Research

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CPI noses up again, IIP shrivels on GST jitters

CRISIL First Cut

August 2017

CPI reverses three month downtrend

Inflation based on the consumer price index (CPI) spurted to 2.4% in July, reversing a three-month downtrend that had pushed it down to 1.5% in June. The pick-up was led by a much slower decline in food inflation, besides a pick-up in in items such as housing and pan, tobacco and intoxicants, where higher Goods and Services Tax (GST) rates are likely to have pushed up prices.

The recent dip in inflation was accentuated by a demonetisation-led crimp in demand and seasonal downside pressures on food, most of which are temporary and will soon fade.

The months ahead could see some bump-up in prices at the retail level as producers scamper to price their products and services in line with GST rates. Meanwhile, some food items will also see their low-base effect wear off.

However, beyond this noise, a number of factors will act as curbs on inflation. These include: (i) a normal monsoon, which will keep food inflation in control; (ii) benign global oil and commodity prices, which along with a strong rupee, will keep imported inflation in check; and (iii) only a moderate pick-up in domestic demand, which will keep the pressure on core inflation muted.

CRISIL expects CPI to average 4% in fiscal 2018 (down from 4.5% in fiscal 2017).

- Food inflation continued to dip, but the fall was arrested by a waning out of the low-base effect and a seasonal uptick in vegetables inflation. Food inflation fell slower, clocking -0.3% compared with -2.1% in June. The decline continued to be led by pulses (at -24.7% in July), besides eggs, meat and fish, and edible oils, but a significantly slower fall in vegetables inflation (to -3.6% from -16.5% in June) capped further downside. Excluding vegetables, food inflation stood at -1.3% compared with -1.1% in June. This suggests inflation has been declining in other food categories.
- Fuel inflation, measured by adding petrol, diesel, fuel and light components, stayed unchanged from the previous month, at 4.3% in July. Within this category, inflation in fuel and light rose to 4.9% from 4.5%, while in petrol and diesel, it eased to 2.4% from 3.3%, led by lower global crude oil prices and a stable rupee.
- Core inflation (CPI excluding food, fuel and light, petrol and diesel) rose to 4.1% in July, from 4% in June. The pick-up was led by services such as health and education, while in housing and pan, tobacco and intoxicants, higher prices due to GST implementation are likely to have pushed up inflation.

IIP goes negative for the first time in 4 years

Industrial activity, as measured by the new series of the Index of industrial production (IIP), shrank for the first time in four years to -0.1% on-year in June, compared with 2.8% in May.

While a high-base effect was partly to blame, much of the damage is expected to have come from destocking of goods ahead of the transition to the GST.

A sharp slowdown in inflation based on the Wholesale Price Index (WPI) in June may also have contributed to the decline, considering the new IIP series (2011-12) has more value-based components compared with the older one. In a value-based system, the value of good is deflated by the WPI to derive the volume indicator.

Cumulatively, IIP grew 2.1% in the April-June period, down from 7.1% a year ago.

- Industrial activity turned red in June as both electricity and mining sectors displayed subdued growth, and manufacturing activity – the biggest contributor to IIP with 77.6% weight – shrank. Manufacturing activity declined 0.41% in June, compared with a growth of 2.6% the previous month and 7.5% in June last year. It was the second straight month of sub-1% growth for the mining sector, while for the electricity sector growth fell sharply to 2.2% from 8.3% in May. Along with the high base of last year, the GST rollout beat down industrial activity. Production activity is expected to have slowed down as retailers rushed to clear existing stock at a discount.

- Fifteen of the 23 industry groups in manufacturing registered negative growth. Among the main laggards were electrical equipment (3% weight) with -20.1% growth, fabricated metal products (2.7% weight) with -11.1% growth and non-metallic (4.1% weight) with a growth of -7.0%. However, certain groups managed to display high positive growth, including pharmaceuticals, medicinal chemical and botanical products (5% weight) that grew 19.2% and other transport equipment (1.8% weight) that grew 8.1%. In terms of end use, while consumer-oriented sectors (accounting for 37% of the manufacturing sector IIP) did manage to grow positively (0.8%) on account of positive growth in consumer non-durables, the growth of industrial & investment-oriented manufacturing sectors worsened to -1.6% compared with -0.02% in May.
- According to the use-based classification, there was a decline in all the categories save for infrastructure & construction goods and consumer non-durables, which grew 0.6% and 4.9%, respectively. The sharpest decline was in the capital goods category, at -6.8%.

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