CRISIL
An S&P Global Company

Macroeconomics | First cut

Inflation sticky, IIP zooms on base effect

July 2022

CPI stabilises above RBI's target

Inflation, as measured by the Consumer Price Index (CPI), remained stable at 7.0% on-year in June as in the previous month, but was higher than 6.3% seen in June last year. This marked the sixth consecutive month of headline inflation remaining above the Reserve Bank of India's (RBI's) target of 2-6%. While food inflation moderated, fuel and core inflation rose during the month.

*The June inflation print reflects persistent underlying pressure on all categories. That said, government interventions have helped ease the burden on some items such as transport fuels, pulses, and edible oils. A normal and well-distributed monsoon is critical for taming food inflation. Although international commodity prices have softened recently, they remain higher on-year for most commodities. Owing to these factors, **we expect CPI inflation to average 6.8% this fiscal, up from 5.5% in the previous year.***

Inflation trends in June: highlights

- CPI inflation was stable at 7.0% in June as in the previous month, but higher than 6.3% in June 2021
- Food inflation moderated to 7.7% from 8.0% in May, but was much higher than 5.1% a year ago
- Fuel inflation rose to 10.4% from 9.5% in the previous month, but was lower than 12.6% a year ago
- Core CPI inflation remained sticky, slightly higher at 6.0% in June compared with 5.9% in May, but lower than 6.1% a year ago
- Within core inflation, both goods (excluding transportation) and services saw a rise
- Rural inflation remained unchanged at 7.1% as in May, while urban inflation slowed to 6.9% from 7.1%

How inflation moved in key items

- **Moderation in food inflation was driven by** slowing inflation in pulses (-1.0% in June versus -0.4% in the previous month), eggs (-5.5% versus -4.6%), edible oils (9.4% versus 13.3%), and vegetables (17.4% versus 18.3%). Inflation in pulses and edible oils has been falling over the past few months, aided by a high base and import duty cuts. Softening international edible oil prices after Indonesia lifted the ban on palm oil further eased domestic prices. Vegetable prices also softened sequentially as the impact of the heatwave subsided.
- However, inflation was up in cereals (5.7% versus 5.3%), milk (6.1% against 5.6%), meat and fish (8.6% versus 8.2%), spices (11% compared with 9.9%) and fruits (3.1% against 2.3%). Within cereals, both rice and wheat products saw rise in inflation.

- **Fuel inflation also rose, driven by** liquefied petroleum gas, or **LPG** (21.2% versus 19.4%) **and kerosene** (95.7% versus 95.2%). While electricity inflation remained negative, the pace of decline slowed (-1.4%

versus -2.2%). Electricity inflation will move up in the coming months as states revise their power tariffs. States such as Maharashtra, Karnataka, Kerala and Goa have already announced an increase in tariffs

- **Core inflation rose for all goods and services, barring transportation**
  - Transport and communication inflation eased (6.9% versus 9.5%), helped by excise duty cuts on petrol and diesel
  - Excluding petrol and diesel, however, core goods inflation rose (7.1% versus 6.7%). Services inflation rose as well (5.1% against 4.7%). This reflects a broad-based pass-through of cost pressures to consumers, with demand on the path of recovery
  - Clothing and footwear saw the sharpest increase (9.5% versus 8.9%), followed by household goods and services (7.5% against 6.8%), recreation and amusement (7.0% compared with 6.0%), personal care and effects (6.7% versus 6.2%), health (5.5% compared with 5.4%), education (4.5% against 4.2%) and housing (3.9% versus 3.7%)

Rural inflation catching up, but urban poor continue to face heavy burden

While urban inflation slowed to 6.9% in June from 7.1% in the previous month, rural inflation remained stable at 7.1%. Urban inflation slowed, driven by food and core. Meanwhile rising fuel and core inflation kept pressure in rural areas.

While rural inflation is catching up, it remains lower than urban areas on essential items, namely food and fuel.

Rural versus urban CPI inflation (on-year, %)

Category	June 2022	
	Rural	Urban
Overall	7.1	6.9
Food	7.6	8.0
Fuel	9.3	12.2
Core	6.2	5.8

Essential items occupy a greater share in the consumption basket of people having lower incomes. With higher inflation in essential items in urban areas, the urban poor have been facing the heaviest burden of inflation.

The burden of inflation varies across income groups, as the share of spending on food, fuel and core categories differs across classes. Using data from the National Sample Survey Organisation, we mapped expenditure baskets of three broad income groups — bottom 20%, middle 60%, and upper 20% of the population — with June[1] inflation trends. The table below gives average inflation faced by each income class.

CPI inflation across income classes (on-year, %)

Income segment	June 2022	
	Rural	Urban
Top 20%	6.9	6.9
Middle 60%	7.2	7.3
Bottom 20%	7.3	7.7

Source: NSSO, National Statistics Office (NSO), CEIC, CRISIL

[1] For detailed methodology and findings, refer to CRISIL Quickonomics: *Same inflation, different burdens by income* (October 2021)

Outlook

We expect CPI inflation to average 6.8% in fiscal 2023 compared with 5.5% last year, with the rise being broad-based across food, fuel and core inflation.

Food inflation outlook remains grim after the heatwave hit production of key crops. A normal and well-distributed monsoon is critical to secure adequate supplies of kharif crops, including rice, pulses, and oilseeds. Early sowing trends indicate a fall in sowing for rice and oilseeds relative to last year. Monsoon's catch-up, intensity and distribution will remain a monitorable. That said, wheat supplies are expected to remain tight until the arrival of fresh rabi crop next year.

