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An S&P Global Company

Macroeconomics | First cut

Inflation soars to 8-year high, IIP holds ground

May 2022

CPI inflation reaches 7.8% in a broad-based surge

Inflation based on the Consumer Price Index (CPI), also known as retail inflation, rose for the seventh consecutive month, reaching 7.8% in April 2022, the highest since May 2014. Most major goods and services saw prices jump, with food and fuel recording relatively higher inflation. Worryingly, core[1] inflation too rose to its 8-year high, reflecting the broad-basing of inflationary pressures in the economy.

Inflationary pressures are getting generalised, with food, fuel and core, all recording a sharp rise. This trend expected to continue this fiscal, as a wide-ranging rise in commodity prices and supply disruptions push producers to pass on cost pressures to consumers. ***We expect CPI inflation to average 6.3% in fiscal 2023 compared with 5.5% in the previous year, with risks tilted to the upside.***

Inflation trends in April: Highlights

- CPI inflation rose to 7.8% in April compared with 7% previous month and 4.2% in April 2021
- Food inflation jumped to 8.4% from 7.7% previous month and 2% a year ago
- Fuel[2] inflation rose to 10.8% from 7.5% previous month and 8% a year ago
- Core CPI inflation rose to 7.1% from 6.4% previous month and 5.3% a year ago
- Within core, both goods and services saw rising trend. Core goods inflation (excluding petrol and diesel) rose to 7.7% in April from 7.4% previous month, while services inflation rose to 5.4% from 5.2%
- Rural CPI inflation was higher at 8.4% in April versus 7.1% in urban areas
- The poorest 20% of income segments faced maximum inflation burden in both rural and urban areas

How inflation in key items moved

- **The jump in food inflation was driven by essentials** such as cereals (6% inflation in April vs 5% previous month), fruits and vegetables (11.7% vs 8.6%), milk (5.5% vs 4.7%), and spices (10.6% vs 8.5%).
- Edible oil inflation remained in double digits at (17.3% vs 18.7%), despite a high base (25.9% in April 2021)
- Prepared meals, snacks and sweets inflation rose to 7.1% from 6.6%, reflecting the cost pressures getting passed on in manufactured food products
- However, there was some let-up in prices of protein items such as pulses (1.9% vs 2.6%), and eggs, meat and fish (6.3% vs 9%). Sugar and confectionery too moderated (5.2% vs 5.5%)

[1] CPI excluding food and beverages and fuel and light
[2] Refers to CPI fuel and light

- **Fuel inflation rose as prices were unfrozen** for a range of fuel items such as liquefied petroleum gas, or LPG (15.1% inflation in April vs 10% previous month), and kerosene (91.1% vs 65.2%). After 6 months of almost no change, the government began hiking fuel prices from late March, allowing some pass-through of surging international crude prices. Brent crude prices averaged $105.8 per barrel in April, 63.3% higher on-year
- Electricity tariffs were revised up gradually in several states in response to surging coal prices. This reflected in a slower decline in electricity inflation (-0.6% vs -1.7%)
- **Core inflation saw a broad-based rise across goods and services**, reflecting rising pass-through of cost pressures
    - Transport and communication saw the sharpest rise (10.9% vs 8%), as petrol and diesel prices underwent multiple hikes in the month
    - Inflation surged for clothing and footwear (9.9% vs 9.4%), household goods and services (8% vs 7.7%), and recreation and amusement (7.3% vs 7%).
    - Education, which saw subdued inflation last fiscal, has begun picking up (4.1% vs 3.6%). Health services also saw a rise (7.2% vs 7%)
    - Slight moderation was seen in personal care and effects (8.6% vs 8.7%), driven by moderating gold prices

Rural poor hit the hardest

Rural inflation saw a sharper rise (8.4% in April vs 7.7% previous month) than urban (7.1% vs 6.1%). Worryingly, the poorest segments continue to face the highest burden in both these areas, given that food and fuel – which occupy the largest share in the consumption basket of the poorest – saw highest inflation.

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[3]. We also estimated this separately for rural and urban areas.

Our estimates show, the bottom 20% of the income segment in rural areas faced the highest inflation at 8.5% in April. Inflation was higher in food and beverages (8.4%) and fuel (11%) than core (7.9%) in rural areas, which does not augur well for their consumption basket.

In urban areas, too, the bottom 20% faced higher inflation than other segments, due to the similar nature of inflation (food and beverages inflation at 7.7%, fuel at 10.4%, and core at 6.4%). However, the burden was slightly lesser than their rural counterparts, given the sharper rise of inflation in rural areas.

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

Income segment	April 2022	
	Rural	Urban
Top 20%	8.3	7.1
Middle 60%	8.4	7.4
Bottom 20%	8.5	7.6

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

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

Outlook

We expect CPI inflation to rise to 6.3%, on average, this fiscal compared with 5.5% in the previous year. Risks are tilted to the upside. Inflationary pressures are rising and becoming broad-based, driven by elevated commodity prices and persistent supply shocks.

