Macroeconomics | First cut

Food lifts CPI, industrial activity buoyant

December 2023

Food lifts CPI, non-food continues to soften

Inflation based on the Consumer Price Index (CPI) rose to 5.6% in November from 4.9% in October, driven by a jump in the prices of vegetables, fruits, sugar and pulses that lifted food inflation to 8.7% from 6.6% in October. A low-base effect also came into play. On the other hand, non-food CPI softened further.

Higher food prices come back to haunt: This fiscal, India has seen two vegetable price shocks in the first nine months. While the first vegetable price shock was due to tomato, ginger and brinjal turning dearer, this time it was onion, garlic and tomato. The recurring flare-ups are a reminder that as long as food prices remain high and volatile, they will continue to influence headline inflation and subsequently, the monetary policy. In recent years, most of the volatility in food inflation has stemmed from vegetable prices where focused policy actions can help tame swings. In our October Insight[1], we had highlighted how:

1. Vegetable inflation in India has been trending up, with more frequent price spikes in recent years
2. Demand for vegetables has outpaced supply keeping prices high
3. Unfavourable risk-reward dynamics and price uncertainty also disincentivise vegetable growers

An existing demand-supply gap magnified by weather vagaries could cause recurring vegetable price shocks. Meanwhile, food prices have been a concern this fiscal given the unfavourable weather and patchy rains and lower reservoir levels to water the rabi crops. The upward pressure on prices is due to the delayed arrival of kharif crops and slower rabi sowing so far[2] for crops like wheat and pulses which are witnessing double-digit inflation. An adverse base effect will add a statistical lift to inflation for the next one or two months, but a catch-up in rabi sowing and the arrival of kharif crops could provide relief. Fingers crossed on the weather factor though as reservoir levels remain low.

Non-food inflation still declining: The non-food CPI inflation remained supportive. A sharper fall in fuel inflation — thanks to lower oil prices (on-year and on-month) and reduced retail prices of liquefied petroleum gas (LPG) pulled down the non-food CPI gauge sharply. Core inflation at 4.1%, continues to reflect the impact of lower input costs in general and some softening of domestic demand, compared with the previous quarters. Steadily softening core inflation — the stickier part of inflation — since July, has been a relief to monetary policy. To be sure, non-food inflation is currently below 4%, implying that food inflation is the culprit.

We expect the Reserve Bank of India (RBI) to closely monitor inflation as it remains above the Monetary Policy Committee's (MPC) long-term target of 4%. In our base case, we expect CPI inflation to average 5.5% this fiscal, and foresee the RBI holding interest rates steady for the remainder of this fiscal. While softening core inflation rules out the possibility of a rate hike, high food prices and 'higher for longer' stance of the western central banks will not permit an early rate cut.

[1] https://www.crisil.com/en/home/our-analysis/views-and-commentaries/2023/10/not-on-top-of-it.html

[2] As on December 8, 2023, rabi sowing was 2.7% below 2022 level for the same period with sowing for pulses down 8.4%, coarse cereals 2%, wheat 0.9% and oilseeds up 1%.

Key data points in November

- CPI inflation hardened to 5.6% from 4.9% in October
- Food inflation accelerated to 8.7% from 6.6% led by vegetables and pulses
- Fuel[3] inflation declined to -0.8% from -0.4%
- Core CPI[4] inflation eased to 4.1% from 4.2%

Food inflation jumps sharply

- Vegetables inflation jumped to 17.7% from 2.8% in October driven by a sharp sequential rise in the prices of tomatoes and onions. An adverse base effect also contributed to the rise as vegetables inflation fell sharply in November 2022 (-8.1% from 7.8% in October 2022). Inflation in onions surged to 86.5% from 42.4%, hardening for the eight straight month. The government recently restricted the export of onions till March 2024 to control onion inflation. Inflation in tomatoes also jumped to 11.4% from -43.9%. It hardened in non-tomatoes, onions, potatoes (TOP[5]) vegetables to 13.5% from 10.4% in October
- While inflation in fruits touched double digits in November, hardening to 11% from 9.3% in October., the price rise in bananas (16.5% vs 10.4%) and apples (33.8% vs 28.7%), which have the highest weights among fruits, drove fruits inflation
- With inflation in pulses accelerating to 20.2% from 18.8%, it hardened in arhar (42.4% vs 40.9%) and moong (13.3% vs 12.8%) and was benign at 0.1% in masur
- Inflation in cereals eased to 10.3% from 10.7%, driven by cooling inflation in wheat by non-public distribution system (PDS) sources (6.4% vs 7.6%) while it hardened 20 bps to 11.8% in rice by non-PDS sources
- Inflation in milk continued to ease to 5.7% from 6.4%
- Inflation in sugar hardened to 6.6% from 5.5% as global prices remain high. This prompted government to impose curbs on sugar exports and use of sugarcane juice and syrup for ethanol production.

Fuel inflation declines further

- Fuel inflation declined further to -0.8% from -0.4% the previous month driven by softening inflation in LPG (-12.9% vs -12.7%) and fire and woodchips (2.6% vs 3%)
- On the other hand, inflation hardened marginally in electricity (10.5% vs 10.4%)
- Inflation in kerosene by PDS sources (-15.3% vs -12.6%) eased, while it rose for kerosene by non-PDS sources (17.5% vs 17.1%)

Core inflation eases a touch

- Core inflation eased 10 bps to 4.1% in November
- Inflation eased in several sub-categories, including health (5.5% vs 5.9%), education (5% vs 5.1%), housing (3.6% vs 3.8%), clothing and footwear (3.9% vs 4.3%).
- Transport and communication saw inflation harden marginally (2.1% vs 2%), primarily due to hike in bus and tram fares (2% vs 1.9%)
- Inflation remained unchanged at 7.8% in the personal care and effects category. It accelerated in gold (17.6% vs 16.5%), while easing in silver (19.1% vs 20.3%)
- Services inflation eased to 3.9% from 4%, led by softening inflation in rent (3.6% vs 3.7%)

[3] Refers to CPI fuel and light.
[4] CPI excluding food and beverages and fuel and light.
[5] Tomato, onion, potato

High food prices pinch the poorest segment in urban and rural India in November

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.

