

Macroeconomics | **First cut**

Adverse base-effect starts now

November 2023

Softer core to the rescue

Inflation based on the consumer price index (CPI) dropped a mild 15 basis points (bps) to 4.87% in October from 5.02% in September 2023, led by a broad-based decline in core and fuel inflation. Food inflation remained steady despite mixed underlying trend.

The decline in core inflation (to 4.3% from 4.5% in September) was a result of lower input-cost pressure on producers and, hence, on retail prices. Food inflation was steady — as vegetable prices softened, while pulses prices hardened — near 20% and cereal price inflation remained at ~11%. Spices hit 23%. Meanwhile, fuel inflation declined mildly, as it benefitted from a drop in retail LPG prices.

For the December quarter, we expect food inflation to soften, because of the government intervention and as the kharif harvest enters the market. Oil prices remain an unknown and could potentially play a spoilsport, if the Middle East conflict escalates. An adverse index base (inflation had seen a drop in the year-ago period) will somewhat restrict the downside in inflation for two months.

We expect the Reserve Bank of India (RBI) to remain vigilant, as the headline inflation remains above the Monetary Policy Committee's (MPC) 4% target and risks to food and fuel inflation persist. Our base case for this fiscal is an average inflation of 5.5% and the MPC maintaining its policy rate and stance.

Key data points in October

- CPI inflation eased marginally to a four-month low of 4.87% from 5.02% in September
- Food inflation remained unchanged at 6.6%
- Fuel¹ prices continued their decline at a faster pace of -0.4%, compared with -0.1% in September
- Core CPI² inflation eased to 4.3% from 4.5%

Food inflation remains steady, as the underlying components show mixed trends

- Vegetables inflation eased to 2.7% from 3.4%, driven by a steep decline in the prices of tomatoes (-43.9% vs -21.4%) and potatoes (-17.7% vs -15.6%). Inflation in onions rose for the seventh straight month to 42.1% from 35.9% in the previous month. Inflation among other vegetables, such as green chillies, ladyfinger and brinjal, hardened. On a seasonally adjusted basis, vegetables prices fell 3.7% on-month
- Inflation in fruits accelerated for the fifth straight month to 9.3% from 7.3%, led by bananas (10.5% vs 4.9%) and apples (28.9% vs 24.3%).
- Inflation in cereals moderated 20 bps to 10.7%, with inflation softening in both rice (11.6% vs 11.9%) and wheat (7.6% vs 7.9%) from non-PDS (Public Distribution System) sources. Inflation in wheat from PDS sources increased to 36.6% from 34.6%.
- Inflation in pulses accelerated to 18.8% from 16.3%, driven by arhar (40.9% vs 37.3%) and moong (12.8% vs 11.2%). Masur prices continued their decline, but at a far slower pace compared with the previous month (-0.1% vs -1.4%). Among other proteins, meat and fish inflation (3.3% vs 4.1%) eased, while that of eggs increased (9.3% vs 6.5%).

¹ Refers to CPI fuel and light.

² CPI excluding food and beverages, and fuel and light.

- Inflation in milk eased to 6.4% from 7%
- Inflation in sugar hardened to 5.5% from 4.6%.

Fuel inflation mildly negative

- Fuel prices declined at a slightly faster pace of -0.4% compared with -0.1% in the previous month. Softening inflation in electricity (10.4% vs 11.2%) and firewood and chips (3% vs 3.3%) pulled down fuel inflation to -0.4% from -0.1 in the September.
- Inflation in LPG was -12.7% in October, as prices declined compared with the previous year due to a price cut by the Central government.
- Inflation hardened in kerosene from PDS sources (-13.4% vs -17.4%), while that of kerosene from other sources softened (17.1% vs 19.1%)

Core inflation eases

- Core inflation eased to 4.3% from 4.5%.
- Inflation in essential categories, such as education (5.1% vs 5.3%) and housing (3.8% vs 4%), moderated in October, while inflation in health remained unchanged at 5.9%
- Inflation in the personal care and effects category eased to 7.8% from 8.5%, led by moderating inflation in gold (16.5% vs 17.5%) and silver (20.3% vs 24.7%)
- Inflation also eased in transport and communication (2% vs 2.3%) and household goods and services (3.9% vs 4.3%)

Urban rich faced the lowest inflation burden in October

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, command a greater share in the consumption basket of the lower-income group.

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

- The richest segment in both urban and rural areas faced a lower inflation burden than their poorer counterparts in October, as inflation for food items remained elevated above core inflation
- The rural poor faced a higher inflation burden than the urban poor, as food and fuel inflation were higher in rural areas relative to urban areas

CPI inflation across income classes (% on-year)

Income segment	October 2023	
	Rural	Urban
Top 20%	5.0	4.6
Middle 60%	5.1	4.8
Bottom 20%	5.1	4.8

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 October inflation trends. The table above presents the average inflation faced by each income class.

