Macroeconomics | First cut

Inflation jumps, IIP slips

October 2024

Trifecta, base effect crank up the price gauge

Consumer Price Index (CPI)-based inflation rose to a nine-month high of 5.5% in September from 3.7% in August. While a low-base effect was expected to statistically lift the gauge, three factors on the ground were at play as well.

One, fruits and vegetables, where the base effect turned adverse and the damage caused by unseasonal/excess rains led to a sequential price rise. High and volatile vegetable prices, with inflation at 36%, continue to be the sharpest pain point plaguing food inflation, which rose to 9.2%.

Two, prices of edible oils have been rising globally, with lower production from last season adding fuel to fire.

And three, costlier gold pushed up inflation in the 'personal care' segment of core inflation. This, in turn, hauled the core barometer to a 9-month high.

Our base case on inflation: Given that the monsoon season wound up with an 8% surplus, kharif sowing is healthy (101% of the full-season normal acreage) and the harvest will enter the market in October, food prices should start easing at least sequentially. Under this assumption, we expect CPI inflation to average 4.5% this fiscal compared with 5.4% in the last, mainly led by softer food inflation and a mild uptick in non-food inflation.

However, a sharper-than-expected rise in September inflation, particularly coming from a steep sequential rise in vegetables, is a point of worry. October data also bares a further pick-up in vegetable prices.

Last week, the Monetary Policy Committee (MPC) of the Reserve Bank of India took a step closer to cutting the repo rate by changing its stance to 'neutral'.

Visibility on a durable decline in inflation will be the next key determinant of a rate cut. Our base case is a 25 basis points reduction in the repo rate during the MPC's policy review meeting in December. Trouble on the food inflation front can delay this further.

Key data points in September

- CPI inflation rose to a nine-month high of 5.5% in September from 3.7% in August
- Food inflation jumped to 9.2% from 5.7%
- Fuel[1] inflation accelerated to -1.4% from -5.3%
- Core CPI[2] inflation rose to 3.6% from 3.3%

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

Food inflation surges

- Food inflation surged to 9.2% from 5.7%, partly due to an adverse base. The sequential rise in food prices continued, from 0.2% in August to 1.3% in September (seasonally adjusted). Vegetables and edible oils were the key drivers of higher food inflation
- Vegetable inflation jumped to a 14-month high of 36% (vs 10.7% in August). Tomatoes (42.2% vs -47.2%), garlic (70.9% vs 47.1%) and onions (66.1% vs 54.1%) led the surge. Vegetable prices were up 5.5% on-month (seasonally adjusted), the fastest on-month rise since November 2023. Excluding vegetables, food inflation moderated to 4% from 4.5%
- Edible oil inflation turned positive for the first time since January 2023, at 2.5% vs -0.9%. Prices rose sharply by a seasonally adjusted 3% on-month
- Fruits inflation accelerated to 7.6% from 6.5%, primarily due to apples (8.3% vs 5.9%)
- Foodgrain inflation moderated to its lowest level since September 2022 (7.5% vs 8.6%). Pulses inflation eased to a 16-month low of 9.8% (vs 13.6%) while cereals inflation eased to a 26-month low of 6.8% (vs 7.3%). Non-PDS (Public Distribution System) rice (8.7% vs 10.1%) and arhar (11.4% vs 19.4%) were the main movers
- Spices inflation was at a record low -6.1% from -4.4% in the previous month due to deflation in jeera (-31.8% vs -27.7%) and dry chillies (-8.7% vs -7.7%)

Fuel inflation accelerates

- Fuel inflation remained negative for the 13th straight month, but the pace of deflation slowed relative to August (-1.4% vs -5.3%)
- The high base effect in liquified petroleum gas (LPG) faded somewhat as a subsidy of Rs 200/cylinder had begun from August 30, 2023. The additional Rs 100/cylinder subsidy that came into effect in March 2024 kept LPG inflation negative. Accordingly, LPG inflation still rose to -10.1% from -24.6%
- Electricity inflation rose to 5.5% from 4.9%
- The rise in fuel inflation was partly offset by a decline in kerosene inflation. Inflation fell in both non-PDS (-0.1% vs 2%) and PDS kerosene (-6.7% vs 0.7%)

Core inflation rises

- Core inflation rose to a nine-month high of 3.6%
- An uptick in personal care and effects inflation was the primary reason. Inflation in this category rose to 9% from 8% led by gold (22.9% vs 19.6%) and silver (18.9% vs 16.8%)
- Other categories such as housing (2.8% vs 2.7%), household goods and services (2.5% vs 2.4%) and transport and communication (2.8% vs 2.7%) saw a mild uptick

The lowest income class faced the highest 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 with a lower income.

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

- Urban food inflation (9.6%) outpaced rural food (9.1%) in contrast to the trend seen in the past few months
- The poorest segments (bottom 20%) in both rural and urban areas saw the sharpest rise in inflation rates compared with their richer counterparts since food inflation surged
- The richest segment in urban areas faces the lowest inflation rate as core items make up the largest share of their consumption basket. Core inflation remained well below food inflation in September

CPI inflation across income classes (% on-year)

Income segment	September		August		FY24	
	Rural	Urban	Rural	Urban	Rural	Urban
Top 20%	5.6	5.0	4.1	3.2	5.4	5.1
Middle 60%	6.0	5.6	4.2	3.1	5.6	5.4
Bottom 20%	6.0	5.9	4.1	2.9	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 September inflation trends. The table presents the average inflation faced by each income class.

