

‘Be the Bank of Choice for a Transforming India’

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## THANK GOD ITS WPI !

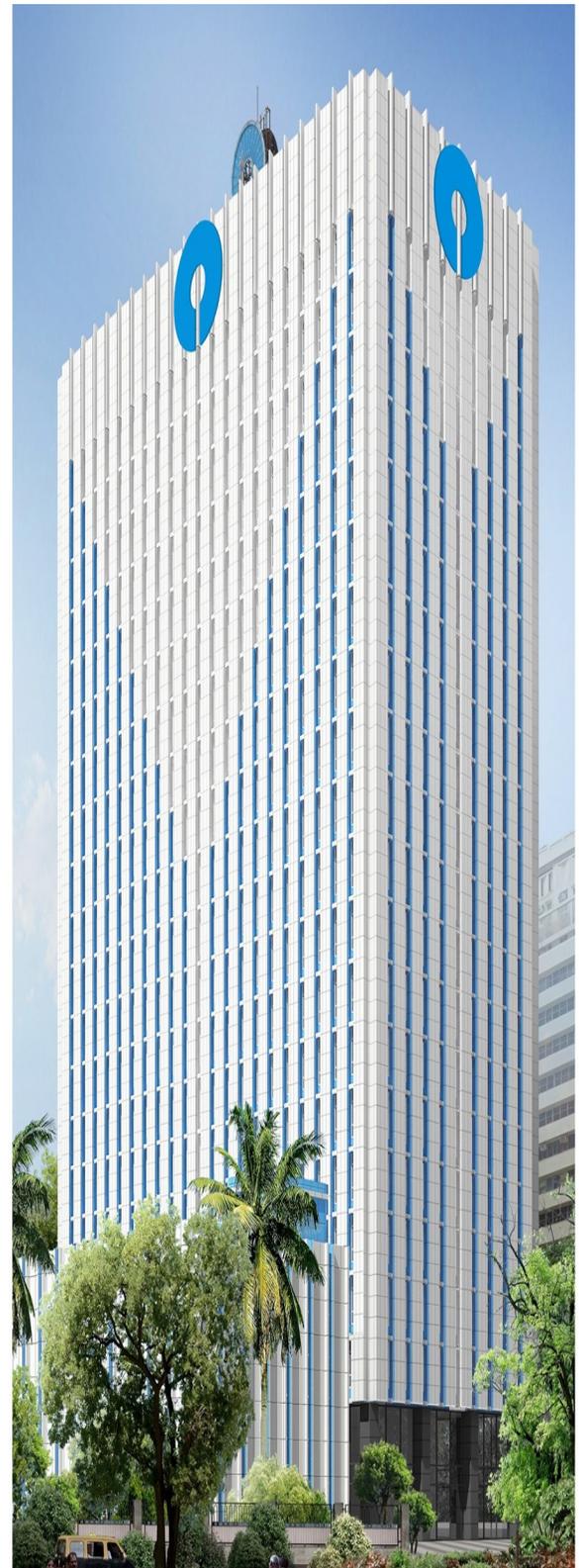
Macro numbers continue to surprise the market pundits on the wrong side! The Wholesale Price Index (WPI)-based inflation for January released recently touched a 10-month low of 2.76%, a sharp 100 point lower than market consensus. This is in addition to the continued decline in CPI numbers and also possibly burying the debate on sudden jump in rural health and education, with both returning to trend growth rates (Hope this continues in February too!). Just prior to that GDP data revisions was a significant surprise for market as it indicated that the narrative of a slowdown from FY17 was a false positive. The back series GDP data was also a pleasant surprise! Clearly, the market is still grappling to understand the nuances of such large magnitudes in data revisions from a decision making perspective. **But the good thing that this time the decline in WPI is perhaps not a data aberration, but a cause of serious concern!**

Coming back to WPI, contrary to the statistical average, the data reveals more than it hides. Manufactured products inflation crashed in January'19. Notably, the imported core and domestic core both declined.

The possible reasons for the decline in metal inflation within imported core could be that the slower economic growth in large metal consuming geographies (Europe, the US and China) is leading to subdued demand in the year 2019. Specifically, the imported core inflation has registered a sharp decline in Jan'19. This is corroborated by the weakening global demand and possible dumping of goods in India (a proxy could be jump in electronic imports). Slower economic growth in large metal consuming geographies (Europe, the US and China) is leading to subdued demand in the year 2019. It is quite known that demand has weakened in China due to slowdown in the real estate and automotive sectors due to the trade war. Coupled with this, Brexit will have a perceptible influence on automotive sector. As the Japanese auto makers pull out of UK, this relocation to will impact the demand for base metals. The concomitant drop in domestic core is equally worrisome, as it indicates loss of pricing power.

