Macroeconomics | First cut

Food price pinches, IIP improves

July 2023

Costlier food props up inflation, falling input costs create some offset

Consumer price inflation (CPI) climbed up to 4.8% in June, after falling to a 20-month low of 4.3% in May. There are three things that the data released on inflation tells us:

1. The pick-up in inflation itself does not come as a surprise because fading high-base benefit was expected to raise the print in June. But the expected upside was accentuated by weather anomalies in addition to seasonal uptick pushing up prices of certain food items
2. Despite being higher, headline inflation has stayed within the 5% bound. But with monsoon erratic, there is worry on the extent of impact on food inflation this fiscal, particularly on cereals, pulses and vegetables that are already seeing high, or rising, inflation
3. The non-food component of inflation continues to steadily soften led by falling oil, commodity, raw material, and transportation costs. This is positive because it reduces the need for manufacturers to increase retail prices

We believe monsoon disturbances amid already high inflation rates for certain food items are lending an upside to the inflation outlook. However, for now, we continue to retain our CPI inflation forecast at 5% average for fiscal 2024 (fiscal 2023 was 6.7%). Both, July and August are critical for agriculture. We will have to wait and watch how the rains pan out.

Dealing with inflation caused by supply-side shortages — as it is now — is outside the purview of monetary policy. Here, fiscal policy can play an important role. Interventions such as release of stocks, facilitating imports, restrictions on hoarding can help contain abnormal price spikes in the short term. That said, a transitory rise in food inflation is usually ignored by the Reserve Bank of India (RBI). But a sustained increase can become a concern. We expect RBI to keep rates and stance unchanged in the forthcoming policy. Rate cuts are expected early next year.

Key data points in June

- CPI inflation rose to 4.8% in June from 4.3% in May. On a seasonally adjusted basis, headline inflation rose 0.8% month-on-month in June, compared with a smaller 0.2% rise in May
- Food inflation jumped to 4.5% from 3%, driven by cereals, milk, spices, pulses, edible oils, and vegetables. The sequential on-month uptick even on a seasonally adjusted basis was 1.5%
- Fuel[1] inflation slowed to 3.9% from 4.7% aided by falling global prices and a high base from last year
- Core CPI[2] inflation was only mildly lower at 5.1% from 5.2% in May

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

Food inflation flares

In food inflation, both seasonal factors as well as weather-related disruptions are creating pressure on prices. Moreover, given the El Niño warning and its threat to Indian monsoon, food inflation remains a worry. So far, a drop in edible oils and vegetables prices was steadily bringing down food inflation. While the gains from vegetable prices are reversing, other key items such as cereals, pulses, milk, and spices are seeing prices quickly firm up

- After softening for four straight months, food inflation accelerated to 4.5% in June from 3.0% in May, led by accelerating inflation in pulses and spices, and slower pace of deflation in vegetables
- Although vegetable inflation, which provided relief to the headline number for the past several months, has remained in the deflation zone, it has hardened significantly. Vegetable inflation stood at -0.9% in June compared with -7.9% in May. Inflation rose across vegetables such as onion (1.7% vs -5.5%), brinjal (8.3% vs -4.3%), green chilli (3.8% vs -12.8%) and carrot (8.8% vs -1.9%). Despite the steep increase in prices in May over June, inflation (on-year) in tomatoes remained firmly in the deflation zone. The deflation rate, however, was slower as compared with the previous month (-34.7% vs -52.8%)
- Among protein categories, pulses inflation accelerated sharply to 10.5% from 6.6% led by faster pace of inflation in moong (7.5% vs 5.8%) and tur (27.5% vs 16.8%). Inflation also hardened in meat and fish (1.4% vs -1.2%) and eggs (7% vs 6.7%). Alternatively, inflation in milk eased, though it remains elevated at 8.6% (vs 8.9% in May). Protein inflation measured by combining these categories jumped to 4.6% in June from 1.7% in May
- Inflation in cereals was stable, but high at 12.7% in June. Among major cereal categories, inflation hardened slightly in rice (non-PDS sources 11.8% vs 11.5%) whereas it eased marginally in wheat (non-PDS sources) to 12.4% vs 12.6%). As inflation in wheat remains elevated, the Government of India continues to ban wheat exports.
- Inflation in spices which has been in double-digits for the past 15 months hardened to 19.2% in June from 17.9% led by high inflation in jeera (74.1%) and dry chilli (25.1%)

Fuel inflation benefits for fall in global prices and a high base

A high-base effect continues to favour this category till August. Besides, while global oil prices have fallen 35-37% since July last year, but domestic fuel prices remain unchanged. This creates some scope for a downside to domestic fuel prices if the benefit from lower global prices is passed.

- Fuel inflation fell to 3.9% from 4.7% in May despite electricity inflation surging for the second month in a row. The average price of Brent crude oil fell to $74.9/bbl in June from $75.7/bbl in May and is expected to average $75-$80/bbl this fiscal.
- Inflation in kerosene from both PDS and non-PDS sources (29.4% vs 36.5%) softened in June, with prices of kerosene by PDS sources falling -26.7% (vs -19.1%). Prices of liquified petroleum gas (LPG) rose 9.2% compared to 11% in May.
- Inflation in electricity rose sharply to 8.7% in June from 5.2% in the previous month.

