Macroeconomics | First cut

Food inflation heats up, IIP makes gains

July 2024

Pricey vegetables lift headline inflation

Inflation based on the Consumer Price Index (CPI) surged in June, corroborating the central bank's position that the last mile of disinflation remains a challenge.

The gauge printed at 5.1% for June, compared with 4.8% in May as food prices remained high.

Notwithstanding a supportive base effect from last year, food inflation surged to 9.4% on account of pricier vegetables, cereals, milk and fruits.

Vegetables inflation, which has remained in double-digits for eight months now, is a major worry as is rigidity in foodgrains inflation.

Non-food inflation eased for the 17th straight month, sliding to a record low of 2.3%.

Although rains were deficient in June, it is not a major cause for concern as July and August rains are more important for kharif crops. We expect the progress of monsoon and pick-up in sowing to improve agricultural output and cool off food inflation in the coming months.

Core inflation, the dominant part of non-food inflation, could see an upside in the coming months owing to the recent firming up in international freight costs, crude oil prices and hike in domestic telecom prices. The uptick though is expected to be mild.

Net-net, we expect decline in food inflation in the coming months to drag down headline inflation to 4.5% on average. That said, no rate cuts are expected in the forthcoming policy in August as the Reserve Bank of India (RBI) pursues a target of 4% durable inflation.

Key data points in June

- CPI inflation rose to 5.1% from 4.8%
- Food inflation surged to 9.4%, led by costlier vegetables
- Fuel[1] prices fell 3.7% on-year, same as the previous month
- Core CPI[2] inflation was unchanged at 3.1%

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

Surging food inflation

- Food inflation rose to a six-month high of 9.4% in June from 8.7% the previous month
- Vegetables inflation rose for the first time in four months to 29.3% from 27.4% despite a supportive base. On a seasonally adjusted basis, vegetable prices rose 3.4% on-month. Unlike the last three months, the rise in vegetables inflation was broad-based with both TOP (tomatoes, onions, potatoes) and non-TOP vegetables inflation rising. TOP inflation surged to 48.4%, driven by onions (58.5% vs 38.1%) and potatoes (57.6% vs 55.3%). Despite an on-month uptick in prices (seasonally adjusted) tomato inflation eased to 26.4% from 41.3% owing to the high base of last year. Non-TOP vegetables saw inflation harden to 19.7% from 18.8% driven by leafy vegetables, brinjal, lady's finger, pumpkin, etc
- Foodgrain inflation was rigid at 10.2%, though 20 bps lower than the previous month. Cereals inflation inched up to 8.8% from 8.7%, mostly owing to non-PDS wheat (6.7% vs 6.5%). Pulses inflation eased a tad to 16.1% from 17.1%. While inflation in arhar dal declined sharply (26.9% vs 32.1%), other pulses such as masur (0.9% vs -0.1%) and split gram (18.5% vs 14.8%) saw a rise in inflation
- Inflation in milk rose for the first time in 13 months on account of a price hike by major milk producers (3% vs 2.6%)
- Edible oils inflation continued to log lower disinflation for the fifth consecutive month to -2.7% from -6.7%
- Spices inflation softened for the 10th straight month to 2.1% from 4.3%

Deflation in fuel prices

- Fuel prices fell 3.7% on-year in June, remaining in deflation for the 10th straight month. Although global oil prices remain under pressure, the government subsidy for LPG has kept fuel inflation negative
- Prices of liquefied petroleum continued to deflate in June (-24.8%)
- Electricity inflation moderated to 8.8% from 10.9% owing to a supportive base
- Inflation in fire and woodchips inched up (2.7% vs 2.6%)

Record low core inflation

- Core inflation was unchanged at a record low 3.1% in June
- Services inflation eased 10 bps to a record low of 2.9%, while core goods[3] inflation was steady at 3.2%
- Personal care and effects saw inflation harden to 8.2% from 7.7%, with gold prices rising 19.7% (vs 18.2% in May)
- Inflation in education slid to 3.6% from 4.1%, driven by softer inflation in tuition fees (3.9% vs 4.3%)

[3] *CPI excluding food and beverages, fuel and light and services*

Rural inflation continues to outpace urban

The effect of inflation varies across income groups since the share of spending on food, fuel and core categories differs according to classes. Items such as food and fuel, being essential, occupy a greater share in the consumption basket of those with a lower income.

Both rural and urban inflation saw an uptick in June. Rural food inflation rose to 9.2% from 8.6% while urban inflation was relatively stickier, rising 20 bps to 8.8%. Fuel (-0.8% in rural and -7.7% in urban) and core inflation (3.3% in rural and 3% in urban), too, were higher in rural areas. Hence, rural residents faced a higher inflation burden than their urban counterparts across income classes.

