Macroeconomics | First cut

Food starts cooling, IIP looks up

September 2023

Food still driving inflation, but sees relief in August

The Consumer Price Index (CPI)-based inflation softened to 6.8% in August, after surging to 7.4% in July. While the non-food components stayed unchanged, a slight moderation in food inflation pulled down the headline number.

Where is the comfort: Inflation in all commonly constructed non-food CPI categories remained low and unchanged from July: non-food CPI at 4.8%, core CPI (excluding food and fuel) at 4.9%, services CPI at 4.5% and core CPI goods (excluding food and services) at 5.1%.

Where is the discomfort: Food inflation falling off its peak provided relief, but not comfort. At 9.9%, food inflation was driven by vegetables inflation at 26.1%, cereals inflation at 11.9% and pulses inflation at 13%, though all these heads displayed moderation in inflation compared with the previous month. We expect a correction in vegetables inflation in the coming months, but some rigidity in cereals and pulses inflation.

Fuel inflation was benign at 4.3%, but can face upside risks if the recent spike in crude prices sustains.

We expect the Reserve Bank of India (RBI) to look through the July-August lift in inflation due to sharp spike in vegetable prices and maintain status quo on rates and stance in the October policy. Food inflation will remain a key monitorable because, if sustained, it can spill over to other components and steer the headline CPI inflation above the RBI's target. And this can constrain the monetary policy as central banks do respond to inflation when it starts becoming generalised.

We have already raised our inflation forecast to 5.5% for this fiscal from 5% earlier. Despite the relief from vegetables, particularly tomatoes, cereals and pulses remain a worry as monsoon continues to be deficient and sowing in pulses has been 8.6% below last year's levels.

Key data points in August

- CPI inflation retreated from its peak of 7.4% in July, to soften to 6.8% in August, aided by lower food inflation
- Food inflation eased to 9.9% from 11.5% led by some cooling of inflation in vegetables, cereals, pulses and milk
- Fuel[1] inflation rose a tad to 4.3% from 3.7% led by high electricity inflation
- Core CPI[2] inflation remained unchanged at 4.9%

Food inflation eases compared with the previous month, but remains high

- Food inflation cooled as inflation eased in vegetables, cereals, milk and pulses. Food prices fell by 0.9% on-month on a seasonally adjusted basis
- After surging to 37.4% in July, vegetables inflation softened to 26.1% in August. Vegetable prices fell by a seasonally adjusted 7.9% on-month after a rise of 28.9% on-month. Tomato inflation eased to 180.3% from

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

202.1%. Inflation also cooled in leafy vegetables (1.3% vs 8.6%) and potatoes (-14.3% vs -13.3%). On the other hand, onion inflation surged to 23.2% from 11.8%

- Inflation in cereals eased to 11.9% from 13% in the previous month as inflation in rice (12.5% vs 13.1%) and wheat (9.3% vs 12%) from non-PDS sources, which have the largest weight among cereals categories, cooled in August
- Among protein categories, inflation cooled marginally in pulses (13% vs 13.3%) and milk (7.7% vs 8.3%), while it rose in eggs (4.3% vs 3.8%), and meat and fish (3.7% vs 2.3%). The slowdown in pulses inflation was driven by cooling inflation in arhar (32.2% vs 34.1%) and masur (-2.2% vs -2%)
- Inflation in spices accelerated to 23.2% from 21.7% led by sky-high inflation in jeera (118.2% vs 101.1%)
- Inflation in sugar and confectionery remained unchanged at 3.8%. Inflation in sugar from non-PDS sources rose to 3.8% from 3.5%, while prices of sugar from PDS sources remained unchanged from the previous year. International prices of sugar rose 34.2% on-year in August as sugar production was hit in some key countries

Fuel inflation hardens

- After softening for seven consecutive months, fuel inflation increased to 4.3% from 3.7%. Price of brent crude oil averaged $86.2/bbl as against $80.1/bbl, a 7.6% increase on-month
- Inflation eased in kerosene from non-PDS sources (17.3% vs 21.3%), while it rose in kerosene from PDS sources (-25.1% vs -32.3%)
- Inflation in electricity increased marginally to 13.5% from 13.4%. Inflation in electricity has averaged 8.6% since the beginning of this fiscal

Core inflation stable

- Core inflation remained unchanged at 4.9% in August
- Inflation in some essential categories such as health (6.2%) and education (5.5%) remained unchanged compared with the previous month, while inflation in housing eased marginally to 4.4% from 4.5%
- Inflation in the personal care and effects category eased to 8.1% from 8.9% led by inflation in gold (15.1% vs 16.7%)

Poorest segment in urban areas faced highest inflation rate in August

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

- The poorest segment in urban areas faced the highest inflation burden for the second consecutive month as both food and fuel inflation were higher in urban areas relative to rural
- As food was the largest contributor to inflation in August, the poorest segments in both urban and rural areas faced a higher burden compared with their rich counterparts

CPI inflation across income classes (% on-year)

Income segment	August 2023		July 2023	
	Rural	Urban	Rural	Urban
Top 20%	6.7	6.5	7.3	7.1
Middle 60%	7.1	7.2	7.8	8.0
Bottom 20%	7.2	7.6	7.9	8.5

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

Source: National Sample Survey Organisation, National Statistical Office, CEIC, CRISIL

Industrial activity picks up on a low base

Industrial output, measured by the Index of Industrial Production (IIP), rose 5.7% on-year in July, compared with 3.8% previous month. IIP pickup was partly driven by a low base, as factory output grew only 2.2% in July last year. Sequentially, IIP declined 1.9% on-month on a seasonally adjusted basis.