Food inflation is expected to rise on account of the higher costs of production, surging international crop prices and extreme weather-related disruptions. Agricultural commodities, whose international prices have surged post Russia-Ukraine war, include: (a) agricultural inputs such as fertilisers and animal feed, (b) major exports such as wheat, and (c) major imports such as edible oils. This has caused an all-round increase in price pressures. While normal monsoons are expected to augur well for agriculture production, its distribution will need to be seen. Other weather events will also have a bearing on production, such as the adverse impact of recent heatwaves on wheat yields.

Fuel inflation is expected to stay high, with crude prices likely to stay elevated through the fiscal. CRISIL Research expects Brent crude to average $94-99 per barrel in calendar year 2022 (up 33-40% on-year), or even higher, if the geo-political tensions continue.

Weakening of the Indian rupee will further add to the imported cost of crude and commodities.

A wide-ranging surge in prices of food, energy and industrial commodities has raised cost pressures for Indian producers further, marking the second year of elevated input costs. Producers will try to pass on these cost pressures to consumers, which will raise core inflation.

Pressure on core inflation is also expected to become broad-based as the services sector recovers after two years of subdued growth. Like goods, services are also facing rising cost pressures. Findings of S&P Global India Services PMI show input costs increased this April at a near-record pace, and are getting passed on to consumer prices, amid the rebound in demand. As the impact of the pandemic waves subside this fiscal and services activities strengthen, producers would be able to pass on the rise in costs this year.

Industrial production marginally up

The Index of Industrial Production (IIP) printed at 148.3 in March, compared with 131.8 in February, representing 1.9% on-year growth, up from 1.5% growth in February.

IIP growth was marginally up from February, suggesting domestic demand is still soft and there are external headwinds from Russia-Ukraine war and Chinese lockdown impact. Moreover, the improvement in IIP was premised on high electricity and mining growth, while manufacturing moved in baby steps. Worryingly, capital goods growth softened again, even as consumer goods remained in red.

Highlights

- IIP growth rose marginally to 1.9% on-year in March from 1.5% in February, suggesting that industrial activity held ground in the face of adverse impacts of the Russia-Ukraine war and Covid-related lockdowns in China. That said, the improvement in IIP was supported in large part by healthy growth in the electricity and mining sectors, while manufacturing growth remained soft.
- Manufacturing (which has the highest weight of 77.6% in IIP) grew 0.9% on-year in March, marginally up from 0.5% in February. The tepid growth likely reflects headwinds from rising commodity prices amid subdued consumption demand and some disruption to raw material supplies from China, faced with Covid-19-related lockdowns.
- Mining (14.4% weight) grew 4.0% on-year in February, a tad lower than 4.5% in February. Electricity (7.9% weight), on the other hand, rose further, to 6.1% on-year in March from 4.5% in February, attributable to rise in power demand amid severe heat waves. The rise in electricity component was, however, capped by lower coal output, as was reflected in the negative coal output growth in the eight core industries data released earlier.
- Of the 23 manufacturing categories, only nine saw an annual increase in activity; together these have 38.1% weight in IIP. On the other hand, 14 manufacturing categories (39.6% weight in IIP) registered an annual decline in activity. The three sectors that witnessed the maximum growth in March were *wearing apparel* (37.3% on-year), *furniture* (13.0%) and *printing and reproduction of printing media* (12.9%). On the other hand, the three sectors that witnessed the sharpest decline in activity were *tobacco products* (-15.5% on-year), followed by *electrical equipment* (-15.3%) and *pharma products* (-12.8%).
- The use-based classification of IIP suggests infrastructure activity continued to do well in March as *infrastructure and construction goods* production grew 7.3% on-year, following a healthy 9.1% previous month, suggesting a pick-up in government infrastructure spending towards the fiscal-end. Growth in *capital goods*, on the other hand, fell to 0.7% on-year in March, from 2.0% in February, pointing towards weakness in private sector investment activity. At the same time, weakness in consumption demand continued, with *consumer durables* and *consumer non-durables* registering negative growth of -3.2% and -5.0% respectively.

Outlook

Industrial activity, especially manufacturing, remains subdued, as it faces challenges such as elevated commodity prices on account of the Russia-Ukraine conflict and increasing freight costs, implying input cost pressures. Lockdowns in China to contain the pandemic also mean some disruption in raw material availability. This would mean a range-bound movement in manufacturing, the largest component of IIP, in the near term. The duration and magnitude of the Russia-Ukraine conflict would remain a key monitorable. The next two months would see IIP getting a statistical lift as the index had fallen in April and May last year on account of the second Covid wave. Beyond that, broad-basing of domestic economic activity, especially with contribution from contact-based services, and forecast of a normal monsoon, augur well for industrial activity. Government-led capex should also continue to lend a helping hand.

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