Fall in input costs benefitting core inflation

Core inflation saw only a mild softening to 5.1% in June, from 5.2% in May. This was despite lower input costs leading most manufacturers to curtail price hikes. Much of the stubbornness in core is being influenced by health and education inflation, which has stayed rigid at ~6%. Inflation in the personal care and effects category has also been high over the past several months, keeping core inflation elevated.

- The marginal decline in core inflation was led by moderating inflation in personal care and effects (9% vs 10%), which had accelerated in the previous month due to prices of gold and silver.
- Inflation ticked up in the transport and communication category (2.5% vs 1.1%) as prices of petrol for vehicles (-0.4 vs -6.5%) fell by a slower pace on-year compared with the previous month.
- Services inflation eased marginally to 4.7% from 4.8%. Among major essential services, rental prices rose by a slower pace (4.6% vs 4.8%) while inflation in school and college fees picked up (6.4% vs 5.9%).
- Core goods inflation remained unchanged at 5.6%.

Top income segment in urban areas faced highest inflation rate in June

The burden of inflation varies across 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.

Inflation in June affected different income groups in urban and rural areas as follows:

- Urban residents across income segments faced a higher burden than their rural counterparts as fuel inflation was higher in urban areas (5.5%) than rural (2.9%).
- While food inflation surged in June, core inflation remains elevated above food inflation, and therefore, the top income segment in urban and rural areas alike faced a higher inflation burden than their poorer counterparts.
- Given higher urban fuel inflation and elevated core inflation, the top income segment in urban areas faced the highest inflation burden.

CPI inflation across income classes (% on-year)

Income segment	June 2023	
	Rural	Urban
Top 20%	4.8	5.0
Middle 60%	4.7	4.9
Bottom 20%	4.6	4.9

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 June inflation trends. The table below presents the average inflation faced by each income class.
Source: NSSO, National Statistical Office, CEIC, CRISIL

Industrial activity sees a broad-based improvement

The Index of Industrial Production (IIP) rose for second consecutive month, growing 5.2% on-year in May compared with 4.5% in previous month. The improvement was seen across most sectors, infrastructure and industrial-related goods being the strongest contributors.

The improvement in IIP was broad-based across major manufacturing sectors in May. Strong government capex, inflation relief for consumers, better-than-expected global demand conditions, and easing producer cost pressures have supported industrial activity so far.

However, two swing factors remain to be monitored going forward – impact of high, and rising interest rates on growth in advanced countries, and monsoon's impact on domestic agricultural prospects. Overall, we expect India's real gross domestic product (GDP) to slow to 6% this fiscal from 7.2% in the previous one.

Data highlights

- IIP growth rose to 5.2% on-year in May compared with 4.5% previous month
- All major sectors recorded an improvement, namely mining (6.4% in May versus 5.1% previous month), manufacturing (5.7% vs 5.2%), and electricity (0.9% vs -1.1%)
- Within manufacturing, growth was led by infrastructure and construction goods (14% in May), followed by capital goods (8.2%), consumer non-durables (7.6%), primary goods (3.5%), intermediate goods (1.6%) and consumer durables (1.1%)

Capex remains the propellant of industrial activity

- Infrastructure and construction goods IIP grew in double digits for the second consecutive month (14% in May vs 15% previous month). This is reflective of central government's capital expenditure (capex), which is typically front-loaded in a fiscal. For April-May 2023, centre's capex was 56.7% higher on-year. A sharp revival was also seen for capital goods (8.2% vs 4.6%).

- Consumer-related sectors painted a mixed picture. Consumer non-durables moderated, while sustaining healthy growth (7.6% vs 10.8%). Easing inflation seems to have supported demand for essentials till May.
- Consumer durables recorded a weak improvement (1.1% vs -2.5%), driven primarily by automobiles (13.4% vs 3.6%). IIP continued to decline for wearing apparel (-20.9% vs -29.1%), and electronics (-5.7% vs -11.7%)
- Export-linked sectors remained relatively weaker, such as textiles (-3.7% vs -6.3%) and chemical products (-2.1% vs 2.9%). Petroleum products improved slightly (2.5% vs -1.7%). IIP moderated for basic metals (9.6% vs 10.2%), and pharmaceuticals (20.9% vs 24.5%).
- Commodity-linked sectors have been volatile for the past few months. May saw an improvement for primary goods (3.5% vs 1.9%) even as international commodity prices slid in the month.

Outlook

The rise of IIP in May ties up with S&P Global Purchasing Manager's Index (PMI) for manufacturing reaching a record high of 58.7 in May compared with 57.2 previous month.

Domestic demand remains the primary driver of manufacturing, supported by capex push, and easing inflationary pressures for consumers. While external demand is less strong, it is also holding up better than expected in the first half of this year. Falling commodity prices and supply constraints further boosted manufacturing relative to last year.

That said, two factors can swing the industrial performance in coming months. Firstly, a global economic slowdown - if not a recession - remains on the cards under the weight of rising interest rates. More rate hikes are expected in United States (US) and European Union (EU) in 2023 amid elevated inflation and strong labour makrets. S&P Global expects this to lead to a shallow but a more protracted slowdown from the second half of 2023.

Secondly, monsoon's performance will critically influence industrial prospects through impact on inflation and rural demand. While overall monsoon has turned normal (2% above long period average as on July 12), spatial distribution remains very uneven – with 11 states remaining in deficit till date. The El Nino has set in as expected, whose timing and intensity could weigh on rain performance this year.

Overall, we expect GDP growth at 6.0% this fiscal compared with 7.2% the previous year.

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