Source: NSSO, National Statistical Office, CEIC, CRISIL

IIP slips towards the end of second quarter

Industrial output, measured by the Index of Industrial Production (IIP), slowed to 5.8% on-year in September from 10.3% in the previous month. The slowdown was broad-based, with consumer-oriented sectors recoding the weakest growth. This is in tandem with the S&P Global Manufacturing PMI, which printed 57.5 in September, down from 58.6 in August.

Despite the slowdown in September, IIP growth was stronger at 7.4% on average in the second quarter compared with 4.8% in the first quarter. Other high-frequency indicators, such as PMI and exports, corroborate the upside to GDP growth. Yet, downside risks persist from global demand slowdown in the second half of this fiscal. Domestic rural demand is somewhat vulnerable to weak agricultural output. The impact of rate hikes by the RBI may also weigh on demand during the remainder of this fiscal.

Data highlights

- IIP growth slowed to 5.8% on-year in September, compared with 10.3% in the previous month
 - All major sectors recorded a decline: mining (11.5% in September versus 12.3% previous month) manufacturing (4.5% vs 9.3%) and electricity (9.9% vs 15.3%)
 - Within manufacturing, growth was the weakest for consumer durables (1%) and non-durables (2.7%). Growth fared better for primary goods (8.0%), infrastructure and construction goods (7.5% vs 13.5%), capital goods (7.4%) and intermediate goods (5.8%).
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Consumption goods lose steam

- IIP growth slowed the most for both essential and discretionary consumption goods in September
- Consumer non-durables' IIP growth fell sharply to 2.7% in September from 9.6% in the previous month, driven by a considerable decline in food products (-0.4% vs 4.4%). Granular IIP data available until August suggest a weakening of fast-moving consumer goods (FMCG) in the second quarter relative to the first. This could be a reflection of the weakness in rural demand that consumes more of essential goods.
- Consumer durables slowed (1.0% vs 5.8%): driven by wearing apparel (-17.9% vs -17.1%), electronic products (-8.9% vs -8.7%), rubber and plastic products (1.5% vs 4%). However, automobiles growth remained strong (11.2% vs 12%) . High-value consumption items continue to perform relatively better
- IIP also weakened for export-oriented sectors such as chemical products (-5.6% vs -3.9%), coke and refined petroleum products (2.6% vs 10.2%), machinery and equipment (4.8% vs 13%) and pharmaceutical products (6.8% vs 16.8%). However, textiles improved (3.7% vs 1.6%). Overall, merchandise exports value had contracted 2.6% on-year in September, compared with 3.9% in August

Commodities and infrastructure goods fare better

- Commodity-linked sectors recorded the strongest IIP growth in September, though moderating relative to the previous month. This included basic metals (12.5% vs 14.6%) and primary goods (8% vs 12.4%)
- Infrastructure and construction goods IIP was healthy, but slowed to 7.5% from 13.5%. Government capital expenditure (capex) lent support, with centre's capex 29% higher on-year and major states' ~80%³ higher this month

³ 18 major states combined

Outlook

Despite the September slowdown, IIP growth fared better in the second quarter relative to the first quarter. Infrastructure and construction goods recorded the strongest growth in the second quarter, helped by the government capex. Industrial goods (primary and capital goods) also recorded a strong uptick, helped by demand from resilience among advanced economies this quarter.

Higher IIP growth, along with an improvement in other high-frequency indicators (such as PMI manufacturing and services, E-way bills, and exports) suggest a potential upside to GDP growth in the second quarter.

However, downside risks persist from the slowing global growth, due to the sharp rise in interest rates in advanced economies. These are India's top export destinations. While the US has continued to outperform growth expectations until date, financial conditions have tightened sharply in recent months, which will eventually weaken demand.

On the domestic front, rural demand remains somewhat vulnerable to weak agricultural output this year. Rural-related high-frequency indicators fared worse in the second quarter (such as FMCG IIP, tractor and two-wheeler sales, and NREGA demand). Kharif output is estimated to be lower for 2023⁴, hit by an uneven monsoon. Lower reservoir levels on-year also risk the upcoming rabi output.

Transmission of the RBI's rate hikes may weigh on demand in the remainder of this fiscal. So far, bank credit growth has not slowed significantly despite a rise in lending rates.

The timing and materialisation of these risks will decide growth trajectory in the remainder of this fiscal year.

⁴ Based on the government's first advance estimates

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