Macroeconomics | First cut

Food fires up consumer inflation, IIP continues gradual rise

April 2022

CPI inflation jumps with a sharp rise in food inflation

Inflation based on the Consumer Price Index (CPI), or retail inflation, rose to 7% on-year in March compared with 6.1% in February, and 5.5% in March 2021. This is the highest since October 2020, and 100 basis points (bps) above the Reserve Bank of India's (RBI's) upper band of tolerance set at 6%. Food inflation — the most volatile component of CPI — increased sharply, along with core[1] inflation. Fuel[2] inflation moderated despite surging international energy prices, as domestic prices were kept unchanged for majority of the month.

With this, CPI inflation averaged 5.5% in fiscal 2022, compared with 6.2% in the previous year.

Pressure on retail inflation is rising and becoming broad-based, driven by protracted supply shocks. Food inflation – which had helped contain headline CPI inflation in fiscal 2022 – faces upside risks in fiscal 2023 from surging international food prices and input costs. Fuel inflation is expected to rise further if international crude prices remain above $100/barrel. A wide-ranging surge in international prices across energy, agriculture, and metal commodities post the Russia-Ukraine conflict has brought more cost pain for producers, which we expect to be passed on to consumers to a greater extent this fiscal. This will raise core inflation further.

Inflation trends in March: Highlights

- CPI inflation rose to 7.0% in March from 6.1% in the previous month and 5.5% in March 2021
- Food inflation climbed to 7.7% from 5.9% in February and 4.9% a year ago
- Fuel inflation moderated to 7.5% from 8.7% in February and 4.4% a year ago
- Core CPI inflation increased to 6.4% from 5.8% in the previous month and 5.9% a year ago.
- Within core, goods inflation[3] was higher at 7.4% compared with 5.2% in services in the month
- Rural CPI inflation was higher at 7.7% in March versus 6.1% in urban areas

How key items saw inflation move

- **Most food commodities saw inflation rise,** with the sharpest jump in vegetables (11.6% in March versus 6.1% in February), followed by edible oils (18.8% versus 16.4%), meat and fish (9.6% compared with

[1] CPI excluding food and beverages and fuel and light
[2] Refers to fuel and light CPI
[3] Excluding petrol and diesel

7.4%), milk products (4.7% against 3.9%), cereals (4.9% versus 4%), prepared meals, snacks and sweets (6.6% versus 6.3%) and sugar products (5.5% against 5.4%)

- However, inflation eased for pulses (2.6% versus 3.0%) and eggs (2.4% against 4.1%)
- **Fuel inflation moderated** because of a fall in electricity price (-1.7% versus -1.5%) and slowing inflation in liquified petroleum gas or LPG (10% versus 19.1%). Domestic LPG price was kept unchanged between October and mid-March, which helped ease inflation during this period
- **Core inflation saw a broad-based rise** across goods and services. This reflects rising pass-through of cost pressures as demand conditions recover
    - Among goods, personal care and effects (8.7% versus 5.5%) recorded the sharpest rise, driven by gold (up 12% versus 2.3%), as international prices have gone up 7.3% since January 2022. Inflation in FMCG products such as soaps, toothpaste, creams, etc. also rose
    - Clothing and footwear inflation rose for the 11th consecutive month (9.4% versus 8.9%). The textiles sector has seen a sharp rise in raw material prices, which is being passed on to retail prices
    - Household goods and services inflation was a tad higher at 7.7% from 7.2%. Household appliances and utensils also saw inflation rise as producers passed on pressure from surging metal prices
    - Inflation in transport and communication moderated (8% versus 8.1%) as petrol and diesel prices were unchanged for majority of the month. However, certain conveyance services such as taxi, autorickshaw fares and airfare saw inflation rise.
    - Among services, health inflation rose to 7% from 6.8%, while education remained stable at 3.6%.

Food shock hits poor the most

The sharp rise in food inflation is likely to have hit the poor to a greater extent given that food occupies majority share in their consumption basket.

The burden of inflation varies across different 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 estimated average expenditure across three broad income groups — bottom 20%, middle 60%, and upper 20% of population — and mapped them with the inflation trends[4]. We have estimated this separately for rural and urban areas.

Based on this, we estimate the rural bottom 20% and middle 60% of the income segments faced highest inflation at 7.7%. In urban areas, too, the bottom 20% faced higher inflation than other income segments. However, the burden was slightly lesser than their rural counterparts given the sharper rise of inflation in rural areas. For rural areas, overall CPI inflation was 7.7% and food CPI stood at 8.0% in March, while for urban areas overall CPI was 6.1% and food CPI was 7%.

