Macroeconomics | First cut

Inflation down, IIP up

February 2024

Food and core drive down headline inflation

Inflation based on the Consumer Price Index (CPI) eased to a three-month low of 5.1% in January from 5.7% in December largely driven by lower food prices. However, a further drop in core inflation to 3.5% – a 50-month low – stole the limelight.

After persistently sprinting for two months, from 6.6% in October to 9.5% in December 2023, food inflation changed course this January and eased to 8.3% as inflation in food grains (pulses and cereals) cooled to 10.1% after averaging 12% over the past seven months. However, vegetable inflation remained high and rigid at ~27%.

The steep and broad-based disinflation in core inflation is both comforting and intriguing. Inflation in clothing and footwear is at a 38-month low, housing at a 35-month low, household goods and services at a 33-month low, health at a 41-month low, recreation and entertainment at an all-time low, and personal care and effects at a 23-month low. Though low input costs have contributed, the role of softer demand in keeping core inflation benign cannot be ruled out.

The trajectory of inflation was largely driven by food prices this fiscal. Despite easing in January, overall food inflation remains elevated. On the positive side, rabi sowing has picked up and exceeded last year's level, which augurs well for food inflation going forward.

We expect CPI inflation to average 4.5% in fiscal 2025 vs an estimated 5.5% this fiscal. Cooling domestic demand, assumption of a normal monsoon along with a high base for food inflation should help moderate inflation next fiscal. A non-inflationary budget that focusses on asset-creation rather than direct cash support also bodes well for core inflation.

However, an unusual weather event, if at all, could reverse the easing. Similarly, recent developments in the Red Sea and a fading low base effect for commodity prices could put some upside pressure on core inflation and would need monitoring.

We believe slowing inflation, a smaller fiscal deficit and an imminent turn in the US Federal Reserve's policy rates will create the ground for the Monetary Policy Committee (MPC) to start cutting rates. However, we believe more clarity on the path of disinflation could push this decision at least to June 2024, if not later. While CPI inflation has remained in the Reserve Bank of India's (RBI) tolerance band of 2-6% since August, it is still shy of the 4% target and that keeps the MPC on watch.

Key data points in January

- CPI inflation eased to 5.1% from 5.7% the previous month
- Food inflation decelerated to 8.3% from 9.5%
- Fuel[1] prices fell 0.6% on-year but the pace of decline slowed
- Core CPI[2] inflation eased to 3.5% from 3.8%

Food inflation eases on-month but remains high

- Vegetable inflation stayed rigid, easing slightly to 27% from 27.6% in December, driven by decline in onion prices (29.6% vs 74%). Inflation rose in other key vegetables such as tomato (38.3% vs 33.5%), brinjal (33.7% vs 31.9%) and leafy vegetables (14.2% vs 8.3%). Potato inflation remained negative but picked up on-month (-1.9% vs -8.8%)
- Inflation in cereals eased for the seventh consecutive month to 7.8% from 9.9%, driven by softening in prices of wheat from non-Public Distribution System (PDS) sources (2.3% vs 4.7%). However, inflation in non-PDS rice, which has the highest weight among cereals, increased to 13% from 12.3%. Inflation in PDS wheat eased to (13% vs 36.6%), while it jumped for PDS rice (0.2% vs -21.5%)
- Inflation in pulses eased for the first time in five months to 19.5% to 20.7%, as inflation eased in arhar (39.1% from 42.4%), moong (12.6% vs 13.2%) and masur (-0.2% vs 0.1%)
- Inflation in spices decelerated to 16.4% from 19.7%, driven by jeera (89.8% vs 114.3%) and dry chilies (5.9% vs 8.2%)
- Inflation in sugar hardened for the tenth straight month to 7.5% from 7.2%, mirroring global prices

The pace of deflation in fuel slows

- Fuel inflation remained negative for the fourth consecutive month, at -0.6%, but the pace of deflation slowed on-month (-1%)
- Prices of LPG fell at a faster pace in January compared with December (-13.3% vs 13%), electricity inflation remained broadly unchanged (at 10.4%), while PDS kerosene saw a lower deflation rate of -14.3% compared with -19.5%

