Macroeconomics | First cut

Inflation gathers pace, IIP trudges up, too

December 2021

CPI inflation rises for second consecutive month

Inflation based on the consumer price index (CPI) moved up to 4.9% on-year in November compared with 4.5% in October. However, it was lower than the 6.9% printed in November 2020. While the high-base effect from last year is helping, it is wearing out gradually, and this is contributing to the pick-up in inflation. Rising food and core inflation also pulled the CPI up, while fuel inflation eased as crude prices moderated.

With impact of the high statistical base wearing off, CPI inflation is beginning to reflect the pressure built over the past few months. While non-food inflation had already been rising over the past few months, food inflation has begun to tick up as well. We expect non-food inflation to remain under pressure in the coming months as commodity prices remain elevated, and producers passing through high input costs to consumers amid improving demand conditions.

Inflation trends in November: highlights

- CPI inflation rose to 4.9% on-year in November from 4.5% in October and 6.9% in November 2020
- Sequentially, CPI grew 0.5% on-month on a seasonally adjusted basis, slower than the 0.8% seen in October[1]
- Food inflation rose to 1.9% on-year compared with 0.8% October, but was lower than 9.5% in November 2020
- Fuel[2] inflation moderated to 13.3% from 14.3% in October, but higher than 1.6% in November 2020
- Core[3] inflation rose to 6.2% from 5.9% in October, and 5.7% in November 2020
- Urban inflation rose to a greater extent than rural. Urban inflation came at 5.5% in November compared with 5% in October, while rural inflation was 4.3% versus 4.1% in October

How key items saw inflation move

- **Food and beverages** inflation rose to 2.6% on-year in November compared with 1.8% in October. Essential commodities such as cereals, milk, fruits and vegetables drove the rise.

[1] All on-month inflation numbers are seasonally adjusted
[2] Refers to fuel and light category
[3] Refers to CPI, excluding food and beverages and fuel and light

    - Cereal prices rose for the second consecutive month, at 1.5% in November after growing 0.4% in October
    - Vegetable inflation continued to show a decline on-year due to a high-base effect, but has surged sequentially over October. Inflation came at -13.6% on-year in November compared with -19.4% in October and 15.5% in November 2020. Sequentially prices rose 7.2% on-month. Unseasonal rains have affected vegetable arrivals over the past two months[4]
    - Fruits inflation jumped to 6% on-year from 4.9% in October
    - Milk inflation rose for seventh consecutive month, at 3.4% in November from 3.2% in October
    - Sugar and confectionery rose to 6.2% from 5.4% in October
    - However, protein items saw inflation ease, such as pulses (3.2% vs 5.4%), and eggs, meat and fish (4.9% vs 6.3%).
    - Edible oil inflation moderated for second consecutive month (29.7% vs 33.6%), helped by the cuts in import duties.
- **Fuel inflation** moderated to 13.3% compared with 14.3% in October. Prices of petroleum products eased as Brent crude oil prices moderated to $80.8 per barrel average in November from $83.7 per barrel in October.
- **Core inflation** rose to 6.2% from 5.9% in October
    - Rising inflation for following items growing pass-through of input costs to consumers: clothing and footwear (7.9% in November vs 7.5% previous month), recreation and amusement rose to (7.6% vs 6.9%), household goods and services (6.4% vs 6.2%) and personal care and effects (3.2% vs 2.5%)
    - Excise duty cuts on petrol and diesel, along lower crude oil prices, led transport and communication inflation moderate to 10% in November from 10.9% in October
    - Inflation reduced for health (7.3% vs 7.6%) and education (3.1% vs 3.3%).

Urban poor continue to face maximum inflation

The burden of inflation varies across different income groups, as the share of spending on food, fuel and core categories differs across classes. Using the National Sample Survey Organisation data, we estimated the average expenditure patterns across three broad income groups (bottom 20%, middle 60%, and upper 20% of population) and map them with the inflation trends[5].

