Research

Sliding in sync

CRISIL First Cut I January 2019

CPI inflation continues its downward journey

Inflation based on the consumer price index (CPI) fell to an 18-month low of 2.19% in December on negative food and softening core inflation, besides a high base of the previous year.

With this, inflation has fallen for the fourth consecutive month. However, there could be some upside from next month as the statistical high-base effect starts waning.

Food inflation has been negative since October and has been the major factor behind the decline in headline inflation. Sans food, inflation continues to remain above 5%.

Fuel inflation also moved down sharply, given a significant downward movement in domestic petrol and diesel prices.

Interestingly, core inflation – which strips out the volatile categories such as food and fuel – again went up. This is largely on account of components such as health and education, where inflation has remained sticky because of inadequate supply. Core inflation, therefore, isn't able to capture effectively the slowdown in demand side pressures, especially private consumption, in the economy as indicated by the GDP data.

The current inflation and growth scenario seems to have created adequate room for the Monetary Policy Committee (MPC) to consider changing its monetary policy stance from *calibrated tightening* to *neutral* and administer a rate cut going ahead.

For fiscal 2019, CRISIL forecast CPI inflation at 3.7% (revised down from 4.6% earlier) compared with 3.6% recorded in fiscal 2018 given the continuous and sharp decline in food prices and slowdown in international crude oil prices compared with a few months ago. In fiscal 2020, however, inflation may see some upside as a) food inflation, which has remained unusually low, might move up if the monsoon this year is inadequate; b) some global indicators are already pointing to higher food inflation in 2019; and, c) core inflation, which remains sticky, moves up on factors such as implementation of Pay Commission hikes by more states and populist measures such as farm loan waivers. Accordingly, CRISIL pegs fiscal 2020 CPI inflation at 4.5%.

Data readings

- Food inflation was negative for the third consecutive month. It was recorded at -2.5% in December compared with -2.6% in November. Fruits were the new entrants to the negative food inflation zone at -1.4%. Others such as vegetables, pulses, sugar and confectionery, and eggs continued to witness negative inflation at -16.1%, -7.1%, -9.2% and -4.3%, respectively.
- Fuel inflation, calculated by adding petrol, diesel, fuel and light components, softened to 3.7% in December, from 7.7% in November. Breaking it up, fuel and light inflation moderated to 4.5% from 7.2%, while petrol and diesel inflation to 0.7% from 9.2%. The latter was largely on account of moderation in international Brent spot prices to $57/barrel in December from $65/barrel in November and reduction in domestic retail prices.
- Core inflation led overall inflation, rising to 5.5% in December from 5.3% in November. Even as *housing* inflation fell – on expected lines – to 5.3% from 6.0%, other categories such as *health, education, personal care and effects and recreation and amusement* saw their inflation rise.

IIP growth slumps in November dragged by weakness in manufacturing

IIP growth fell sharply to 0.5% in November after scoring 8.4% in the previous, primarily due to high-base effect. The plunge was driven by manufacturing, where growth turned negative to -0.4% from 8.2%, while electricity growth halved over October. Within manufacturing, there was a near across-the-board de-growth in capital, intermediate and consumer goods segments. Last year same month, manufacturing growth had surged after GST-related constraints faced by exporters eased, the impact of demonetisation on some sectors waned, and exports darted up.

Despite the big decline, industrial production has fared much better this fiscal (5% average growth) compared with last (3.2%). November growth is a blip and IIP growth should improve in the coming months. The Central Statistics Office's estimates of GDP growth for fiscal 2019 show industry growing robustly, led by manufacturing and construction.

For fiscal 2020, growth impetus will be mostly domestic, driven by private consumption and investment. Benign inflation, ongoing salary revisions of state government employees and continued government spending on construction should support private consumption. Private investment is also expected to sustain some momentum as deleveraging is finally ebbing out and capacity utilisation improving across sectors.

Data readings

- Industrial activity growth fell sharply in November by 0.5% after displaying reasonable strength in the last several months. For the year so far, IIP growth has been considerably higher at 5% compared with 3.2% seen in the same period last year.
- The dip in November was largely caused by a high-base effect: IIP growth in November last year had surged 670 basis points to 8.5%. Another factor behind the slower growth was the end of festive season in October.
- The plunge was driven by manufacturing, where growth turned negative to -0.4% from 8.2%, while electricity growth halved over October. Within manufacturing, there was a near across-the-board de-growth in capital, intermediate and consumer goods segments. Last year same month, manufacturing growth had surged after GST-related constraints faced by exporters eased, the impact of demonetisation on some sectors waned, and exports darted up. Nearly 13 of the 23 industry groups (weighing close to 40% of the index) saw negative growth in November. Heavyweights that saw a dip in growth were chemical products, automobiles and machinery and equipment.
- According to end-use classification, the decline came from both investment and consumer goods. Capital goods output declined 3.4% in November, intermediate goods was down 4.5%, while the dip in consumer goods was smaller at -0.9% for consumer durables and -0.6% for consumer non-durables. Infrastructure goods output was robust at 5% growth displaying the strength in government supported construction activity.
- Growth of core infrastructure index (comprising indices for coal, crude oil, natural gas, refinery products, fertilisers, steel, cement and electricity, and having 40.3% weight) also slowed in November, to 3.5% from 4.7% in the previous month. Sluggishness was led by sectors such as coal, crude oil, cement and electricity. Still, for the year so far, core sector growth has averaged higher at 5.1% compared with 3.9% seen in the same period last year.

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