Industrial activity continues to be supported by robust capital expenditure by centre and state governments. In July, IIP also saw higher growth for some export-oriented sectors such as petroleum products and textiles. For commodity-linked exports, volumes seem to be holding up even as prices drive the export decline.

That said, industrial activity will face a bigger drag by slower global growth in the coming months. One factor that will influence domestic demand's resilience this year, will be the final monsoon outcome and associated inflation risks. 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 rose 5.7% on-year in July compared with 3.8% previous month
- All major sectors recorded an improvement: mining (10.7% vs 7.6%), manufacturing (4.6% vs 3.1%) and electricity (8.0% vs 4.2%)
- Within manufacturing, growth was the strongest in infrastructure and construction goods (11.4%), followed by primary goods (7.6%), consumer non-durables (7.4%), capital goods (4.6%) and intermediate goods (1.9%). Consumer durables (-2.7%) was a drag (see Chart 1)

Industrial activity revives in some export-oriented sectors

- IIP growth picked up for some manufacturing goods that are among India's top exports. These include coke and refined petroleum products (4.2% on-year growth in July vs 3.1% previous month), textiles (0.9% vs -0.3%), and pharmaceutical products (12% vs 6.7%)
- Coke and petroleum products production grew, despite a 18% drop in export value in July, suggesting volumes holding up (see Chart 2). Similarly, basic metals production growth was strong (12.8% vs 13.6%), despite 7% decline in exports this month. Lower prices on-year seem to be driving export decline for these commodities
- However, growth weakened for other major export goods such as chemicals (-7.4% vs -2.2%), electronics (-16.8% vs -32%), and machinery and equipment (4.7% vs 5.5%)
- Overall, merchandise exports declined for the sixth consecutive month in July, though at a lesser pace (-15.9% vs -18.8%)

Weakness reflected in discretionary consumption goods

- Production was stronger for essentials than discretionary consumption goods. Consumer non-durables IIP strengthened to 7.4% in July from 0.3% previous month. However, consumer durables declined for the second consecutive month (-2.7% vs -6.7%)
- The decline in consumer durables was driven by apparels (-22.5%), electronics (-16.8%) and leather products (-4%) whereas motor vehicles production continued to rise (8.9% vs 7.9%)

Infrastructure activity remains strong

- IIP growth in infrastructure and construction goods remained strong at 11.4% in July, though below the 12.9% previous month

- Both the centre and state governments are contributing to higher capex growth. The centre's capex was 14.9% higher on-year in the April to July period, while combined capex of 17 major states was 11.8% higher

Chart 1: For most sectors IIP grew in July

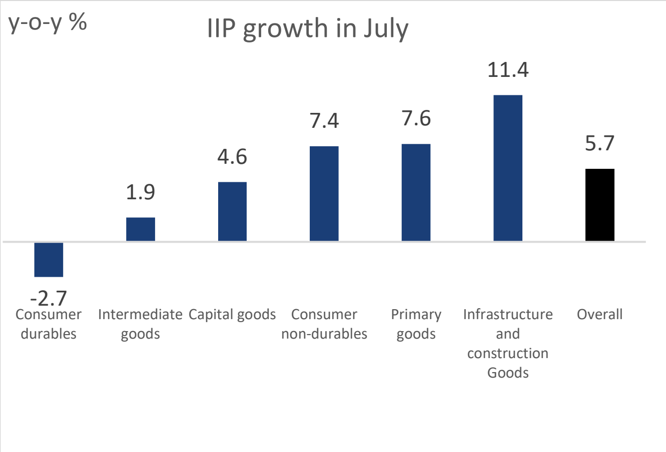
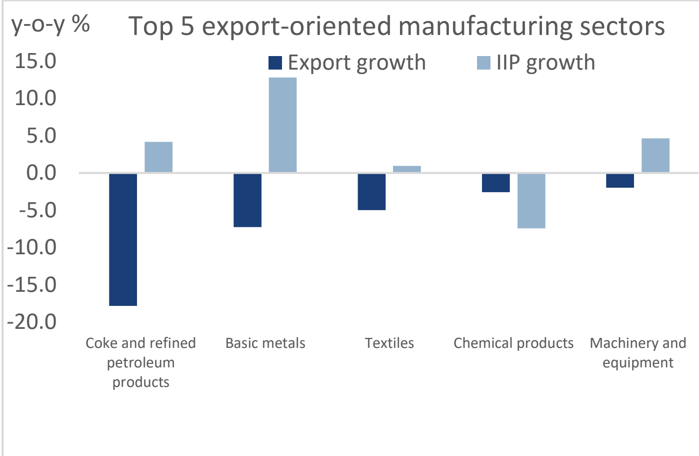


Chart 2: IIP growth holding up in major export sectors



Source: National Statistics Office, Ministry of Commerce and Industry, CEIC, CRISIL

Outlook

Industrial activity seems to be holding up with resilient domestic demand. S&P Global Purchasing Managers' Index (PMI) for manufacturing again reached a 3-month high of 58.6 in August, suggesting improved prospects for IIP growth. Other high-frequency indicators such as auto sales, E-way bills and railway freight also hint at a pickup in economic activity.

That said, two factors can swing industrial performance in the coming months. Firstly, global economic slowdown is expected to intensify from the second half of 2023. This will keep exports weak and spill over to manufacturing sectors depending on export demand.

Secondly, monsoon's performance will critically influence industrial prospects through impact on inflation and rural demand. Monsoon remained deficient at 10% below the long period average until September 12.

Also, the lagged impact of RBI's rate hikes will likely play out in the second half this year.

Due to these factors, we expect GDP growth to slow after the peak of 7.8% reached in the first quarter. Overall, we expect GDP growth at 6.0% this fiscal compared with 7.2% the previous year.

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