CPI up despite higher base, big pop in IIP

CRISIL First Cut | January 2018

CPI darts up to 5.2% in Dec despite higher base; core inflation up at 5.1%

Consumer price index (CPI)-based inflation rose to 5.2% in December, up from 4.9% in November. The low-base effect, which was behind the acceleration in CPI inflation from July to November 2017, faded away in December. Yet CPI inflation printed at a 17-month high driven by higher inflation in housing, food (especially vegetables) and personal care and effects – factors that still warrant caution on part of the Reserve Bank of India (RBI).

This is corroborated by the fact that the three-month moving average of seasonally adjusted CPI shows a continued increase in momentum, despite the base effect turning favourable (excluding the base effect, inflation would have stood at ~5.4% in December).

The steep rise in housing inflation (at 8.2% from 7.4% in November) clearly reflects the impact of higher house rent allowances paid to government employees – a concern that was persistently highlighted by the RBI. Meanwhile inflation in vegetables soared to 29.1%, while inflation in personal care and effects (at 4.5% from 3.4%) is reflective of both, return of pent up demand in the economy and impact of higher taxes on services due to goods and service tax implementation).

Core inflation climbed to 5.1% in December – also a 17-month high, from 4.9% in November led by inflation in housing and personal care. Meanwhile, fuel inflation dipped while food inflation rose led by vegetables.

For fiscal 2018, CRISIL maintains the average inflation forecast at 4%. Accordingly, we also expect the Monetary Policy Committee to keep policy rates on hold for the remainder of this fiscal.

So far, inflation has averaged 3.2% for the fiscal, which suggests that the last quarter is expected to see a steep rise in inflation. Overall food inflation is expected to stay benign, but mild pressures could arise due to some shortfall in rabi sowing so far (especially oilseeds and wheat). Of bigger concern is the firming up of housing inflation and the sharp and sustained rise in global oil prices. On the downside, items of mass consumption could see softer prices if the latest downward revision in the Goods and Services Tax rates on some items is passed on to consumers. The interplay among factors will therefore determine the pressures on inflation.

Data snapshot

- Food inflation rose to 5% in December, from 4.3% in the previous month. The increase was supported by somewhat higher inflation in eggs, meat & fish, oils & fats and fruits, but mainly driven by a steep climb in vegetables' inflation which rose to 29.1% from 22.5%. Meanwhile, inflation in cereals and pulses continued to climb down (at -23.5% for pulses and 2.6% for cereals), capping the upside in the food index.
- Fuel inflation, calculated by adding petrol, diesel, fuel and light components, eased to 7% in December from 7.5%, that in fuel and light it slipped to 7.9% from 8.2%, while inflation in petrol and diesel fell to 3.6% from 4.9%. During December, prices for the Indian crude oil basket saw a slower climb – they were up 18.1% on-year, compared to 37.9% increase in November, but a stronger rupee also supported in capping the upside to imported fuel inflation
- Core inflation (CPI excluding food, fuel and light, petrol and diesel) climb higher – to 5.1% in December, from 4.9% in November. This was led by a continued sharp jump in housing inflation (up to 8.2% from 7.4%) reflecting the impact of revision of house rent allowance paid to government employees. But other than housing, inflation in personal care and effects rose sharply reflecting the impact of pent-up demand and impact of higher taxes on services due to goods and service tax implementation.

Big surge in IIP

The Index of Industrial Production (IIP) growth rocketed in November to 8.4%, propelled by manufacturing, and after a tepid October. The purchasing manager's index and a sharp pick up in merchandise exports too had indicated positive growth in manufacturing activity in November. This could be indicative of de-clogging of manufacturing activity after the government simplified the GST refund rules and that led to a sharp surge in exports in November.

While there was improvement in the industrial activity on the sequential basis, it also benefitted from lower base of last year (the index had slowed down in November last year). Since this index has generally displayed large volatility in the past, one will have to look at this sharp pick-up in growth cautiously and it remains to be seen whether such high growth is sustainable.

- Industrial activity benefited from a surge in exports in November as government eased the GST refund process, a key concern of the manufacturers. Index of industrial production (IIP) growth shot up to 8.4% on-year in November from a downwardly revised 2.0% (from 2.2% earlier) growth in October. Manufacturing sector (the largest contributor to IIP, having 77.6% weight) was the key to this surge. Manufacturing sector grew 10.2% - the highest ever growth in this series - in November, up from 2.2% in October. Growth in the other two components of IIP – mining and electricity – was only marginally better. While mining growth improved to 1.1% from -0.1%, electricity grew by 3.9% compared with 3.2% in October.
- Within manufacturing, 15 out of 23 industry groups showed positive growth on an annual basis. Sectors which displayed high positive growth were, 'pharmaceuticals, medicinal chemical and botanical products', growing by 39.5%, followed by 'computer, electronic and optical products, which was up 29.1%, and 'other transport equipment, which clocked a growth rate of 22.6%. Sectors that displayed high negative growth were, 'Other manufacturing' (-15.9%), followed by 'wearing apparel' (-13.1%) and 'electrical equipment' (-13.2%). It is also the fourth consecutive month that saw positive growth in both the industrial & investment-oriented manufacturing sectors and the consumer-oriented sectors (accounting for 37% of the manufacturing sector IIP), suggesting a broad based improvement in manufacturing activity. Both sets grew by 3.7% in November.
- According to the use-based classification, all the segments displayed positive growth. Capital goods displayed a high growth of 9.4% despite a high base of last year, suggesting some churn there. Infrastructure and construction goods saw their growth jumping to 13.5% in November, from 5.5% in October. Consumer goods too grew positively with consumer non-durables clocking a 23.1% growth.

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