March 2016

CRISIL Economy First Cut

Good news for inflation; IIP continues to sulk

Overview

After five months of steady rise, the CPI dropped, to 5.2% in February, from 5.7% in January*, making the case stronger for another repo rate cut by the Reserve Bank of India (RBI). The Budget's focus on fiscal consolidation had already created conditions for the RBI to cut rates;* ***we expect the policy rate to be sliced by 25-50 basis points (bps) in 2016. A benign inflation climate further allows for this; CPI, we believe, will stay soft at 5% average, unchanged from our estimate for fiscal 2016, if India is blessed with a normal monsoon.*** *Given the excess industrial capacity, weak demand and soft commodity and crude oil prices, the impending Seventh Pay Commission payouts are unlikely to swing inflation away from the RBI's glide path.*

The much awaited decline in CPI came on the back of a fall in food inflation in February (to 5.3% from 6.8% in January), especially in pulses, vegetables, oils and fats, and meat and fish. ***While the slide in CPI is a relief, sticky-inflation in some items has now come under the radar of the RBI.*** *Sticky items, as per our estimates, comprise nearly 20% of the CPI index. Education and health are two such where inflation has only fallen by 80 bps and 10 bps respectively in fiscal 2016 and remains high at 5.8% and 5.2%. These maintain an upward pressure on core, which rose 20 bps to 5.4% in February.*

IIP dipped for the third month in January, reporting -1.5% growth, compared to -1.2% in December. This was led by a steep fall in manufacturing activity, mainly in industrial and investment related goods. Capital goods continued to be major drag on industrial activity reflecting the investment lull in the economy, while consumer durables output was flat on-year reflecting weak demand. In fiscal 2017, assuming a normal monsoon, an uptick in the rural economy will drive consumption. The lagged impact of interest rate reductions, salary revisions and easier monetary conditions will also support demand and boost industrial capacity utilisation. ***We expect GDP to rise to 7.9% in fiscal 2017 from 7.6% in fiscal 2016 and industry GDP to grow at 7.6% driven by manufacturing and construction activity.***

Retail inflation falls to 5.2%, on lower food inflation; core inflation rises on sticky items

- The 140 bps fall in food inflation over January was led by pulses (where the inflation fell to 38.3% from 43.3%), vegetables (down 0.7% from 6.4%). oils and fats (at 5.1% from 6.4%) and meat and fish (down to 7.3% from 8.2%).

- Despite, downward pressures from global oil prices and a slower recovery in domestic demand, core inflation felt some upside pressures which mainly came from the sticky inflation in items like health, education and personal care and effects. Core inflation (excludes fuel and light, petrol and diesel) rose to 5.4% from 5.2% in January.

IIP: Industry growth shrinks

- **IIP dipped for the third consecutive month, in January.** IIP growth slipped to -1.5%, from -1.2% in January, mainly led by a steep fall in manufacturing sector output. The electricity sector gathered momentum (growth at 6.6%), and mining growth stayed afloat (at 1.2%).

- **Manufacturing growth tanks led by a fall in investment-oriented sectors.** Output growth in investment-oriented sectors fell to -7.3% in January, while in consumer-oriented sectors it was down at -2.9%. Investment oriented sectors such as electrical machinery, machinery and equipment, basic metals and other transport equipment continued to see sharp decline in output. Among consumer-oriented sectors, output declined in sectors such as food and tobacco products, publishing & printing and leather products. Overall, output in 11 of the 22 manufacturing categories declined in January.
- As per the use-based classification, the decline was sharpest in the capital good category (-20.4%) while consumer goods output remained flat on-year. Among consumer goods, consumer durable output growth decelerated to 5.8% while growth in non-durable output fell to -3.1%.

Figures: CPI and IIP trends

Figure 1: Fall in food inflation drags down CPI after five months

CPI (%y-o-y)	Weight	May-15	Jun-15	Jul-15	Aug-15	Sep-15	Oct-15	Nov-15	Dec-15	Jan-15	Feb-14
Headline CPI	100.0	5.0	5.4	3.7	3.7	4.4	5.0	5.4	5.6	5.7	5.2
Food CPI	39.1	4.8	5.4	2.1	2.2	3.9	5.3	6.0	6.4	6.8	5.3
- Oils and fats	3.6	1.9	3.1	2.8	3.1	3.7	5.0	6.6	7.2	6.4	5.1
- Vegetables	6.0	4.7	5.3	-8.0	-6.3	0.1	2.3	3.9	4.4	6.4	0.7
- Pulses and products	2.4	16.6	22.2	22.9	25.8	29.8	42.4	46.1	45.8	43.3	38.3
Fuel & light, petrol & diesel	9.2	2.4	2.9	1.9	1.5	1.1	1.6	2.5	3.1	3.4	3.6
Core CPI	54.1	5.6	5.8	5.3	5.4	5.4	5.4	5.4	5.4	5.2	5.4
- Housing	5.6	4.6	4.5	4.4	4.7	4.7	4.9	5.0	5.1	5.2	5.3
- Personal care and effects	8.6	2.9	4.2	2.8	2.2	3.6	3.9	4.3	3.6	3.4	4.8
- Education	4.5	7.4	7.2	6.5	6.0	6.0	6.0	6.1	5.6	5.5	5.8

Note: Food CPI excludes Pan, tobacco, prepared meals and beverages, Core CPI excludes 'food CPI', 'fuel & light', and 'petrol and diesel'.

Source: CEIC, Central Statistical Office, CRISIL Research

Figure 2: What the latest trend says about sectoral growth?

% yr	Weight %	Jun-15	Jul-15	Aug-15	Sep-15	Oct-15	Nov-15	Dec-15	Jan-16	Q3 FY15	Q3 FY16
General	100	4.2	4.3	6.3	3.7	9.9	-3.4	-1.2	-1.5	2.0	1.8
Mining	14	-0.4	1.3	4.5	3.5	5.3	1.9	2.7	1.2	2.1	3.3
Manufacturing	76	5.2	4.8	6.6	2.7	10.6	-4.7	-2.2	-2.8	1.1	1.3
Electricity	10	1.2	3.5	5.6	11.4	9.0	0.7	3.2	6.6	9.4	4.3
Use-based classification											
Basic	46	5.1	5.4	3.7	4.2	4.2	-0.7	0.5	1.8	8.3	1.3
Intermediates	16	1.3	2.0	2.8	1.8	6.3	-1.3	1.3	2.7	0.8	2.1
Capital goods	9	-2.0	10.1	21.3	10.1	16.5	-24.5	-19.1	-20.4	3.2	-9.0
Consumer Goods	30	7.2	1.1	6.0	1.2	18.3	1.0	3.0	0.0	-6.4	7.4
-Durables	8	16.1	10.5	17.0	8.5	41.9	12.5	16.4	5.8	-20.9	23.6
-Non durables	21	2.3	-4.4	-0.9	-3.6	4.8	-5.0	-3.0	-3.1	3.2	-1.1
Contraction	Growth slowing	Growth rising									

Source: CEIC, CRISIL Research

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