Macroeconomics | First cut

Inflation cheers, IIP worries

May 2023

Inflation rides on a base effect, sequential momentum easing

April saw consumer price inflation (CPI) print at 4.7%, down from 5.7% in March. A considerable part of the fall is due to a high-base effect of last year when the Russia-Ukraine conflict intensified, pushing up fuel, metal, and food prices. Accordingly, there was an across-the-board benefit *(see section below on key data points in April).*

A high-base effect-led correction warrants close inspection of sequential momentum. Month-on-month, there seems a near broad-based uptick across sectors, including in core inflation. But much of this is due to seasonal factors and can be misleading. Correcting for seasonal elements, there is a perceptible sequential easing across most inflation categories except pulses, sugar, spices, education and personal care and effects.

Another noticeable aspect is the still-elevated inflation rates in cereal (at 13.7%), and milk (8.8%), and the recent creep up in pulses (5.3%). With rabi harvest entering the market, some respite for cereal and pulses prices could be felt in the next 2-3 months.

But a looming El Niño effect occurrence and threat to monsoon are causes of worry. Similarly, high procurement prices are expected to keep milk inflation high. Elevated inflation in these essentials can continue to pinch pockets.

Inflation moving below the 5% mark gives relief to the Monetary Policy Committee (MPC), which in its recent policy review kept the repo rate unchanged leaving room to assess the cumulative impact of rate hikes on inflation. We expect CPI inflation to average 5% this fiscal from 6.7% in the last on the assumption of a normal monsoon. A high base should favour inflation rates for another a month or two (charts below). In the coming months, the key monitorable for food inflation will be the progress of monsoon given the El Niño risk. Core inflation, the pain point for the Reserve Bank of India (RBI) due to its stickiness, should see limited easing as producers continue to pass on input costs.

For now, we expect the MPC to maintain a pause as it continues to watch the impact of past rate hikes. As growth slowdown seeps in and inflation moderates, we expect it to cut rates by the end of this fiscal.

Key data points in April

- CPI inflation moderated sharply to 4.7% from 5.7% in March, lower than the 7.8% in April 2022
- Food inflation slowed to 3.8% from 4.7% in the previous month
- Fuel[1] inflation slowed to 5.5% from 8.8% in the previous month
- Core CPI[2] inflation eased to 5.1% from 5.8% in March

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

Softer food inflation

- Food and beverages inflation decelerated in April to 4.2% from 5.1% in March. Some major categories — vegetables (-6.5%), edible oils and fats (-12.3%), and meat and fish (-1.2%) — saw prices fall on-year. The fall in edible oils was aided by the downward trend in international prices
- Inflation in cereals, which is a major contributor to food inflation remains high at 13.7% (vs 15.3%) led by the rice and wheat categories
- Inflation in fruits decelerated significantly to 2.1% compared to 7.6% in the previous month led by on-year fall in price of mangoes, watermelons, grapes, and coconuts.

Sharp correction in fuel inflation

- Fuel inflation corrected sharply from 8.8% in March to 5.5% in April aided by a high base. The slowdown was led by lower inflation in electricity (2.1% vs 3.1%) and liquefied petroleum gas (15.1% vs 20%).
- Prices of kerosene (by PDS) fell by 12.9% on-year. Inflation in kerosene by other sources remained high at 31.8%, but moderated compared with the previous month (35.1%)

Broad-based moderation in core inflation

- Core inflation and its stubbornness, which has been a major concern over the past year cooled significantly in April. Core inflation moderated to 5.1% in April from 5.8% in March. The April print of 5.1% is the lowest since May 2020
- Inflation softened across categories — clothing and footwear (7.5% vs 8.2%), household goods and services (6.5% vs 7%), transport and communication (1.2% vs 4%), housing (4.9% vs 5%)
- Inflation ticked up in some categories such as education (5.7% vs 5.4%) and personal care and effects (9% vs 8.3%)

