Macroeconomics | First cut

Inflation and IIP inch up

September 2024

A high base keeps retail inflation below 4% for yet another month

Though inflation based on the Consumer Price Index (CPI) inched up to 3.7% in August from 3.6% in July, it remained below the Reserve Bank of India's (RBI) target of 4% for the second straight month. While the base effect has been supportive since July (mainly led by the food index), it somewhat faded in August, causing inflation rate to see a slight bump up.

Food inflation rose to 5.7% in August from 5.4% in July. That said, the sequential decline in prices kept a check on food inflation. Within food, the foodgrains inflation eased to a two-year low of 8.6%, while that in vegetables rose, compared with July.

Core (which excludes food and fuel) inflation eased 10 bps to 3.3%.

A high base has helped keep inflation under 4% since July. But September onwards, this effect is expected to fade considerably. Any further easing of inflation will depend on sustained softening of food prices.

For the fiscal, a steady progress of monsoon and kharif sowing should bring down food inflation, compared with the past fiscal. Daily food prices data shows that the prices of key food items, such as cereals, pulses, tomatoes and milk have been declining in September. A sustained drop in food inflation should help align the headline inflation to RBI's target of 4%, allowing RBI to initiate rate cuts.

Non-food inflation is expected to remain benign as commodity prices are projected to remain soft. CRISIL expects crude oil prices to average $80-85 per barrel, close to the levels of the previous year.

In our base case, we expect two rate cuts this fiscal, with the first one in October unless risks arising from the geopolitical situation and weather shocks push the rate cut decision.

Key data points in August

- CPI inflation inched up to 3.7% from 3.6% in July
- Food inflation rose to 5.7% from 5.4%
- Fuel[1] prices fell 5.3% on-year
- Core CPI[2] inflation eased 10 bps to 3.3%

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

Food inflation rises marginally

- Food inflation ticked up to 5.7% from 5.4%, due to August's fading base effect
- The fading base effect in vegetable inflation was the primary driver of higher food inflation in August. Vegetable inflation rose to 10.7% in August from 6.8% in July, though it remained below the June print of 29.3%. Sequentially, vegetable prices declined 0.5% (seasonally adjusted) on-month. Inflation in tomato stood at -47.9% in August vs -43% in July. Onion (54.1% vs 60.6%) and potato (64% vs 65.8%) inflation remained high but eased relative to the previous month
- Foodgrain inflation slowed down to 8.6% from 9.5% displaying broad-based easing across key categories. Cereals inflation eased to 7.3% from 8.1%, driven by easing inflation in non-public distribution system rice (9.5% vs 10.9%). Pulses inflation dropped for the third straight month to its lowest value since September 2023
- Edible oil inflation was broadly steady at -0.9% vs -1.1% last month
- Sugar inflation dropped to 4.7% from 5.2%, in line with the fall in international sugar prices
- A high base drove down inflation in spices to -4.4%, a record low

Fuel inflation negative

- Fuel prices remained in deflation, falling 5.3% on-year in August vs 5.5% decline in July
- Prices of liquified petroleum gas (LPG) declined 24.6% on-year, with government subsidies keeping LPG prices in deflation for the past year. From September, the high base effect is expected to slightly fade as a subsidy of Rs 200/cylinder was kicked off on August 30, 2023. That said, the additional Rs 100/cylinder subsidy that came into effect in March 2024 should keep LPG inflation negative
- Electricity inflation remained steady at 4.9% (vs 4.8% in July), owing to neutral base effect for the category. Electricity tariffs were hiked sharply from May-July 2023, which has since normalised

Core inflation eases a touch

- Core inflation eased 10 bps to 3.3%
- Services inflation (3.6%) was higher than core goods[3] inflation (3%), due to the impact of tariff hikes by major domestic telecom companies. Excluding the impact of the tariff hikes, services inflation remained close to core goods inflation at 3.1%
- Inflation in personal care and effects eased for the first time in six months in August (7.9% vs 8.4% in July). However, inflation in the category remains well above other key core categories. Inflation in precious metals, such as gold (19.5% vs 20.8%) and silver (16.6% vs 21.4%) eased in August

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[3] *Refers to CPI, excluding services, food, and fuel and light*

Urban poor face the lowest inflation

The effect of inflation varies across income groups since the share of spending on food, fuel and core categories differs for classes. Essential items, such as food and fuel, occupy a greater share in the consumption basket of those earning lower income.

The poorest segment (bottom 20% income group) in urban areas faced the lowest inflation rate in August as urban inflation remains lower than rural. This quarter's softening food inflation (relative to the previous quarter) augurs well for the poor as these items occupy a greater share in their consumption basket. In August, urban food inflation stood at 5%, while that of rural clocked 6%.

