

Macroeconomics | **First cut**

CPI, IIP spawn macro relief

April 2023

Inflation finally dips below 6%. But will the downtrend sustain?

Consumer Price Index (CPI)-based inflation eased to 5.7% in March from 6.4% in February. The gauge had fallen below 6% —the upper limit of the inflation tolerance band of the Reserve Bank of India (RBI) — the last time in December 2022, only to surge soon thereafter and stay above through January and February 2023.

This time, though, the decline should sustain for three reasons:

1. High base of last year played a big role in lowering inflation this March. The base had swelled due to a sharp surge in oil and food prices after the Russia-Ukraine conflict began last February, and due to strengthening demand after the third Covid-19 wave subsided. The high-base effect will remain supportive for the next 4-6 months.
2. Most of the relief in March was due to lower food and core inflation, where some more downside is expected in the coming months. In food, deflation or on-year price decline in edible oils, vegetables, meat and fish supported. However, prices of cereals, milk and spices, despite some moderation, remained quite high. As the rabi crop enters the market in April/May, some of the moderation, especially in cereals, is expected to sustain.

Also, assuming normal southwest monsoon, as predicted by the Indian Meteorological Department (IMD), and only a limited impact of the unseasonal rains in March, we expect food inflation to ease notably. But there will be pressure from milk prices, which are expected to be hiked over the coming months.

Core inflation, too, fell below 6% after staying above it for the past 10 months. There was an across-the-board easing in core, led by personal care and effects (mainly gold and other ornaments), recreation and amusement, and transport and communication. As economic growth slows, from 7% last fiscal to 6% in this one, some softening of inflation is expected in line with waning demand. But the easing should be moderate due to continued pass-through of high input prices by producers.

3. Fuel-related inflation continued to soften, driven by a high base and easier global oil prices. Despite the ~\$4/barrel fall in global oil prices between January and March, domestic pump prices of petrol and diesel have not changed. If the government were to pass on that benefit, fuel inflation should ease considerably and positively influence headline inflation.

Upsides that bear watching: The key monitorables for food inflation will be the progress of the southwest monsoon, given the prediction of an El Niño event by meteorologists, and frequent and intense changes in weather patterns. For fuel inflation, the impact of oil production cuts announced by the OPEC+, the demand impact on prices due to the upcoming summer season in the US/Europe, and the recovery in China will need to be monitored. For core, pressure on producers to pass on prices remains. This is reflected by CRISIL's input-output index computed using Wholesale Price Index until February, which shows that despite the recent softening of input cost, the index stays above the mark of 1, indicating that input prices remain higher than the output price.

CRISIL expects CPI inflation to average 5% this fiscal, down from 6.7% in the last. We expect the RBI to keep another rate hike on hold unless inflation rises above its forecast. As growth slowdown seeps in and inflation moderates, we expect the apex bank to cut the repo rate by the end of this fiscal.

Key data points in March

- CPI inflation moderated to 5.7% from 6.4% in February, lower than the 7% print in March 2022
- Food inflation softened sharply to 4.8% from 6% in the previous month
- Fuel¹ inflation slowed to 8.9% from 9.9% in the previous month
- Core CPI² inflation eased to 5.7% from 6.1% in February

Sharp correction in food inflation

- Food and beverages inflation decelerated in March, led by deflation in prices of vegetables and edible oils
- Inflation in cereals, which has been a major pressure point for headline inflation, eased a bit to 15.3% in March from 16.7% in February
- Inflation softened in meat and fish (-1.4% vs 3.3%), as well as milk and milk products (9.3% vs 9.6%), whereas in eggs it remained relatively stable (4.4% vs 4.3%)
- Inflation in fruits jumped to 7.6% in March from 6.4% in the previous month

Softer fuel inflation

- Fuel inflation moderated to 8.9% in March from 9.9% in February. Brent crude oil prices softened to \$78.5/bbl in March from \$82.7/bbl, providing some relief. The broader measure of fuel inflation (fuel and light, and petrol and diesel, which is a part of the miscellaneous category), fell to 6.9% from 7.8%.
- Kerosene (by the public distribution system) inflation decelerated sharply from 28.8% in February to 9.9% in March. On the other hand, kerosene inflation (from other sources) hardened to 35.1% from 34.0% in the previous month
- Inflation in electricity was broadly flat at 3.1% compared with 3% in the previous month, but could see some upside in April, reflecting tariff revisions. Coal (11.3% vs 10.4%) and charcoal (11.9% vs 11.5%) inflation also hardened

Broad-based softening in core inflation

- The core inflation rate dropped below 6% for the first time since August 2022, showing broad-based relief across categories. Core inflation has been persistently sticky over the last fiscal. Slowdown in core inflation was led by softening inflation in clothing and footwear (8.2% vs 8.8%), transport and communication (4% vs 4.5%), and personal care and effects (8.3% vs 9.4%)
- Inflation in some essential categories such as housing (5.0% vs 4.8%) and health (6.6% vs 6.5%) ticked up

¹ Refers to CPI fuel and light

² CPI excluding food and beverages, and fuel and light

Sharp easing in inflation faced by rural poor, limited moderation for urban poor

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 occupy a greater share in the consumption basket of lower income classes.