Goods versus services inflation

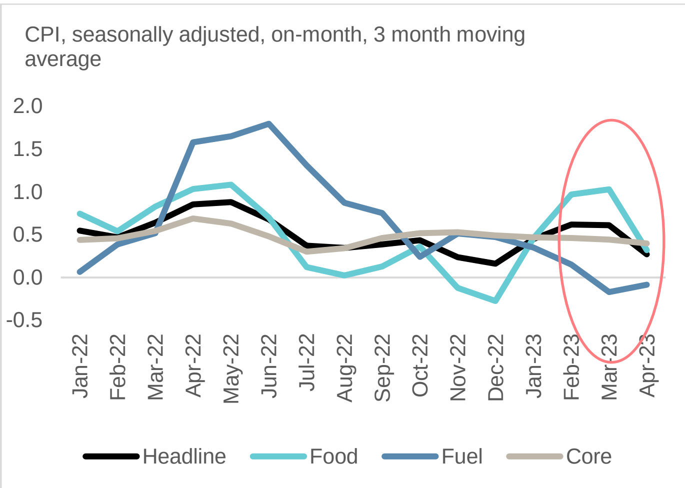
- Overall goods inflation moderated sharply to 4.6% from 5.8% in March supported by softening food inflation and fuel inflation. Core goods inflation (5.4% vs 6.5%), which excludes food and fuel, also moderated indicating broad-based relief in goods inflation
- Services inflation, continued to see limited easing, coming down to 5.1% from 5.3% in March led by transport related categories. Rent, which is a major sub-component, saw inflation tick down marginally to 4.8% from 4.9% in March. Other services categories such as personal and effects, recreation and amusement and education saw higher inflation rates in April

Some insights on inflation momentum

Easing in headline inflation momentum led by food and fuel, services core is sticky

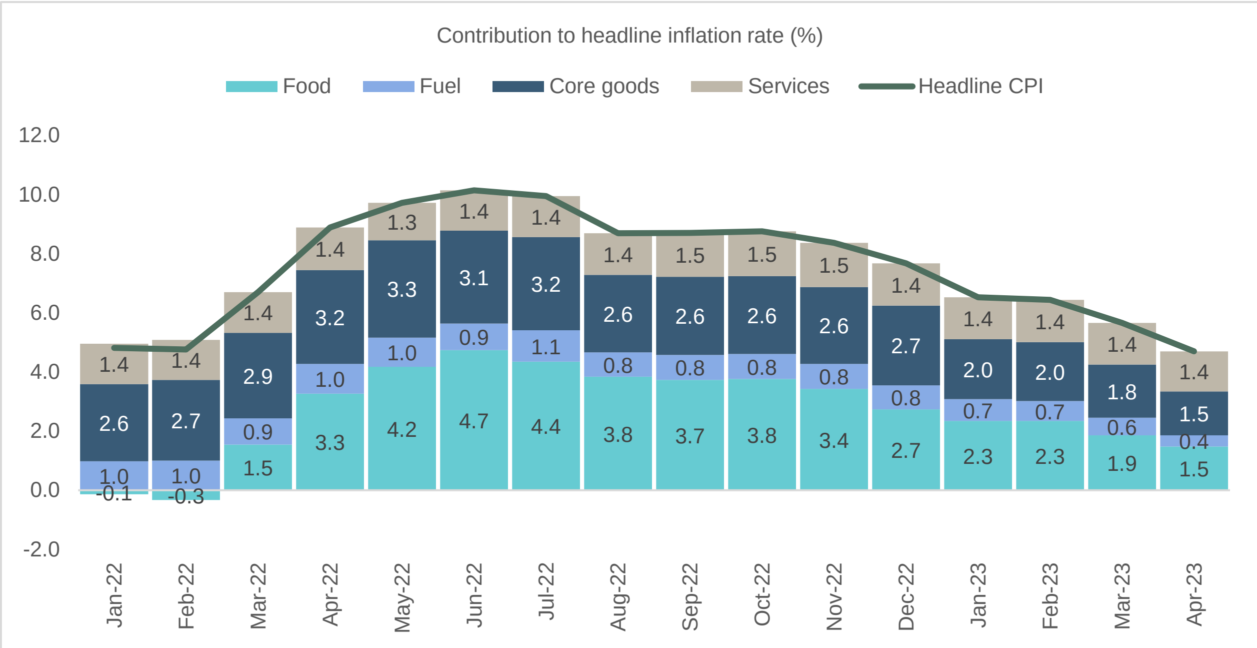
Seasonal adjustment of data shows inflation climbed only 0.1% on-month in April, compared with 0.3% in March. This is the fourth consecutive month of easing momentum in headline inflation. Similar trend for food inflation is also seen. Within food, inflation is on a sequential downtrend in most items except milk, pulses, sugar, and spices.