CPI inflation across income classes (% on-year)

Income segment	August		July		FY24	
	Rural	Urban	Rural	Urban	Rural	Urban
Top 20%	4.1	3.2	4.1	3.1	5.4	5.1
Middle 60%	4.2	3.1	4.1	2.9	5.6	5.4
Bottom 20%	4.1	2.9	4	2.7	5.6	5.6

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

Source: NSSO, National Statistical Office, CEIC, CRISIL

IIP picks up unevenly in July

The Index of Industrial Production (IIP) recorded an uptick to 4.8% on-year in July from 4.7% in June, driven by a pickup in manufacturing output growth. Mining and electricity output growth, however, moderated.

Industrial production saw mixed trends across major sectors. Higher IIP growth in July was primarily driven by capital and intermediate goods, while consumption-related goods saw weaker production.

Recent gross domestic product (GDP) data showed rising private consumption as well as investment growth. Prospects look bright for consumption this year as rural demand – the laggard last year – is likely to pick up on a good monsoon and higher agricultural production. Investment growth shows signs of a pickup in the private sector.

However, a lower fiscal impulse from government amid higher interest rates can weigh on growth this year. Additionally, slower global growth could impact manufacturing exports, even as global trade flows pick up.

Overall, we expect India's GDP growth to moderate to 6.8% this fiscal, compared with 8.2% in fiscal 2024.

Data highlights

- IIP growth marginally rose to 4.8% on-year in July from 4.7% in June. The index contracted 0.4% on-month after seasonal adjustments. The June reading was revised, up from 4.2% previously
- The uptick was driven by manufacturing (4.6% on-year vs 3.2%), while output growth in electricity (7.9% vs 8.6%) and mining (3.7% vs 10.3%) slowed down
- The pickup in manufacturing growth was driven by increasing output growth in capital goods (12.0% vs 3.8%) and intermediate goods (6.8% vs 3.0%); while consumer non-durables (-4.4% vs -1.5%), infrastructure and construction goods (4.9% vs 7.1%), primary goods (5.9% vs 6.3%) and consumer durables (8.2% vs 8.7%) recorded worsening performance

Positive momentum in some investment-related goods

- The sharp uptick in capital goods (12.0% on-year in July vs 3.8% in June) was driven by a significant rise in output growth of other transport equipment (25.5% vs 9.1%), fabricated metals (11.0% vs 3.6%) as well as machinery and equipment (6.3% vs 1.8%)
- The pickup in intermediate goods was driven by increasing output growth in rubber and plastic products (8.8% vs 7.6%) and chemicals (4.7% vs 1.0%)
- However, infrastructure and construction goods recorded a moderation (4.9% vs 7.1%) despite revival of government (Centre and state) capex[4] in July

Performance of consumer goods worsened overall

- Consumer non-durables output continued to contract on-year in July for the second consecutive month (-4.4% vs -1.5% in June), driven by a contraction in output of food products (-1.8% vs 2.5%). Deepening decline in pharmaceuticals (-8.1% vs -2.9%) also played a role – though the sector was impacted more by weakening exports. However, there was an uptick in other categories, such as tobacco products (13.1% vs -10.9%), and beverages (2.3% vs 0.2%)
- Consumer durables slowed to a lesser extent in July (8.2% vs 8.7% in June), driven by decreasing output growth in automobiles (3.2% vs 4.2%) and furniture (7.9% vs 16.2%). However, growth strengthened for wearing apparel (7.3% vs 2.1%) and remained stable for electronic products (10.5% in July and June)
- The IIP data for consumer goods has been at odds with the GDP data recently, as the latter showed a sharp rise in private consumption growth in the first quarter. This could be because of consumption demand rising faster for services than for goods. It is also possible that some of the domestic demand is being met by imported goods rather than domestic production

[4] *Based on data from 17 states*

Primary goods moderate due to slowing mining and electricity growth

Growth in primary goods output moderated (5.9% vs 6.3%) on the back of a sharp slowdown in mining output growth (3.7% vs 10.3%) and a moderation in electricity output growth (7.9% vs 8.6%).

Outlook

Industrial growth is expected to benefit from improving household consumption this fiscal. Rural demand – the laggard last year – is likely to pick up on a good monsoon and higher agricultural production. Easing food inflation is also expected to increase the purchasing power for discretionary consumption. However, elevated interest rates could weigh on consumption, especially in urban areas where credit penetration is higher.

Recent GDP data for the first quarter of fiscal 2025 showed a rise in both private consumption and investment. It further showed signs of a pickup in private investment. High-capacity utilisation, lean balance sheet of corporates and banks remain conducive for private investment. This could help sustain the overall investment momentum this fiscal.

However, a lower fiscal impulse can weigh on growth, as the government moves to reducing its fiscal deficit.

Slower global growth could impact manufacturing exports, even as global trade flows pick up. In particular, the world's two biggest economies – the United States and China – are poised to slow down this year.

Overall, we expect GDP to grow 6.8% this fiscal, compared with 8.2% in fiscal 2024.

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