In November, the urban poor faced the highest inflation at 5.6%. In contrast, the lowest inflation was faced by rural poor at 4.1% in November. For both rural and urban poor, food and fuel inflation constitute the highest share in their consumption basket. Inflation in both these commodities was higher in urban than rural areas.

CPI inflation across different income classes* (on-year, in %)

Income segment	November 2021	
	Rural	Urban
Top 20%	4.6	5.5
Middle 60%	4.2	5.5
Bottom 20%	4.1	5.6

** with share of commodity groups in expenditure basket of respective income class as weights*
Source: NSSO, National Statistics Office (NSO), CEIC, CRISIL

Outlook

We expect CPI inflation to average 5.5% this fiscal compared with 6.2% last year. The high-base effect is playing a key role in keeping headline CPI inflation lower than last year.

[4] For further details, refer to CRISIL Impact Note: *Extended Simmer* (November 2021).
[5] For detailed methodology and findings, refer to CRISIL Quickonomics: *Same inflation, different burdens by income* (October 2021)

While food inflation remains benign, it could be swayed by items such as vegetables, which account for a significant share in CPI and experience high volatility in prices. Further, the rain shock could keep prices under pressure in the coming months. That said, overall agriculture growth this fiscal is expected to remain healthy at 3-3.5%, given the normal monsoon, expectation of record kharif production, and adequate reservoir levels which bode well for rabi production.

Non-food inflation remains elevated. Although prices of crude oil, metals and costs of shipping have moderated over the past month, they remain significantly higher than last year. That, coupled with supply disruptions such as semiconductor shortages worldwide, has maintained pressure on producer margins. A pass-through of input-cost pressures to consumers, which was already happening in the past months, is likely to continue as domestic demand improves further.

Industrial production moved up in October

The Index of Industrial Production (IIP) printed at 133.7 in October, up from 128.2 in September. This represents a 3.2% on-year growth in October, compared with September's 3.3%.

After declining sequentially in the previous two months, industrial activity switched gears and moved up in October with both manufacturing and mining sectors recording higher output. The pick-up, however, remained uneven, pointing towards both, supply side bottlenecks (especially shortage of semiconductors) and subdued demand conditions, as reflected in a sequential decline in consumer durables output despite the festive season. High raw material prices, which are getting passed on to end-consumers, are also acting as a deterrent amid a fragile economic recovery.

Highlights

- The slowdown in on-year IIP growth to 3.2% in October, from 3.3% in September, was entirely because of a high base. Given the distortion related to base effect, sequential or on-month movement (and on a seasonally adjusted basis) is a better gauge of the performance than annual growth. On a seasonally adjusted basis, IIP grew 2.6% on-month in October, after declining 3.5% in September.

- The sequential improvement in IIP was led by higher manufacturing (which was in sync with a pick-up in exports and an eight-month high manufacturing PMI of 55.9 in October) and mining output.

- According to the use-based classification, *consumer durables* was the only segment that registered negative on-month growth despite October marking the onset of the festive season, which suggests overall private consumption demand in the economy remains weak. The latest RBI consumer confidence survey done in November corroborates this. According to it, despite a marginal improvement recently, consumer confidence in the current situation remains below pre-pandemic levels and in the pessimistic territory.

- On the other hand, *infrastructure and construction goods* output registered the fastest pick-up, suggesting economic recovery continues to hinge on government capex.

Outlook

Although an improvement over the previous month, industrial activity was disappointing, particularly in the consumer goods space. It was hit by a combination of fragile private consumption demand and supply-side bottlenecks in the form of raw material shortages and higher input costs. These factors are likely to create headwinds for industrial activity in the near term. Waning off of the base effect will also put downside pressure on annual IIP growth numbers in coming months. While the pace of vaccination continues to gather pace, the Covid situation has become uncertain once again with the emergence of the *Omicron* variant. The impending third wave, if severe, can impede the progress of industrial activity afresh.

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