Fruit & veggies lift CPI, base-effect pop for IIP

CRISIL First Cut

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Dearer fruits and vegetables, GST on services, take CPI further up

Consumer price index (CPI)-based inflation rose 100 basis points (bps) to 3.4% in August from 2.4% in July, marking the second month of ascend.

Food inflation turned positive as low-base effect waned, and on the back of sharp increase in food and vegetables inflation. The August print at 1.5% marked a turnaround after 3 months of deflation. Inflation in fruits and vegetables surged to 5.9%, quite a turnaround from -5.6% average for the preceding 11 months. **But exclude fruits and vegetables, and CPI inflation would be 1.4%, compared with 1.6% in July.**

Pulses inflation continued to slide at -24.4% in August. Our recent report, Pulses & Rhythms shows how this trend has put the profitability of pulse growers at risk even as consumers benefit.

Meanwhile, core inflation edged up 10 basis points to 4.4%, again the second consecutive month of rise. This was was led by housing, pan, tobacco and intoxicants, recreation and transport and communication. This broad increase in core inflation categories reflects the impact of the implementation of the Goods and Services Tax (GST).

GST rates for most services are higher than the erstwhile service tax rate and is likely to have pushed up prices.

Fuel inflation jumped to 6% from 4.3% in July, led by a steep increase in diesel and petrol – where prices rose to the highest level since August 2014 – prices.

The months ahead could see some bump-up in prices at the retail level as producers price products and services in line with the GST rates. Meanwhile, some food items will continue to see their low-base effect wearing off.

There are other factors that will curb inflation, such as a normal monsoon, which will keep food prices in check; benign global oil and commodity prices, which, along with a strong rupee, will keep imported inflation in check; and, moderate pick-up in domestic demand, which will have a subduing effect.

CRISIL expects CPI to average 4% in fiscal 2018 (down from 4.5% in fiscal 2017).

- Food inflation rebounded to 1.5% in August after three months of deflation. The sharp rise was led by food and vegetables, where inflation jumped to 5.9% from -1.7% in July. Excluding this category, food inflation declined further to -1.6% from -1.1% in July. The fall in the index also was caused by a -24.4% inflation in pulses (compared with -24.7% in July), and -1.7% in eggs (from -2% in July). Inflation also eased in sugar (down 90 bps to 7.4%), milk (down 20 bps to 3.6%), meat and fish (down 20 bps to 2.9%) and cereals.
- Fuel inflation, calculated by adding petrol, diesel, fuel and light components, jumped to 6% in August from 4.3% in July. Within this category, inflation in fuel and light was nearly unchanged from the previous month at 4.9%, while in petrol and diesel, it surged to 10.3% from 2.4% led by steep increase in domestic price of petrol and diesel.
- Core inflation (CPI excluding food, fuel and light, petrol and diesel) rose slightly to 4.4% in August, from 4.3% in July. This is the second straight month of rise in core inflation. The pick-up was led by by hardening inflation in nearly all categories, especially housing (up 70 bps to 5.6%), pan, tobacco and intoxicants (up 50 bps to 6.8%), recreation (up 50 bps to 3.9%) and transport and communication (up 20 bps to 1.8%). This across-the-board increase reflects the impact of the implementation of the Goods and Services Tax (GST). GST rates for most services are higher than the erstwhile service tax rate and is likely to have pushed up prices.

IIP returns back to positive territory on account of low base

After declining for the first time in four years in June, industrial activity turned positive in July. The Index of Industrial Production (IIP) grew 1.2% in July against -0.17% in June, the month when GST related uncertainties had led to destocking and cutback in production. That said, it would be too early to infer a turnaround in production activity on the basis of positive IIP growth in July as there is also a base effect at play. IIP growth in July 2016 had stood at 4.5%, a sharp slowdown from 8% in June 2016. July's IIP index is lower than June's, suggesting slowdown on a sequential basis.

- Though the turnaround in IIP growth was largely premised on a low-base effect, among the sectors, electricity did the best, growing at 6.5% (up from 2.2% in June), followed by mining sector, which grew 4.8% (up from 0.4%). Manufacturing activity, which at 77.6%, has the largest weight in IIP, was almost stagnant, Manufacturing IIP grew a meagre 0.08% in July compared with -0.5% in June.
- Within manufacturing, there were some sectors that displayed high positive growth. For instance, 'pharmaceuticals, medicinal chemicals and botanical products' grew 18.9%, followed by 'transport equipment', which was up 10.5%. Overall, only 8 out of 23 industry groups in the manufacturing sector showed positive growth on an annual basis. Some sectors that displayed extreme negative growth were, 'tobacco products' (-43.4%), followed by electrical equipment (-11.1%) and 'printing and reproduction of recorded media' (-8.8%). Broadly, the industrial & investment-oriented manufacturing sectors registered negative growth (-1.1%) for the second consecutive month whereas consumer-oriented sectors (accounting for 37% of the manufacturing sector IIP) managed to stay afloat with 0.8% growth.
- According to the use-based classification, while capital goods continued with their downward journey (growing 1.02% in July), intermediate goods closely followed suit and grew negatively (-1.8%) for the second consecutive month. The relatively high growth (3.7%) in infrastructure and construction goods shouldn't surprise as it is mostly on account of a favourable base effect (negative growth in the same month last year). In the consumer category, non-durables (which largely represents the FMCG segment) continued to do well, growing 3.4% in July, suggesting positive impact of normal monsoon in most rural parts. But durables continued to perform poorly, with a de-growth of -1.3% for the second consecutive month in July.

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