Core inflation eases further

- Core inflation eased to 3.5% from 3.8% the previous month. Core goods[3] inflation and services inflation eased by ~20 bps each to 2.7% and 3.5%, respectively
- Among essentials, inflation in health (4.8% vs 5.1%) and housing (3.2% vs 3.6%) eased but moved up a tad in education (4.9% vs 4.8%)
- Inflation eased significantly in the personal care and effects category (5.9% vs 7.3%), and slowed in gold (12.2% vs 15.9%) and silver (9.2% vs 14.4%)

---

[1] Refers to CPI fuel and light

[2] CPI excluding food and beverages, and fuel and light

[3] CPI excluding services and food

Inflation more burdensome for the urban poor, in January

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

In fiscal 2024 so far, the urban poor have faced the highest inflation burden, as food prices in urban areas (7.5%) have risen more than in rural areas (7.1%). This trend continued in January. That said, the urban poor saw the largest reprieve in January as urban food inflation eased to 9% from 10.4%.

On the other hand, the richest segment in urban areas faced the lowest burden since a large part of their consumption basket consists of non-food items. Core inflation was 3.5% in urban areas compared with 3.7% in rural areas.

As long as food inflation is elevated, the poor will continue to face the highest burden.

CPI inflation across income classes (% on-year)

Income segment	January 2024		December 2023	
	Rural	Urban	Rural	Urban
Top 20%	5.1	4.9	5.7	5.4
Middle 60%	5.4	5.4	6.0	6.0
Bottom 20%	5.4	5.6	6.1	6.3

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

Mild improvement in industrial activity

The Index of Industrial Production (IIP) increased to 3.8% on-year in December from 2.4% in November driven by consumption and industrial sectors. Growth in manufacturing IIP picked up, while that in electricity and mining IIP slowed.

Notwithstanding the pick-up in December, average IIP growth in the third quarter (October-December) of fiscal 2024 was lower at 5.9% on-year compared with 7.8% the previous quarter. Infrastructure and industry-related goods production slowed in the third quarter, while consumption goods production was uneven.

Domestic demand may moderate next year, driven by delayed impact of the RBI's rate hikes and regulatory measures to clamp down credit growth. Investment – the primary driver of growth this fiscal – may see lower support from the central government's capital expenditure (capex) next year as envisaged in the interim budget.

Exports face renewed risks from global trade disruptions, emanating from continuing unrest in the Middle East. Global demand, too, is expected to slow as the US growth slows, with progressing transmission of past rate hikes by the Federal Reserve.

We expect slowing growth in manufacturing and services to lead to gross domestic product (GDP) growth of 6.4%, on average, next fiscal compared with current print of 7.3%.

Data highlights

- IIP growth improved to 3.8% on-year in December from 2.4% the previous month. The index grew 0.8% on-month after seasonal adjustments
- Growth in manufacturing picked up (3.9% on-year in December vs 1.2% the previous month), while growth in electricity (1.2% vs 5.8%) and mining (5.1% vs 7.0%) slowed
- Manufacturing growth was driven by consumer durables (4.8% vs -5.5%), infrastructure and construction goods (4.1% vs 1.7%), intermediate goods (3.4% vs 3.1%), capital goods (3.2% vs -1.1%), and consumer non-durables (2.1% vs -3.3%). Growth in primary good output, however, fell (4.6% vs 8.5%)

Consumption and industrial goods improve

- IIP growth improved the most for consumer durables. While on-year IIP growth for consumer durables was higher than that of non-durables in December (at 4.8% and 2.1%, respectively), sequential analysis (using on-month seasonally adjusted data) showed that output in consumer durables contracted while output growth in consumer non-durables picked up.
- Among consumer segments, the on-year improvement in IIP growth was driven by automobiles (9.2% in December, as in the previous month), textiles (1.6% vs -3.7%) and food products (1.2% vs -3.7%)
- Industrial goods also recorded better performance. The growth in infrastructure and construction goods output picked up significantly (4.1% in December vs 1.7% in the previous month). Capital goods IIP expanded on-year (3.2% vs -1.1%), with output growth picking up in intermediate goods as well (3.4% vs 3.1%). While on-year output growth slowed for primary goods (4.6% vs 8.5%), the sequential contraction in this segment eased. Output expansion was also recorded in export-oriented sectors, including fabricated metal products (8.9% vs -5.2%), basic metals (7.3% vs 7.2%) and pharmaceuticals (3.0% vs -3.0%)

- Better manufacturing performance, including in export-orientated sectors, is in line with an improved export performance. In December, India's merchandise exports increased 0.97% on-year from a 2.9% contraction in November

- However, electricity IIP growth slowed sharply to 1.2% in December from 5.8% in November. This is the slowest pace of expansion since May

Outlook

While industrial activity has been steady so far, it is expected to lose some momentum next fiscal as domestic and external demand moderate.

