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Macroeconomics | First cut

Inflation dips, IIP climbs

January 2025

Baby steps towards the inflation target

Headline inflation continued making progress towards the central bank’s 4% inflation target with food inflation easing for the second consecutive month and non-food inflation stablising. Consumer Price Index inflation cooled to 5.2% from 5.5% in November; food inflation eased to 8.4% from 9% whereas non-food inflation stayed at 3.1%.

During December, vegetable and pulses inflation softened but edible oil prices continued to simmer. Despite the softening, however, vegetable inflation sizzled at 26.6%, while edible oils inflation was at a 33-month high of 14.6%. Despite easing a tad over the past two months, food inflation remains elevated and somewhat rigid.

Food inflation, which has a 39.1% weight in the Consumer Price Index (CPI) basket, has averaged 8.4% so far this fiscal, higher than the 7.5% in fiscal 2024. Food prices have been the major hurdle for rate cuts, keeping headline inflation high and household inflation expectations elevated.

That said, recent trends have been encouraging, with the CPI food index reporting an on-month drop in November and December. Retail price data for January indicates sharp a easing in key vegetables prices, both on-month and on-year.

Meanwhile, some uptick is expected in non-food (fuel plus core) inflation in the March quarter. Core inflation, which has a weight of 47.3% in CPI, is expected to pick up since expected price hikes by manufacturing and services companies and the low base effect will put upward pressure on core inflation. Even so, it is expected to remain soft overall, given benign global commodity prices.

Net-net for this fiscal, we expect CPI inflation to average 4.6% with some upside bias to the forecast. A sustained decline in food inflation coupled with soft non-food inflation should create room for a rate cut in the coming months. We expect the Reserve Bank of India to ease monetary policy either through liquidity measures or possibly a rate cut during the February meeting.

Key data points in December

- CPI inflation moderated to 5.2% in December from 5.5% in November
- Food inflation eased to 8.4% from 9%
- Fuel[1] inflation picked up marginally to -1.4% from -1.8%
- Core CPI[2] inflation was steady at 3.7%

Food inflation decelerates

- Food inflation decelerated to 8.4% in December from 9% the previous month, driven by a sharp deceleration in vegetables inflation. Sequentially, food prices were down 0.2% on a seasonally adjusted basis
- Vegetable inflation moderated to a four-month low of 26.6% from 29.4%. Inflation was down in garlic (58.2% vs 85.8%), tomatoes (31.3% vs 41.8%), brinjal (13.7% vs 28.4%) and leafy vegetables (17.1% vs 24.7%), among others. This was partially offset by inflation in onions (rose to 11% from 5.5% due to an adverse base) and potatoes (68.2% vs 66.5%)
- Foodgrain inflation eased to 5.9% from 6.6% the previous month led by softer pulses inflation (3.8% vs 5.4%). Inflation eased in cereals as well to 6.5% vs 6.9%
  - Within pulses, softer inflation was driven by tur (1.5% vs 3.4%), moong (0.2% vs 1.3%) and masur (-0.6% vs -0.1%)
  - Within cereals, the decline was due to rice from non-Public Distribution System (PDS) sources (6.9% vs 7.6%) while inflation in non-PDS wheat was relatively sticky at 7.8% vs 7.9%.
- Edible oil inflation, facing pressure from elevated global prices and a rise in import duties, rose to a 33-month high of 14.6% vs 13.3%. Global edible oils inflation rose to 33.5% on-year in December from 32.2% in November as per the Food and Agriculture Organisation. That said, global prices were broadly stable on-month, offering some respite
- Spices inflation remained at a record low of -7.4%
- Sugar inflation eased for the sixth straight month to 0.3% from 1.3%

Fuel inflation remains negative

- Fuel inflation remained negative for the 16th straight month in December. That said, the pace of deflation slowed relative to the previous month to -1.4% from -1.8%
- Inflation in electricity, which has the highest weight in fuel and light, inched up 10 basis points (bps) to 5.2%

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

- Liquified petroleum gas prices fell 9.3% on-year compared with a 10.2% decline in the previous month
- The pace of deflation picked up in non-PDS kerosene (-3.1% vs -2.3%) while deflation slowed in the PDS segment (-5.2% vs -16.3%)

Stable core inflation

- Core inflation was stable at 3.7%
- Inflation in housing eased 20 bps to 2.7%; it remained steady in other essentials such as health and education saw at 4% and 3.9%, respectively
- Inflation softened in personal care and effects to 9.7% from 10.4%
- On the other hand, inflation rose a tad in recreation and amusement to 2.7% from 2.6% due to higher prices of cinema tickets (3.1% vs 2.8%)

Urban residents see a larger relief in inflation burden

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

- Food inflation came down more sharply in urban areas (7.9% vs 8.7%) relative to rural (8.7% vs 9.1%); hence, there was a larger decline in the inflation rate for urban residents
- The rural poor continued to face the highest inflation rate given their consumption basket has the highest weight of food
- The gap in inflation rates among the relatively poorest and richest widened relative to the previous month. The gap between the inflation rate faced by the rural poor and urban rich inched up to 1.3 percentage points (vs 1.2 last month)

CPI inflation across income classes (% on-year)

Income segment	December		November		FY24	
	Rural	Urban	Rural	Urban	Rural	Urban
Top 20%	5.5	4.5	5.7	4.8	5.4	5.1
Middle 60%	5.8	4.9	6.0	5.3	5.6	5.4
Bottom 20%	5.9	5.1	6.1	5.5	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 December inflation trends. The table presents the average inflation faced by each income class.

