in milk eased below 3% for the first time since 2021, standing at 2.6% in May, down 40 bps from April

Fuel inflation remains negative

- Fuel inflation remained negative for the ninth straight month, though the pace of deflation slowed (-3.8% vs -4%)
- Prices of liquefied petroleum gas prices fell 24.9% on-year in May, same as the previous month
- Electricity inflation eased to 10% from an upwardly revised 10.9% in April
- Inflation inched down in fire and woodchips (2.7% vs 2.8%)

Core inflation eases further

- Core inflation continued to trend downwards, to 3% from 3.2%
- Inflation was down in several key categories such as housing (2.6% vs 2.7%), health (4.2% vs 4.3%) and education (4.1% vs 4.2%)
- Inflation in personal care and effects care and effects accelerated for the third consecutive month, to 7.7% (vs 7.4% in April), as gold prices surged (18.2% vs 17.8%)

Inflation burden faced by rural residents eases

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.

Inflation in rural areas eased compared with the previous month while that in urban areas rose. This was due to higher food inflation relative to the previous month in urban areas (8.8% vs 8.6%). Rural food inflation eased (8.6% vs 8.8%). That said, the inflation burden faced by rural residents continues to be higher since rural non-food inflation (2.4%) is higher than urban non-food inflation (2.1%). Additionally, food makes up a greater share of the rural consumption basket.

CPI inflation across income classes (% on-year)

Income segment	May		April	
	Rural	Urban	Rural	Urban
Top 20%	5.0	4.1	5.1	4.1
Middle 60%	5.4	4.6	5.5	4.4
Bottom 20%	5.4	4.7	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 May inflation trends. The table above presents the average inflation faced by each income class.

Source: NSSO, National Statistical Office, CEIC, CRISIL

IIP moderates on the back of manufacturing slowdown

The Index of Industrial Production (IIP) slowed to 5.0% on-year in April, down from 5.4% in March. Meanwhile, March's reading was revised up significantly from 4.9% to 5.4%. The April slowdown was driven by manufacturing, but mining and electricity recorded an uptick.

While manufacturing growth slowed in April, the trends varied across its major sectors. Growth slowed in three of the six major manufacturing subsectors.

Among industrial sectors, infrastructure and construction goods growth was ahead of export-linked sectors. Among consumer-oriented sectors, consumer durables grew stronger than non-durables, reflecting higher-value consumption items were continuing to drive growth.

Domestic demand could rebalance in the current fiscal if rural consumption catches up with urban. This is expected if monsoon is normal and well distributed. The urban economy, which has been stronger so far, could be tempered by tighter credit conditions this year.

Additionally, the government's fiscal consolidation efforts could moderate capex support to industry this year.

Due to these factors, we expect gross domestic product (GDP) growth to slow to 6.8% this fiscal from 8.2% in the previous fiscal.

Data highlights

- IIP growth decreased to 5.0% on-year in April from 5.4% the previous month. However, the index grew 1.3% on-month after seasonal adjustments
- The slowdown was driven by manufacturing (3.9% on-year versus 5.8%) while growth picked up in mining (6.7% vs 1.3%), and electricity (10.2% vs 8.6%)
- The slowdown in manufacturing growth was driven by capital goods (3.1% on-year versus 6.6%) and intermediate goods (3.2% vs 5.5%) along with a contraction in consumer non-durables output (-2.4% vs 5.3%). Meanwhile, growth picked up in consumer durables (9.8% vs 9.5%), infrastructure and construction goods (8.0% vs 7.4%) and primary goods (7.0 vs 3.0%)

Growth trends vary across industrial sectors

- Among industrial goods, capital goods recorded the lowest output growth (3.1% on-year vs 6.6%), driven by slowing output growth in machinery and equipment (1.0% vs 2.5%), electrical equipment (3.3% vs 14.0%) and fabricated metals (10.2% vs 20.3%)
- Intermediate goods also recorded slowing output growth (3.2% vs 5.5%) on the back of an output contraction in paper and paper products (-4.0% vs 0.1%) and wood and wood products (-5.5% vs 3.1%), as well as slowing output growth in other non-metallic mineral products (1.7% vs 7.7%)
- Slowdown in some of the above categories as well as pharmaceutical products (3.1% vs 16.7%) was reflected in deteriorating export performance: non-oil export growth slowed on-year in April (0.6% vs 8%)
- On the other hand, output growth picked up in infrastructure and construction goods, reflecting an on-year pickup in central capex growth in April. Additionally, growth picked up substantially for primary goods

Consumer durables grow, non-durables contract

- Consumer durables recorded a slight pickup in on-year output growth (9.8% in April versus 9.5% in March), driven by a broad-based growth pickup across categories. Growth picked up in furniture (38.4% on-year versus 31.0%), automobiles (11.4% vs 6.6%) as well as computer and electronic products (3.9% vs -1.0%)
- Consumer non-durables output contracted in April (-2.4% vs 5.3%). However, sequentially, output grew after staying steady in the previous month (on a seasonally adjusted basis). The on-year contraction was driven by a steep contraction in output of food products (-12.7% vs -3.9%)

Outlook

IIP growth has slowed gradually in the past two months. The Purchasing Managers' Index (PMI) for manufacturing indicates further slowdown in May (57.5 in May versus 58.8 previous month). However, India's manufacturing PMI remains the strongest among its Asian peers.

There could be some rebalancing in domestic demand in the current fiscal with rural demand catching up with urban consumption. The expectation of an above-normal monsoon augurs well for rural incomes. However, rainfall distribution will have a bearing on agriculture. The easing of food inflation also matters, since it can create space for discretionary consumption.

The urban economy could be tempered by tighter credit conditions. Bank retail credit growth has been moderating in recent months, while regulatory measures to restrict bank lending to non-banking financial companies will also trickle to consumer loans. The Reserve Bank of India’s consumer confidence survey conducted in May 2024 also shows moderating consumer confidence in urban areas.

Notwithstanding healthy government capital expenditure, we expect it to be lower than the previous year with the government pursuing fiscal consolidation.

Slower global growth can restrict upside to goods exports owing to normalisation of supply chains and an expected pick-up in volume of trade in calendar 2024.

Due to these factors, we expect GDP to slow to 6.8% this fiscal from 8.2% in the previous year.

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