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

Income segment	March 2022	
	Rural	Urban
Top 20%	7.6	6.1
Middle 60%	7.7	6.3
Bottom 20%	7.7	6.4

** With share of commodity groups in expenditure basket of respective income class as weights*
Source: NSSO, National Statistics Office (NSO), CEIC, CRISIL

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

Outlook

Pressures on inflation are rising and becoming broad-based this fiscal. In the previous fiscal, low food inflation had contained headline CPI, while fuel and core inflation had gone up. Now, food inflation is expected to rise along with fuel and core inflation.

Upside risks on food inflation have risen because of the Russia-Ukraine conflict. Among the agriculture commodities witnessing the sharpest price rise are wheat and sugar (India's major exports) and vegetable oils and fertilisers (major imports). While the first three items will directly influence domestic retail prices, fertilisers will indirectly exert pressure through increasing agriculture costs. The livestock sector is also feeling the pain of rising international prices of commodities used for animal feed such as maize and soymeal.

Core inflation is expected to face a broad-based rise as producers increase pass-through of cost pressures across all segments. After a year of double-digit WPI inflation, cost pressures have increased further for Indian producers. Improving demand conditions will enable producers to pass on cost pressures to retail prices to a greater extent. This will particularly be seen in services, where inflation was subdued so far due to incomplete pick-up in activity.

Fuel prices are expected to face pressure from surging international energy prices as well as delayed pass-through from the previous fiscal. Fuel prices were frozen between November 2021 and mid-March despite international crude prices rising ~$30/barrel during this period. Since then, prices of petrol, diesel, LPG and CNG have been unfrozen. A sharp rise in prices across different energy commodities signals the pressure on fuel inflation will continue this fiscal. We expect every $10 per barrel increase in crude price can raise headline CPI inflation by ~40 bps.

Industrial production marginally up

The Index of Industrial Production (IIP) printed at 132.1 in February, compared with 138.6 in January, representing 1.7% on-year growth, up from 1.5% growth in January.

IIP growth has been gradually inching up, rising for the third consecutive month in February, albeit the pace remains mild as economic recovery is still subdued. While February saw improvement in the infrastructure and construction goods category, consumer goods was still in the red, reflecting weakness in private consumption demand.

Highlights

- IIP growth improved marginally to 1.7% on-year in February from 1.5% in January, suggesting that the economy may be well past the impact of the third wave of the pandemic that peaked in January. The hit to economic activity from the third wave was in any case mild. That said, the improvement in IIP growth was supported largely by the electricity and mining sectors, while manufacturing growth softened.
- Growth in manufacturing (which has the highest weight of 77.6% in IIP) fell to 0.8% on-year in February, from 1.3% in January, likely reflecting headwinds from rising commodity prices amidst subdued consumption demand. Some disruption to raw material supplies from China, which grapples with Covid-19-related lockdowns, could have also impacted the domestic manufacturing activity.
- On the other hand, mining (14.4% weight) growth improved to 4.5% on-year in February from 2.8% in January, as rising commodity prices possibly acted as a tailwind for the sector. Electricity (7.9% weight) growth, too, rose sharply (to 4.5% on-year in February from 0.9% in January).
- Of the 23 manufacturing categories, 10 saw an annual decline in activity; together these have 30.4% weight in IIP. On the other hand, 13 manufacturing categories (47.2% weight in IIP) registered annual rise in activity. The three sectors that witnessed the maximum growth in February were *Furniture* (25.7% on-year), *Tobacco Products* (14.5%) and *Wearing Apparel* (14.4%). On the other hand, the three sectors that witnessed the sharpest decline in activity were *Leather and Related Products* (-16.6% on-year), followed by *Other Transport Equipment* (-15.5%) and *Computer, Electronic and Optical Products* (-14.8%).
- The use-based classification of IIP suggests infrastructure activity continued to improve in February as growth in *Infrastructure and Construction Goods* increased to 9.4% on-year from 6.1% in January, suggesting a pick-up in spending towards the close of the fiscal. Growth in *Capital Goods* stood at 1.1% on-year in February, suggesting mild improvement in investment activity. That said, weakness in consumption demand continued. Not only did *consumer durable goods* witness growth declining for the fifth straight month in February (-8.2% on-year), but *consumer non-durables* also slipped into the negative territory in February (-5.5%).

Outlook

While industrial activity weathered the impact of the third wave of the pandemic, it faces newer challenges going ahead. Escalation in commodity prices on account of the Russia-Ukraine conflict and rise in freight costs mean input costs pressure for the manufacturing sector. Increase in lockdown measures in China to contain the pandemic could also mean disruption in raw material availability for the sector. Being the largest component of IIP, this would mean a range-bound movement in the near term. The length and magnitude of the Russia-Ukraine conflict would remain a key monitorable. Beyond that, broad-basing of domestic economic activity and forecast of a normal monsoon augur well for 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

Hiral Jani Vasani
Media Relations
CRISIL Limited
D: +91 22 3342 5916
M: +91 982003 9681
B: +91 22 3342 3000
hiral.vasani@crisil.com

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