CPI inflation across income classes (% on-year)

Income segment	June		May	
	Rural	Urban	Rural	Urban
Top 20%	5.3	4.4	5.1	4.2
Middle 60%	5.8	4.9	5.4	4.6
Bottom 20%	5.8	5.0	5.5	4.7

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

Source: NSSO, National Statistical Office, CEIC, CRISIL

Industrial activity gains momentum with revival in consumption

The Index of Industrial Production (IIP) increased to 5.9% on-year in May, up from 5.0% in April. The pick-up was mainly driven by a higher manufacturing and electricity output growth, while output growth in mining slowed marginally.

IIP growth reflects healthy industrial activity. Consumption-oriented sectors were the main drivers of growth in May. However, growth in infrastructure and investment-related goods slowed down.

This fiscal, improving domestic consumption is expected to support industrial activity. The expectation of an above-normal monsoon augurs well for agricultural incomes and food inflation this year. Urban economy remains likely to be dampened by tighter credit conditions this year. RBI consumer confidence index points at softening prospects for urban consumption.

The upcoming Budget will confirm the central government's nature of support to growth. Overall, fiscal consolidation would lead to lower government support to growth this year.

Globally, an improved trade outlook is expected to support exports, though uneven growth in major economies could be a dampener.

Due to these factors, we expect GDP growth to slow down to 6.8% this fiscal from 8.2% last year.

Data highlights

- IIP growth increased to 5.9% on-year in May from 5.0% in April. Sequentially too, the index rose 1.4% on-month after seasonal adjustments
- The pick-up was driven by electricity (13.7% on-year versus 10.2%) and manufacturing (4.6% vs 3.9%), while growth in mining (6.6% vs 6.8%) slowed down marginally
- The uptick in manufacturing growth was driven by consumer durables (12.3% vs 10.0%), primary goods (7.3% vs 7.0%) and consumer non-durables (2.3% vs- 2.5%). On the other hand, growth in infrastructure and construction goods (6.9% vs 8.0%), capital goods (2.5% vs 2.7%) and intermediate goods (2.5% vs 3.2%) slowed

Consumer goods record better overall performance

- Consumer durables logged an increase in on-year output growth (12.3% in May versus 10.0% in April), driven by a sharp rise in computer and electronic products growth (20.1% vs 2.4%). This was despite a slowdown in furniture (23.2% vs 44.7%) and automobiles (6.2% vs 11.8%)
- Consumer non-durables output rebounded in May (2.3% vs -2.5%), partially driven by some recovery in output of food products (-5.5% vs -12.8%), textiles (-0.7% vs -1.1%) and pharmaceuticals (7.5% vs 3.0%). The rebound in consumer non-durables output was in line with some recovery seen in rural demand indicators

Industrial goods record mixed performance once again

- Among industrial goods, primary goods recorded an uptick (7.3% vs 7.0%), driven by a rise in electricity production (13.7% vs 10.2%), on account of higher demand amidst heatwave conditions
- Increasing output was also seen in export-oriented sectors such as pharmaceuticals (7.5% vs 3.0%), fabricated metals (12.3% vs 10.2%) as well as machinery and equipment (1.7% vs 0.3%). This was reflected in a sharp pick-up in non-oil exports in May (7.8% vs 0.6% in April). Notably, the rising share of electronic products in total exports is also getting reflected in IIP as mentioned earlier
- On the other hand, output growth slowed down for infrastructure and construction goods, capital goods and intermediate goods. Growth in infrastructure and construction goods declined owing to an on-year contraction in government capex in May
- Meanwhile, the slowdown in intermediate goods was because of output contraction in chemicals (-0.5% vs 0.8%) and rubber and plastic products (-0.9% vs 1.7%), as well as slowing output growth in other non-metallic mineral products (0.2% vs 0.9%)

Outlook

IIP growth has averaged 5.4% on-year in April-May 2024, stronger than 5.1% in the previous quarter. The Manufacturing Purchasing Managers' Index (PMI) has risen to 58.3 in June from 57.5 in May, indicating the strengthening of industrial activity.

This fiscal, industrial activity is expected to gain support from domestic consumption. Private consumption, which had weakened to 4% last fiscal, is expected to improve with rural demand. Monsoon turning normal in July and increasing kharif sowing on-year augurs well for agriculture output. The expected easing of food inflation would also help boost discretionary consumption.

The urban economy continues to be supported by robust credit growth, but is likely to cool off as rate hikes bite and services slow. The rise in lending rates by some banks in July indicates transmission of the RBI's past rate hikes is still in progress.

However, moderating fiscal support could cap growth, as the central government reduces its fiscal deficit. The upcoming Budget will be watched closely to assess its nature of support to the economy.

Globally, the picture is mixed for export demand. While global GDP growth is expected to slow down this year, trade volumes are expected to pick up in 2024. Risks from geopolitical tensions to global trade flows remain elevated.

Overall, we expect GDP to moderate to 6.8% this fiscal after a strong 8.2% growth last year. This would still be stronger than the 6.6% average growth seen in the decade before the pandemic.

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