Macroeconomics | First cut

Inflation cools, IIP ticks up

December 2024

Retail inflation moderates with correction in vegetable prices

Correction in vegetable inflation and a dip in foodgrain inflation to a 28-month low cooled food inflation in November. As a result, headline consumer price inflation declined to 5.5% — within the Reserve Bank of India's (RBI) upper tolerance limit of 6%, but still at a distance from the central bank's 4% target.

Even so, food inflation remains high at 9% in November, driven by rigidity in vegetable inflation and elevation in edible oils inflation, warranting caution. Edible oils inflation at a 30-month high of 13.3% is being driven by global supply disruptions and increase in import duties, and since October has seen the fastest sequential climb among all food categories.

The non-food component of Consumer Price Index (CPI) inflation remained low at 3.1%, supported by the recent softening in global energy and commodity prices.

In the coming weeks, we expect food prices to ease sequentially. Vegetable prices tend to come down in December when the kharif crop enters the market. A high base from last year will also help lower inflation since vegetable prices missed their seasonal decline last year. Pressure from edible oil prices, though, will have to be monitored.

The RBI Governor noted in his December policy statement that manufacturing and services firms expect their selling prices to increase in the fourth quarter of this fiscal, which could push up non-food inflation. Yet, given subdued domestic demand conditions and soft global prices, we expect non-food inflation to remain benign for the rest of the fiscal.

Overall, we expect inflation to soften in the coming months led by food inflation; however, rigidity in vegetable and edible oil prices keep the upside pressure high. In our base case, we expect inflation to average 4.6% this fiscal with some upside bias to the forecast and expect a policy rate cut in February.

Key data points in November

- CPI inflation decelerated to a 5.5% in November from 6.2% in October
- Food inflation eased to 9% from 10.9%
- The pace of deflation in fuel[1] prices picked up marginally to 1.8% from 1.7%
- Core CPI[2] inflation inched down to 3.7% from 3.8%

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

Food inflation moderates

- Food inflation moderated to 9% in November from 10.9% in October led by softer inflation in vegetables and foodgrains. Meanwhile, a sharp rise in edible oils inflation restricted further easing in food inflation. Food prices were broadly stable on-month, falling 0.2% compared with a 1.3% rise in the previous month
- Vegetable inflation fell to 29.3% from a 57-month high of 42.2% led by a sharp fall in tomato (41.7% vs 161%) and onion inflation (5.6% vs 51.9%). Sequentially, tomato prices fell sharply as supplies improved with increased arrivals. That said, inflation rose in other key vegetables such as potatoes (66.6% vs 64.9%), leafy vegetables (24.6% vs 15.1%) and brinjal (28.2% vs 17.1%)
- Foodgrain inflation eased to 6.6% from 7% previous month, its lowest print since July 2022. This was driven by softer pulses inflation (5.4% vs 7.4%) while cereals inflation was steady at 6.9%
- Edible oil inflation accelerated for the tenth straight month to 13.3% from 9.6%, influenced by higher prices worldwide. Global prices of edible oils rose 7.5% on-month in November to their highest level since July of 2022 as per the Food and Agriculture Organisation. The recent rise in import duties is also keeping the pressure on edible oils prices
- Fruits inflation eased for the first time in five months to 7.7% from 8.4% due to softer inflation in apples (0.6% vs 1.2%) and bananas (6.7% vs 10.6%)
- Spices inflation hit a new record low, at -7.4% against -7.1% in the previous month

Negative fuel inflation

- Fuel prices fell 1.8% on-year in November, suggesting a quicker pace of decline compared with the 1.7% fall in the previous month
- Inflation in electricity softened to 5.1% from 5.4%
- Deflation in kerosene picked up in both the non-PDS (-2.3% vs -1.5%) and PDS segments (-16.3% vs -13.3%)
- That said, the uptick in inflation in categories such as fire and woodchips (3.3% vs 3.2%) and coke (10.1% 9.9%) offset the impact of softer electricity and kerosene inflation

Core inflation softens

- Core inflation softened to 3.7% from 3.8% led by a decline in precious metals inflation. Excluding precious metals, core inflation was stable at 3.1%
- Personal care and effects, which includes gold and silver, saw the sharpest downward movement in its inflation rate among the main core categories (10.4% vs 11%). Gold inflation eased to 26.6% from 29% while silver inflation eased to 26.5% from 28.3%
- Softer inflation in transport and communication (2.6% vs 2.8%) driven by vehicles such as cars (3.1% vs 3.3%) and two-wheelers (3.3% vs 3.4%) also contributed to softer core inflation
- Inflation in housing, which has the highest weight in the core index, inched up to 2.9% from 2.8%

November brings relief for the rural poor who bear the brunt of high food inflation

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

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

- Rural residents faced higher inflation rates than their urban counterparts across income groups, driven by a higher weight of food in their consumption basket
- Inflation was higher in rural areas relative to urban across categories. However, compared with October, the inflation rate ticked down from 6.7% to 6.0% in rural areas and from 5.6% to 4.8% in urban areas
- For the year so far, the gap in inflation rates among the relatively poorest and richest has remained wide. The gap between the inflation rate faced by the rural poor and urban rich rose to 1.2 percentage points so far this fiscal compared with 0.5 percentage points last fiscal.

