CPI slips on food, IIP on mining

CRISIL First Cut

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CPI inflation hits record low as food inflation enters negative zone

Inflation based on the consumer price index (CPI) slipped to a record low of 2.2% in May as food inflation dipped into negative territory. A record growth in production of pulses in fiscal 2017, prospects of healthy monsoon in 2017 and continued decline in vegetables inflation supported by a high base effect saw to a deflationary trend in these commodities.

Meanwhile, fuel inflation (fuel and light, petrol and diesel) also continued its downward trajectory, falling to 6.2% compared with 7.1% in April. Core inflation (CPI excluding food, fuel and light, petrol and diesel) saw only moderate easing to 4.1%, compared with 4.2% in April, as inflation stayed stubbornly high in housing (at 4.8%) and education (at 4.9%).

The next few months could see a transitory pick-up in inflation on an adverse base as the goods and services tax (GST) is implemented and prices, especially in the services sector, see a bump-up. But overall so far, inflationary pressures have reduced dramatically, led by food inflation. Though a dent in demand from demonetisation and fire sales during the period could have played a role, the continued drop in food inflation (both perishables and non-perishables) even in 2017 indicates the possibility of a lasting impact of robust food supplies on prices.

Latest estimates by the Ministry of Agriculture suggest growth in food grain production, at nearly 9% in fiscal 2017, was the highest in six years, with pulses production rising 37% on-year. For fiscal 2018, too, agriculture production is expected to stay healthy given the Indian Meteorological Department's rainfall forecast of 98% of normal. Two consecutive years of normal and evenly distributed rains have in the past brought extended period of gains to food production and prices. Also, global food prices are expected to stay benign, which will support lower domestic food inflation by way of cheaper imports.

We therefore expect food inflation to stay low this fiscal, which should keep a tab on overall inflation. Our inflation forecast now stands at 4% for fiscal 2018, down from 4.5% in fiscal 2017.

Yet, some upside risks can creep in on account of three factors. One, the pattern of rainfall distribution and impact on crop production. Two, the impact of revision in house rent allowance on inflation trajectory. Three, resilience in private consumption demand even during the demonetisation phase, and the fact that it is gaining strength as the postponed consumption bounces back.

- Food inflation dipped sharply to -1.1% in May, down from 0.6% in April. The decline continued to be led by the pulses and vegetables category where inflation was down to -13.4% and -19.5%, respectively. Excluding these categories, food inflation stood at 1.6% compared with 1.7% in April. This suggests inflation has been declining in other food categories, too – including cereals (where the inflation rate was down 20 basis points, or bps, on-month to 4.8%), fruits (down 240 bps to 1.4%) and sugar (down 150 bps to 9.8%). Overall protein-based items (pulses, eggs, meat, fish and milk) saw inflation fall to -7.2% in May from -5.5% in April.
- Fuel inflation eased further in May as global crude oil prices stayed benign and rupee gained some strength. Fuel inflation, measured by adding petrol, diesel, fuel and light components, slowed to 6.2% from 7.1% in April. Within this category, inflation in fuel and light fell to 5.5% from 6.1%, while in petrol and diesel, it fell to 8.9% from 10.9%.
- Core inflation saw some moderation during the month, but stayed sticky overall, led by high inflation in certain categories. Core inflation (CPI excluding food, fuel and light, petrol and diesel) eased slightly to 4.1% from 4.2% in April, led by lower inflation in 'health', 'personal care and effects' and the 'transport and communication segment' and some pick-up in inflation in 'recreation and amusement'. In some segments, such as 'housing' and

‘’education’ inflation near 5% remains a cause of worry, especially for the Reserve Bank of India’s Monetary Policy Committee (MPC). The MPC estimates that if the recommended increase in housing rent allowance as per the Seventh Pay Commission is adopted, the direct impact on CPI could be 100-150 bps over their forecast. This is one of the reasons the MPC in its monetary policy review on June 7 maintained caution on the inflation front.

The slow and volatile beginning for IIP

This is the second monthly release of the Index of Industrial Production (IIP) with the new base (2011-12). It looks like it will take some time for the new IIP series to stabilise as the latest data release suggests considerable revision to the previous month’s manufacturing IIP – the most volatile segment of all – and hence in the overall IIP as manufacturing accounts for the bulk of it. Manufacturing IIP growth for March was revised to 2.4% from 1.2% earlier and overall IIP to 3.8% from 2.7%. On the whole, IIP growth slowed down to 3.1% in April from 3.8% in March 2017, following a sharp reduction in growth of mining activity.

- Industrial activity declined in the first month of the fiscal as IIP growth fell to 3.1% on-year from 3.8% in March. Even as manufacturing activity recorded a mild upturn in April (growing 2.6% compared with 2.4% in March), it was the sharp slowdown in mining sector growth and moderation in the growth of electricity sector that pulled the overall IIP growth down in April – while the former slowed down to 4.2% from 10.3% earlier, the latter to 5.4% from 6.2%. Manufacturing, mining and electricity sectors had grown by 5%, 5.1% and 5.9% in fiscal 2017, respectively.
- Within the manufacturing sector – the largest segment of IIP with a weightage of 77.6% – fourteen out of the 23 industry groups have shown positive growth in April, compared with the year-ago period. Sectors which displayed high positive growth in manufacturing were ‘pharmaceuticals, medicinal, chemical and botanical products’ (29.1% growth), followed by ‘tobacco products’ (17.9%) and ‘machinery and equipment n.e.c.’ (9.5%). On the other hand, the industry groups that displayed high negative growth in April were ‘beverages’ (-19.2 % growth) followed by ‘motor vehicles, trailers and semi-trailers’ (-15.6%) and ‘electrical equipment’ (-14.4%).
- According to the use-based classification, the picture was mixed. While the new category of IIP – “infrastructure and construction goods” – displayed a surge in growth in April to 5.8% from 0.9% in March, capital goods growth shrunk to -1.3% from 9.6%, reaffirming the volatile nature of this category. In some bad news for the consumption story, decline in the growth of consumer durable goods category worsened to -6.0% from -3.9%. However, the overall growth in the consumer goods category was anchored by the non-durable category, which grew 8.3% compared with 6.2% in March.

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