Source: NSSO, National Statistical Office, CEIC, Crisil

IIP picks up significantly in November

The Index of Industrial Production picked up to 5.2% in November, from 3.7% in October (revised up from 3.5%). The increase was driven primarily by outperformance in investment goods and consumer durables, while a low base effect also contributed.

The Index of Industrial Production (IIP) reached a six-month high in November. The festive season's boost to discretionary consumption, coupled with resumption of government capital expenditure supported industrial growth. A low base also contributed to higher growth.

On average, IIP growth was better in the third quarter so far compared with the second quarter. This ties in with expectations of higher economic growth in the second half of this fiscal[3] with healthy agricultural output, easing food inflation and improving government capex providing support. However, high frequency indicators are indicating a mixed picture for the third quarter.

For the full fiscal, government capex support is expected to remain lower than last year given fiscal consolidation. For consumers, elevated interest rates and tighter lending conditions are expected to cap spending on discretionary items especially in urban areas. Rural demand, however, is expected to look up.

Data highlights

- IIP grew 5.2% on-year in November, up from 3.7% in October and 2.5% in November 2023. However, the index contracted 0.3% on-month after seasonal adjustments
- The on-year increase in IIP growth was broad-based, with acceleration in all three sectors, namely, manufacturing (5.8% vs 4.4% in October), electricity (4.4% vs 2.0%) and mining (1.9% vs 0.9%)
- The recovery was broad-based across use-based sectors as well. Consumer durables registered the highest growth (13.1% on-year), followed by infrastructure and construction goods (10.0%), capital goods (9.0%), intermediate goods (5.0%) and primary goods (2.7%). On the other hand, growth in consumer non-durables output (0.6%) was the weakest

Consumption durables outperform while non-durables slip

- Growth in consumer durables output picked up sharply (13.1% vs 5.7% in the previous month) on account of the festive season. Output growth was broad-based, driven by furniture (50.1% vs 28.8%), computer, electronic and optical products (18.7% vs 0.6%), wearing apparel (7.9% vs 6.3%) and automobiles (5.2% vs -1.7%)
- Growth in consumer non-durables output slowed (0.6% vs 2.6%), pushed down by output contracting in food products (-3.3% vs 4.9%), tobacco products (1.5% vs 11.6%) and beverages (0.4% vs 3.6%)

Within industrial goods, investment goods show sharpest output growth

- Investment-related goods saw the highest growth among industrial goods in November, buoyed by a sharp pick-up in central capex in the month (21.3% on-year vs -8.4% in October)

[3] *As per the first advance estimates released by the National Statistics Office*

– The highest growth was in infrastructure and construction goods output (10.0% vs 4.8%), with a sharp growth acceleration in cement output

– Capital goods output also picked up significantly (9.0% vs 3.1%), led by increased production growth in fabricated metals (19.6% vs 8.1%) as well as machinery and equipment (7.9% vs -2.4%)

- Intermediate goods output saw a slight growth uptick (5.0% vs 4.6%), led by better performance in chemicals (3.4% vs 2.1%)
- Output in primary goods (2.7% vs 2.5%) also rose slightly, led by output growth in mining and electricity
- While investment-related sectors outperformed, labour-intensive sectors such as textiles (3.8% vs 0.9%), wearing apparel (7.9% vs 6.3%), leather and leather products (-3.3% vs -3.8%) and food products (-3.3% vs 4.9%) turned in a mixed performance, with the latter two sectors showing weakness

Outlook

Fiscal consolidation, elevated interest rates and prolonged high food inflation weighed on the economy this fiscal. Investment growth was sluggish given lower government capex and subdued private investments. Indeed, the National Statistical Office's first advance estimates indicate a growth moderation to 6.4% from the robust 8.2% last fiscal.

However, growth is expected to quicken in the second half (6.8% vs 6.0% in the first half)[4]. Agricultural growth is likely to rise as higher reservoir levels also bode well for the rabi output. This should provide a fillip to farm incomes and rural consumption.

Reflecting this, average IIP growth has been better in the third quarter so far (4.4% average in October-November 2024) as compared with the second (2.7%). Government (centre plus state) capex has also picked up mildly in both these months.

Higher agriculture production is likely to ease the pressure on food inflation in the remainder of this fiscal, which will boost discretionary consumption. November's IIP data reflects tailwinds for consumption from the festival and wedding season; these are likely to continue further. High-frequency indicators such as passenger vehicle sales, tractor sales, and merchandise export growth show an on-year growth uptick in the third quarter. That being said, the Purchasing Managers' Index (PMI) for the manufacturing and services sectors indicate a moderation in the pace of expansion in the third quarter.

Going forward, we expect gross domestic product growth to improve to 6.7% next fiscal in our base case scenario. The Reserve Bank of India rate cuts, lower crude oil prices and a normal monsoon are expected to support growth. While government capex will remain supportive, continued fiscal consolidation implies investment prospects hinge on a sustained revival in private capex.

[4] *As per the first advance estimates released by the National Statistics Office*

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