CPI inflation across income classes (% on-year)

Income segment	November		October		FY24	
	Rural	Urban	Rural	Urban	Rural	Urban
Top 20%	5.7	4.8	6.3	5.5	5.4	5.1
Middle 60%	6.0	5.3	6.8	6.3	5.6	5.4
Bottom 20%	6.1	5.5	6.9	6.7	5.6	5.6

Note: With 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 November inflation trends. The table presents the average inflation faced by each income class.

Source: NSSO, National Statistical Office, CEIC, CRISIL

IIP inches up

The Index of Industrial Production (IIP) registered a marginal 3.5% on-year increase in October, compared with 3.1% in September. Most major industrial sectors performed better.

Industrial activity has begun the third quarter with some improvement, with the IIP growing for most consumption and investment-related sectors.

While consumer durables IIP slowed despite the beginning of festive season during the month, consumer non-durables improved for the second consecutive month. The former possibly reflecting the impact of elevated interest rates, slowing credit growth and high food inflation on urban discretionary consumption.

Infrastructure and construction goods revived with a pickup in government capital expenditure, though the growth rates remain lower than last year consequent to a tighter fiscal belt. Exports further supported industrial activity this month.

Fiscal consolidation and high interest rates are expected to pull down gross domestic product (GDP) growth this fiscal. The second half is expected to be better on account of improving agriculture and rural demand, easing inflation, and higher government capex relative to the first half of this fiscal.

Data highlights

- IIP rose 3.5% on-year in October, from the 3.1% growth in the previous month. The index grew 1.1% on-month after seasonal adjustments
- Growth was driven by a tad improvement in manufacturing (4.1% in October vs 3.9% previous month), pick-up in electricity (2.0% vs 0.5%) and ,continued stagnation in mining (0.9% vs 0.2%)
- Consumer durables saw the highest growth in October (5.9%), followed by infrastructure and construction goods (4.0%), intermediate goods (3.7%), capital goods (3.1%), consumer non-durables (2.7%) and primary goods (2.6%).

Growth in consumer durables falls, while non-durables see slight pick-up

- Consumer durables remained the highest-growing IIP segment, but growth slowed to 5.9% from 6.5% previous month. It was dragged by a contraction in automobiles (-1.6% in October vs 2.1% previous month), and slower growth in furniture (27.7% vs 32.9%)
- High inventories in automobiles may have impacted their production. However, auto sales revived in October with the onset of the festive season
- Consumer non-durables output registered growth for the second consecutive month (2.7% vs 2.2%), though remaining lower than consumer durables growth. Within non-durables, food products continued to improve (4.9% vs 4.8%), with beverages (3.4% vs 0.4%) and tobacco products (11.2% vs 1.6%). Rural demand is likely supporting the recovery

Infrastructure goods revive with government capex

- Among industrial goods, infrastructure and construction goods saw the highest growth, at 4.0%, rising from 3.2% in September. Government capex picked up for states this month. However, the centre's capex remained lower on-year. Due to this, infrastructure and construction goods IIP growth remained lower relative to the 12.6% seen in October last year
- Capital goods growth moderated (3.1% vs 3.6%), hinting at tepid private capex growth. The contraction in machinery and equipment (-2.4% vs 3.6%) was compensated by increased production of other transport equipment (17.4% vs 13.9%) and fabricated metals (8.1% vs 2.4%)
- Primary goods picked up (2.6% vs 1.8%), led by coke and refined petroleum products (5.6% vs 5.3%), electricity (2.0% vs 0.5%) and mining (0.9% vs 0.2%). Growth in intermediate goods was stable (3.7% vs 3.6%)
- Strong export growth supported major export-oriented sectors such as coke and refined petroleum, chemicals, pharmaceuticals and wearing apparel. Merchandise export growth was robust at 17.3% on-year (in nominal terms) in October from a mild 0.5% growth in September.

Outlook

After a disappointing second quarter, industrial activity is expected to improve in the second half of this fiscal with recovering consumption demand.

So far, high food inflation, elevated interest rates and slowing credit growth have impacted consumption recovery. However, with food inflation showing signs of easing, the space for discretionary consumption is expected to increase.

Moreover, the rural economy will likely improve following healthy agricultural production this year.

However, the urban economy is facing waning support from credit growth amid elevated interest rates. A lower fiscal impulse from the government is further expected to have a moderating impact on the GDP growth. While government capex is expected to revive in the second half of this fiscal, growth is likely to moderate relative to the previous fiscal. A revival in private investment is critical to sustain the investment momentum.

Global trade is expected to improve and support export growth this year. However, geopolitical tensions remain a risk for trade flows and supply-chain pressures for industry. Exports will have to navigate increased uncertainties arising from the possibility of an US-China tariff war next year.

Overall, elevated interest rates and fiscal consolidation are expected to slow GDP growth this fiscal. We expect GDP growth at 6.8% on-year this fiscal compared with 8.2% in the previous fiscal, with risks tilted downwards.

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