Consumption demand is expected to remain soft as transmission of the RBI's rate hikes and its regulatory measures lower credit growth.

Investment – the key growth driver this fiscal – may see lower support from the central government's capex next year. The interim budget has cranked up the pace of fiscal consolidation, targeting lower capex growth of 17.7% in fiscal 2025 from 21.5% in current year. A pick-up in private capex is critical to maintain the investment momentum.

Globally, slowing growth in India's major export destinations, especially the US, is likely to weigh on export demand in the remainder of this fiscal. S&P Global expects the US growth to slow to 1.5% in 2024 (vs a better-than-expected 2.4% in 2023), as monetary policy transmission picks up. Persisting tensions in the Middle East, exacerbated by the recent unrest in the Red Sea, have revived risks of disruptions in global trade and raised concerns of a rise in shipping costs.

We expect slowing growth in manufacturing and services to lead to GDP growth of 6.4%, on average, next fiscal compared with 7.3% this fiscal.

Analytical contacts

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

Dipti Deshpande
Principal Economist
dipti.deshpande@crisil.com

Pankhuri Tandon
Senior Economist
pankhuri.tandon@crisil.com

Sharvari Rajadhyaksha
Economic Analyst
sharvari.rajadhyaksha@crisil.com

Bhavi Shah
Economic Analyst
bhavi.shah@crisil.com

Media contacts

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

Roma Gurnani
Media Relations
CRISIL Limited
M: +91 70662 92142
roma.gurnani@ext-crisil.com

About CRISIL Market Intelligence & Analytics

CRISIL Market Intelligence & Analytics, a division of CRISIL, provides independent research, consulting, risk solutions, and data & analytics. Our informed insights and opinions on the economy, industry, capital markets and companies drive impactful decisions for clients across diverse sectors and geographies.

Our strong benchmarking capabilities, granular grasp of sectors, proprietary analytical frameworks and risk management solutions backed by deep understanding of technology integration, make us the partner of choice for public & private organisations, multi-lateral agencies, investors and governments for over three decades.

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, UAE 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.

For more information, visit www.crisil.com

CRISIL Privacy Notice

CRISIL respects your privacy. We may use your personal information, such as your name, location, contact number and email id to fulfil your request, service your account and to provide you with additional information from CRISIL. For further information on CRISIL's privacy policy please visit www.crisil.com/privacy.

Disclaimer

CRISIL Research, a division of CRISIL Limited (CRISIL) has taken due care and caution in preparing this Report based on the information obtained by CRISIL from sources which it considers reliable (Data). However, CRISIL does not guarantee the accuracy, adequacy or completeness of the Data / Report and is not responsible for any errors or omissions or for the results obtained from the use of Data / Report. This Report is not a recommendation to invest / disinvest in any company covered in the Report. CRISIL especially states that it has no financial liability whatsoever to the subscribers/ users/ transmitters/ distributors of this Report. CRISIL Research operates independently of, and does not have access to information obtained by CRISIL's Ratings Division / CRISIL Risk and Infrastructure Solutions Limited (CRIS), which may, in their regular operations, obtain information of a confidential nature. The views expressed in this Report are that of CRISIL Research and not of CRISIL's Ratings Division / CRIS. No part of this Report may be published / reproduced in any form without CRISIL's prior written approval

Argentina | Australia | China | Hong Kong | **India** | Japan | Poland | Singapore | Switzerland | UAE | UK | USA

CRISIL Limited: CRISIL House, Central Avenue, Hiranandani Business Park, Powai, Mumbai – 400076. India

Phone: + 91 22 3342 3000 | Fax: + 91 22 3342 3001 | www.crisil.com

CRISIL

An S&P Global Company