Inflation in November affected different income groups in urban and rural areas as follows:

- Since food inflation surged in November, the poorest segment in both urban and rural areas faced the highest inflation burden
- The top segment in urban areas faced the lowest burden since their consumption basket has the highest share of core items and the lowest share of food

CPI inflation across income classes (% on-year)

Income segment	November 2023	
	Rural	Urban
Top 20%	5.7	5.2
Middle 60%	5.9	5.7
Bottom 20%	5.9	5.9

Note: Using data from the National Sample Survey Organisation (NSSO), CRISIL has mapped expenditure baskets of three broad income groups – bottom 20%, middle 60% and upper 20% of the population – with November inflation trends. The table above presents the average inflation faced by each income class.
Source: NSSO, National Statistical Office, CEIC, CRISIL

IIP rides on festive cheer

Industrial output, measured by the Index of Industrial Production (IIP), rose 11.7% on-year in October from 6.2% in the previous month. This is the highest growth recorded since June 2022 in line with our forecast. While the high reading came on a low base (IIP was -4.1% in October last year), activity rose sequentially with the onset of the festive season. The rise was broad-based across major industries.

Strong manufacturing growth of the second quarter seems to have continued in the third quarter. While consumption-related goods recorded higher IIP growth in October, continuing strong growth in industrial goods suggests robust investment momentum.

However, we expect growth to slow in the remainder of this fiscal as RBI's rate hikes and regulatory measures work their way through demand in the economy. Rural demand remains vulnerable to agricultural output this year. Slowdown in western advanced economies next year can further weaken India's export growth. Share of Indian exports have been rising to US and EU both of which will face weak growth in the coming year.

Data highlights

- IIP growth rose 11.7% on-year in October compared with 6.2% recorded in the previous month. Sequentially, IIP rose 0.8% on-month after seasonal adjustment
- All major sectors witnessed a sharp increase in growth, the highest being recorded by electricity (20.4% on-year in October versus 9.9% previous month), followed by mining (13.1% vs 11.5%) and manufacturing (10.4% vs 4.9%)
- Among the manufacturing sub-sectors, growth was highest among capital goods (22.6% on-year in October), followed by consumer durables (15.9%), primary goods (11.4%), infrastructure and construction goods (11.3%), intermediate goods (9.7%) and consumer non-durables (8.6%)

Festive season spurs electricity production and consumption goods

- Electricity IIP grew 20.4% on-year in October, the strongest reflecting robust domestic economic activity in the festive season
- IIP for both consumer durables (15.9% vs 1.1%) and non-durables (8.6% vs 3%) was higher as compared with the previous month
- Stronger growth in discretionary consumption goods was driven by motor vehicles (24.4 vs 11.2%), leather and leather products (16.5% vs 0%) and rubber and plastic products (8.1% vs 1.5%). This could be due to increased festive spending.
- Meanwhile, growth in essential commodities was sustained by an uptick in food products (6.3% vs -0.4%). The decline in October inflation levels to 4.87%, compared with 5.02% the previous month may be a contributing factor
- The decline narrowed in wearing apparel (-5.0% v -17.9%) and computer electronics (-5.3% v -8.9%)

Industrial goods fare well

- IIP growth rose strongly for capital goods (22.6% vs 8.4%), primary goods (11.4% vs 8%) and intermediate goods (9.7% vs 6.1%).
- Rising IIP in infrastructure and construction goods (11.3% vs 8.9%) coupled with growth in above industrial sectors suggests robust investment momentum
- IIP for many export-oriented sectors also improved in October, compared with the previous month. This is in line with increasing export growth at 6.2% on-year to $33.6 billion in October. Among major exports focused sectors, IIP rose for machinery and equipment (26.1% vs 4.8%), pharmaceuticals (11.2% vs 6.8%), textiles (6.5% vs 3.7%) and chemical products (4.4% vs -5.6%)
- On the other hand, basic metals (11.9% vs 12.5%) and coke and refined petroleum products (2.4% vs 2.6%) recorded slower growth, compared with the previous month

Outlook

Manufacturing has so far been supported by resilient domestic demand, especially from strong investment growth and higher-value consumption items. Export demand also improved in the recent months, driven by advanced economies performing better than expected. Finally, easing cost pressures and supply chain bottlenecks significantly helped manufacturers ramp up production.

However, downside risks persist from the slowing global growth, expected to materialise in 2024 as the impact of rate hikes seeps in advanced western economies. Being India's top export destinations, advanced western economies significantly influence its growth.

On the domestic front too, there are signs of a growth moderation ahead. RBI’s consumer confidence survey of December showed weakening in future expectations in urban areas. S&P Global Purchasing Managers’ Index (PMI) has been lower in the third quarter so far (October-November) on an average, compared with the previous quarter - for both manufacturing and services.

Lagged transmission of RBI’s rate hikes and its recent regulatory measures to clamp down risky lending are expected to moderate credit growth and domestic demand ahead.

Rural demand remains vulnerable to weak agricultural output, erratic weather and El Niño this year.

Due to these factors, we expect gross domestic product (GDP) growth to slow in the second half of this fiscal. Overall, we expect a GDP growth at 6.4% this fiscal, compared with 7.2% in the previous fiscal with an upward bias.

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