Core inflation is witnessing a slow sequential fall with segments such as transport and communication, education, personal care and effects, recreation and amusement, and housing seeing inflation firming up or rigid. This suggests limited downside to core inflation in the coming months, after the base effect fades out.

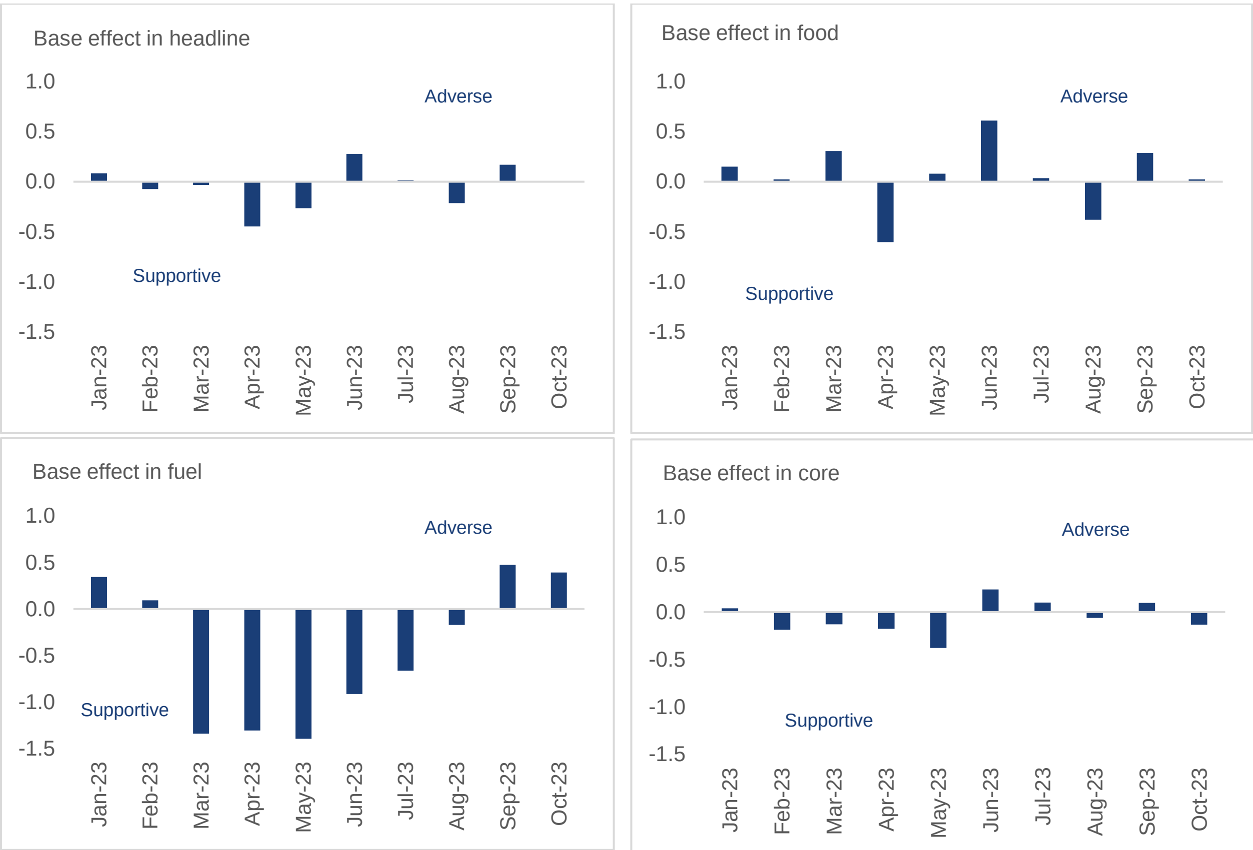


Note: Seasonal adjustment with X13-ARIMA

Sharp easing in goods' inflation, while services stay stubborn



For headline, base-effect benefit to be short-lived



Note: Negative base effect represents a downside to inflation

Rural poor face the lowest burden owing to cooling food and fuel inflation

The burden of inflation varies across income groups, as the share of spending on food, fuel and core categories differs across classes. Essential items such as food and fuel occupy a greater share in the consumption basket of lower income classes.

Using data from the National Sample Survey Organisation (NSSO), CRISIL has mapped expenditure baskets of three broad income groups — the bottom 20%, middle 60%, and upper 20% of the population — with April[3] inflation trends. The table below presents the average inflation faced by each income class.