Although international commodity prices have softened recently, they remain higher on-year for most commodities. Elevated international commodity prices, coupled with pending passthrough of cost pressures from the last fiscal, will continue to exert pressure on food, fuel and core inflation. The weakening rupee will further raise the price of imported crude oil and commodities.

IIP clocks 12-month high growth, aided by base effect

The Index of Industrial Production (IIP) recorded 19.6% on-year growth in May, up from 6.7% (revised down from the earlier estimate of 7.1%) in April 2022.

The latest IIP data suggests that revival in industrial activity remains gradual. The high on-year growth in May was largely driven by low base effect, as the second wave of the Covid-19 pandemic had led to slowdown in industrial activity during the same period last year. Weakness in consumption demand, particularly that of non-durables, which reflects mass consumption, is worrisome.

Highlights

- IIP rose 19.6% on-year in May, up from 6.7% (revised down from 7.1% earlier) in April. The high growth was largely a reflection of a low base as industrial activity had slowed last year owing to the second wave of the pandemic. On a sequential basis, i.e., on-month movement in the de-seasonalised series, which takes care of the base effect and seasonal variations, IIP growth slowed down in May (0.3%) compared to April (2.8%) suggesting industrial revival remains range-bound
- Manufacturing, which has the highest weight of 77.6% in IIP, was up 20.6% on-year in May, compared with 5.8% in April. But again, this was largely driven by low base. On sequential basis, manufacturing growth softened in May, indicating headwinds such as high input prices and subdued consumption demand in the face of high inflation that the manufacturing sector faces. This corroborates with some softening in the manufacturing PMI and slowdown in India's core exports in May
- Of the 23 manufacturing components, eight recorded lower production in May compared with April. These were leather and related products; food products; computer, electronic and optical products; pharma, medicinal chemical and botanical products; other non-metallic mineral products; textiles and paper and paper products
- On the other hand, mining, the second biggest component of IIP with a weight of 14.4%, displayed improvement in both y-o-y as well as sequential terms. This possibly reflects the tailwind from high commodity prices
- Another way to assess the performance of IIP is to look at its use-based classification. Sequential movement suggests a mixed performance there. While consumer goods continued to display weakness with both consumer durable and non-durable IIP declining on-month (in seasonally adjusted terms) in May, infrastructure and construction IIP recorded a healthy uptick, suggesting the government's capex program continued to run well.

Outlook

High IIP growth is expected to start moderating from next month as the low base effect wanes off. Sequentially, industrial activity, especially manufacturing, is expected to remain range-bound in the face of subdued consumption demand and some softening in goods exports. The fall in commodity prices and freight costs would only reflect gradually in terms of lower input prices for the sector as the pass-through of high prices earlier remains incomplete. That said, broad-basing of domestic economic activity, especially with contribution from contact-based services, and the healthy progress of monsoon augur well for rural demand and thereby industrial activity. Government-led capex should also continue to lend a helping hand.

Analytical contacts

Dharmakirti Joshi
Chief Economist, CRISIL Ltd.
dharmakirti.joshi@crisil.com

Adhish Verma
Senior Economist, CRISIL Ltd
adhish.verma@crisil.com

Pankhuri Tandon
Economist, CRISIL Ltd.
pankhuri.tandon@crisil.com

Media Contacts

Aveek Datta
Media Relations
CRISIL Limited
M: +91 99204 93912
B: +91 22 3342 3000
aveek.datta@crisil.com

Riddhi Savla
Media Relations
CRISIL Limited
M: +91 98199 57423
B: +91 22 3342 3000
riddhi.savla@ext-crisil.com

About CRISIL Limited

CRISIL is a leading, agile and innovative global analytics company driven by its mission of making markets function better.

It is India's foremost provider of ratings, data, research, analytics and solutions with a strong track record of growth, culture of innovation, and global footprint.

It has delivered independent opinions, actionable insights, and efficient solutions to over 100,000 customers through businesses that operate from India, the US, the UK, Argentina, Poland, China, Hong Kong and Singapore.

It is majority owned by S&P Global Inc, a leading provider of transparent and independent ratings, benchmarks, analytics and data to the capital and commodity markets worldwide.

About CRISIL Research

CRISIL Research is India's largest independent integrated research house. We provide insights, opinion and analysis on the Indian economy, industry, capital markets and companies. We also conduct training programs to financial sector professionals on a wide array of technical issues. We are India's most credible provider of economy and industry research. Our industry research covers 86 sectors and is known for its rich insights and perspectives. Our analysis is supported by inputs from our large network sources, including industry experts, industry associations and trade channels. We play a key role in India's fixed income markets. We are the largest provider of valuation of fixed income securities to the mutual fund, insurance and banking industries in the country. We are also the sole provider of debt and hybrid indices to India's mutual fund and life insurance industries. We pioneered independent equity research in India, and are today the country's largest independent equity research house. Our defining trait is the ability to convert information and data into expert judgments and forecasts with complete objectivity. We leverage our deep understanding of the macro-economy and our extensive sector coverage to provide unique insights on micro-macro and cross-sectoral linkages. Our talent pool comprises economists, sector experts, company analysts and information management specialists.

CRISIL Privacy