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 March³ inflation trends. The table below presents the average inflation faced by each income class.

Inflation faced by each income class moderated in March. Rural inflation across income segments moderated more sharply than urban inflation due to softening food prices. But still the urban poor face a higher inflation burden than their rich counterparts as fuel inflation remains considerably higher than core inflation.

CPI inflation across income classes (% on-year)

Income segment	March 2023		February 2023	
	Rural	Urban	Rural	Urban
Top 20%	5.6	5.9	6.6	6.1
Middle 60%	5.5	6.0	6.8	6.2
Bottom 20%	5.5	6.1	6.8	6.3

Source: NSSO, National Statistics Office, CEIC, CRISIL

Industrial activity displays resilience

The Index of Industrial Production (IIP) inched up to 5.6% on-year in February compared with 5.5% the previous month. Manufacturing activity picked up, particularly for consumer non-durables, and industrial and investment related goods. This signals resilience in domestic demand past year even as a slowdown is anticipated this fiscal.

While resilient domestic demand supported industrial activity in fiscal 2023, it is expected to moderate this fiscal with tightening domestic financial conditions and slowing goods exports. Rural demand might provide some support if monsoon turns out normal as per the IMD’s prediction. External demand will be a bigger challenge, as the sharp rise in interest rates above decadal average squeezes demand in the US and Europe. Overall, we expect India’s real gross domestic product (GDP) to slow to 6% this fiscal from 7% in the previous one.

³ For detailed methodology and findings, refer to CRISIL Quickonomics: Same inflation, different burdens by income (October 2021)

Data highlights

1. IIP grew 5.6% on-year in February compared with 5.5% in the previous month and 1.2% in February 2022. Sequentially, IIP grew 0.4% on-month on a seasonally adjusted basis⁴
 2. Growth uptick was driven by manufacturing (5.3% on-year growth in February vs 4.0% in the previous month). However, IIP for mining (4.6% vs 8.8%) and electricity (8.2% vs 12.7%) slowed
 3. Within manufacturing, consumer non-durables saw higher growth, while other segments saw slowing growth. IIP for consumer durables and intermediate goods declined
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Manufacturing uptick signals domestic demand holding ground

- The uptick in manufacturing growth was driven by consumer non-durables, where growth doubled to 12.1% in February from 6.3% in the previous month. While this was partly due to a favourable base, activity improved sequentially on-month as well
- However, consumer durables continued to decline for the third consecutive month (-4.0% vs -8.2%). Production declined for export-oriented sectors such as textiles (-9.8% vs -11%). Domestically, too, sectors that are more sensitive to interest rates, such as automobiles, saw some slowdown (8.2% vs 12.9%)
- Industrial and investment-related goods activity moderated, but continued at a healthy pace. Infrastructure and construction goods IIP slowed to 7.9% from 9.8%, while capital goods moderated a tad to 10.5% from 10.7%. This signals a healthy pace of investment activity
- IIP for primary goods (6.8% vs 9.6%) and intermediate goods (-0.3% vs 0.5%) fell, reflecting waning demand for commodity-linked products. Commodity-linked exports are expected to be hit more by slowing global demand and lower international prices than last year

Outlook

While industrial activity held up well in fiscal 2023, it is expected to face pressure this fiscal, as high interest rates moderate demand globally and at home.

The slowdown is expected to be more pronounced in advanced economies, where interest rates have crossed decadal averages. S&P Global expects the US real GDP growth to slow to 0.7% in calendar year 2023 from 2.1% last year, and for Eurozone to 0.3% from 3.5%. These economies account for 33% of India's goods exports, and will be a drag on domestic industrial growth.

While domestic demand has stayed resilient, signs of a slowdown are emerging. The RBI's latest consumer confidence survey shows while household sentiment improved in March, expectations have moderated for a year ahead. Manufacturers surveyed for the RBI's industrial outlook survey were also less optimistic for the first quarter of this fiscal than the previous quarter. Bank credit growth has begun moderating since February, though it remains at a decadal high.

That said, a normal monsoon—as predicted by the IMD—could support domestic demand through improving rural incomes.

Overall, we expect India's GDP to grow 6% this fiscal compared with 7%⁵ in the last one.

⁴ All on-month growth numbers are seasonally adjusted

⁵ Second advance estimate by National Statistics Office

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