The burden faced by all income classes across regions eased in April owing to broad-based relief in inflation. In rural areas, the top income segment faces the highest inflation burden since core inflation remained elevated compared with food inflation. The urban poor saw the largest reprieve between March and April.

CPI inflation across income classes (% on-year)

Income segment	April 2023	
	Rural	Urban
Top 20%	4.8	4.8
Middle 60%	4.6	4.8
Bottom 20%	4.6	4.8

Source: NSSO, NSO, CEIC, CRISIL

Industrial activity faces a broad-based slowdown

The Index of Industrial Production (IIP) slowed to 1.1% on-year in March, compared with 5.8% in February. The fall in manufacturing and electricity growth drove the slowdown. Consumer-facing sectors faced the sharpest decline in March, signalling weakening external and domestic demand under rising interest rates.

The broad-based slowdown in the manufacturing sector reflects the impact of weakening global and domestic demand. External demand is expected to be a bigger drag this fiscal with a sharper slowdown in advanced economies relative to India. While rising interest rates will moderate domestic demand as well, the key monitorable for India will be monsoon, and how it impacts rural income prospects. Overall, we expect India's real gross domestic product (GDP) to slow to 6% this fiscal from 7% in the previous one.

[3] For detailed methodology and findings, refer to CRISIL Quickonomics: *Same inflation, different burdens by income* (October 2021)

Data highlights

- IIP growth slowed to 1.1% on-year in March, compared with 5.8% previous month and 2.2% in March 2022. Sequentially, IIP declined 1.1% on-month on a seasonally adjusted basis[4]
- IIP slowed significantly for manufacturing (0.5% on-year growth in March vs 5.6% in the previous month) and declined for electricity (-1.6% vs 8.2%). However, mining IIP grew (6.8% vs 4.8%)
- Within manufacturing, all segments barring intermediate goods saw IIP slow. Consumer durables saw the sharpest decline

Consumer goods hit most by slowing exports and domestic demand

- IIP fell the most for consumer durables (-8.4% vs -4.1%), marking the fourth successive month of decline. This was primarily driven by textiles (-7.4% vs -9.5%) and readymade garments (-30.7% vs -16.8%). Both these have been hit by declining exports growth
- Exports in industrial goods dragged as well. Primary goods IIP slowed to 3.3% from 6.9%, driven by coke and refined petroleum products (1.0% vs 4.6%) and basic metals (5.5% vs 7.4%). These are India's major commodity exports. Capital goods IIP slowed to 8.1% from 10.5%, in tandem with falling machinery exports
- Domestic demand also showed signs of softening. IIP slowed for consumer durables such as automobiles (5.3% vs 8.3%) and computer and electronic products (-28.7% vs -12.2%), where demand may be hit by rising borrowing costs. IIP also declined for consumer non-durables for the first time in five months (-3.1% vs 12.1%)
- Support from infrastructure activity seemed to wane towards the end of the fiscal, as reflected in IIP for infrastructure and construction goods slowing for fourth consecutive month (5.4% vs 8.4%). However, this should reverse as central government restarts capex push from new fiscal.

Outlook

Overall in fiscal 2023, IIP grew 5.1%, compared with 11.4% in fiscal 2022. Exports weighed heavy since the second half of last fiscal, while domestic demand was relatively supportive.

Exports may become a bigger drag on industrial growth this fiscal, given a sharper slowdown in major advanced economies. Interest rates have risen at a faster pace in United States (US) and Europe than in India over the past year, and the recent banking turmoil in the US has added to the downside risks.
S&P Global expects US GDP growth to slow to 0.7% in calendar 2023 from 2.1% in 2022, and for Eurozone to 0.3% from 3.5%. These economies account for 33% of India's goods exports, so that will weigh on domestic industrial growth.

While the rise in domestic interest rates is relatively lesser than in advanced economies, bank lending rates have reached the pre-pandemic five-year average. This is expected to moderate domestic demand, especially in interest-sensitive segments such as automobiles and housing.

The key swing factor is monsoon, which has a significant bearing on rural demand. While the Indian Metrological Department has forecast a normal monsoon overall, risks from an El Niño clouds agricultural output.

Overall, we expect India's GDP to grow 6% this fiscal, compared with 7%[5] expected in fiscal 2023.

[4] All on-month growth numbers are seasonally adjusted
[5] Second advance estimate by National Statistics Office

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