Source: NSSO, National Statistical Office, CEIC, CRISIL

IIP contracts for the first time since October 2022

The Index of Industrial Production (IIP) contracted by a slight 0.1% on-year in August, a reversal from the 4.7% growth recorded in July. While an adverse base effect was at play, IIP also contracted sequentially this month. Relatively heavier rains relative to August last year seem to have dampened industrial activity.

Industrial production underwent a broad-based deterioration across both the industrial and consumption sectors.

However, the contraction could be transitory since it was driven by adverse base effects and heavy rainfall dampening output. The onset of the festive season in the third quarter could improve consumption. Prospects look better for consumption this year as rural demand – the laggard last year – is likely to pick up on a good monsoon and higher agricultural production.

However, a lower fiscal impulse from government amid elevated interest rates can weigh on growth. Additionally, slower global growth could impact manufacturing exports, even as global trade flows pick up. Investment growth hinges on an uptick in the private sector.

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

Data highlights

- IIP contracted 0.1% on-year in August, a reversal from the 4.7% growth in July. The index contracted more sharply, by 2.0% on-month, after seasonal adjustments
- The headline contraction was driven by sharp contractions in mining (-4.3% in August versus 3.8% in the previous month) and electricity output (-3.7% vs 7.9%) as well as a slowdown in manufacturing output growth (1.0% vs 4.4%)
- The IIP slowdown was broad-based across sectors. Consumer non-durables saw lowest growth (-4.5% in August), followed by primary goods (-2.6%), capital goods (0.7%), infrastructure and construction goods (1.9%), intermediate goods (3.0%) and consumer durables (5.2%)

Worsening performance across industrial goods

- Primary goods fell the most among industrial goods (-2.6% on-year in August versus 5.9% in the previous month), led by contracting output in mining and electricity. Heavier rains relative to August last year likely contributed to lower activity in these sectors
- Investment-related goods, reflected in capital goods, infrastructure and construction goods, also slowed sharply
- Infrastructure and construction goods slowed as well (1.9% vs 4.6%), reflecting a contraction in government (Centre and state) capex[3] in August
- Capital goods have been volatile, recording a sharp slowdown in August after high growth in the previous month (0.7% vs 11.8%). This was driven by a contraction in fabricated metals (-6.5% vs 11.7%) and machinery and equipment (-1.7% vs 5.3%), as well as a sharp slowdown in other transport equipment (7.5% vs 25.5%)
- The slowdown in intermediate goods was driven by worsening performance in chemicals (2.7% vs 5.2%) and rubber and plastic products (6.0% vs 8.6%)
- Performance of export-oriented sectors deteriorated as well. Output contracted in fabricated metals (-6.5% vs 11.7%), pharmaceuticals (-6.1% vs -8.2%), other non-metallic mineral products (-2.2% vs 1.9%), and coke and refined petroleum products (-0.7% vs 6.8%); output growth in basic metals (3.0% vs 5.4%) and chemicals slowed (2.7% vs 5.2%). This was reflected by a sharp contraction in merchandise exports in August (-9.3% vs -1.7%)

Weakness in consumption goods continues

- Consumer non-durables output continued to contract on-year for the third consecutive month (-4.5 % on-year in August versus -4.3% in the previous month), driven by broad-based contraction across pharmaceuticals (-6.1% vs -8.2%), tobacco products (-4.1% vs 13.1%), beverages (-2.9% vs 2.3%) and food products (-1.5% vs -1.6%)

[3] *Based on data from 16 states*

- Consumer durables slowed significantly as well (5.2% vs 8.3%), driven by decreasing output growth in automobiles (0.5% vs 3.2%). However, output growth picked up for other categories such as wearing apparel (14.0% vs 7.3%) and electronic products (11.6% vs 10.5%)

Outlook

Industrial activity could benefit from the onset of the festive season in the third quarter of this fiscal. Domestic consumption is expected to be better this fiscal as rural demand picks up on a good monsoon and higher agricultural production. Easing food inflation is also expected to increase purchasing power for discretionary consumption. The Reserve Bank of India’s latest survey shows a pickup in consumer confidence in September.

That said, the impact of excess and unseasonal rains remains a monitorable. Additionally, elevated interest rates could weigh on consumption, especially in urban areas where credit penetration is higher.

High-capacity utilisation and lean balance sheets of corporates and banks remain conducive for private corporate investment. This could help sustain overall investment momentum this fiscal, even as government capex is slated to revive in the second half of the fiscal.

However, a lower fiscal impulse would dampen growth this year, as the government trims its fiscal deficit.

Global trade is expected to improve and support export growth this year. However, slowing demand, particularly in United States and China, will weigh on global growth. Geopolitical tensions, particularly in the Middle East, remain a risk for trade flows and supply chain pressures for industry.

This, together with impact of high interest rates, will slow GDP growth to 6.8% this fiscal compared with 8.2% in fiscal 2024.

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