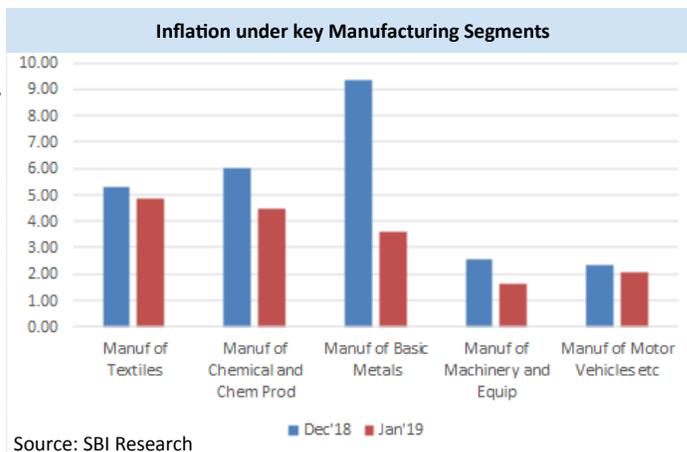
We are thus convinced about a monetary easing by RBI in April, and will not be surprised if the rate cut is of larger magnitude. This is more so given the global growth prospects. The US expansion, which we are currently in, has been uncommonly long, strong and is in the 115th month, making it the second-longest in history, just 5 months short of the longest expansion.

Interestingly, plucking theory in Economics predicts deep downturns is followed by strong expansions. Empirical work in this direction is now finding clear evidence for the plucking theory! This is clearly worrisome!



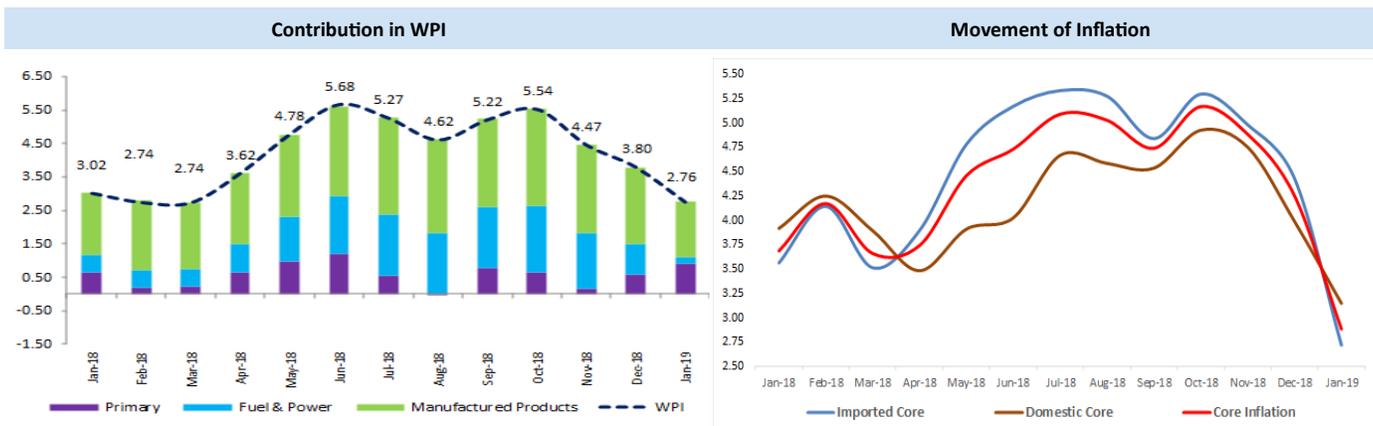
## WPI INFLATION

- ◆ The WPI inflation has come as a surprise to all and has been way below the estimates. The macro economic numbers which have been released in the last month have been quite intriguing and have baffled the analysts and people from academia with the kind of divergence from the estimates. This is in continuation to the unexpected decline in CPI numbers which had eased to 19-month low to 2.05% in Jan'19. Such declines have been missed while making inflation forecasts and even MPC continues to flag non-existent inflation risks.
- ◆ As against an average WPI expectation of 3.7% for WPI, the WPI came at 2.76%. The interesting part is that the expectations ranged between 3% to 4% whereas the final number was virtually 1 percent below the average expectation.
- ◆ WPI inflation for January touched a 10-month low of 2.76% on the back of a sharp fall in manufactured product prices and softening in prices of fuel and food items. Manufactured products inflation, which has a weightage of 64.23% in WPI declined to 2.61% in January, from a level of 2.96% in same month last year. Fuel and power inflation declined to 1.85%.
- ◆ Core inflation, which has a weightage of 55% stood at 15-month low of 2.89% as against 4.25% in the previous month. Deceleration in the manufacturing component led to this downturn in the current month. It may be noted that, within core inflation, major contributing factors were Manufacture of Basic Metals (Wt-9.6%), Chemicals and Chemical products (Wt-6.5%), Machinery (Wt-4.8%), Motor Vehicle (Wt-5.0%) and Textiles (Wt-4.9%). These 5 segments carry a weight of 30% within the 55% core inflation and registered a m-o-m decline of 9% in inflation.



## CORE INFLATION: A SHARP DECLINE?

- ◆ The primary contributor to this decline was 'Manufacture of Basic metals' which fell by -2.13% (m-o-m). Core inflation registered 15-month low of 2.89% as against 4.25% in Dec'18. Within, the manufactured goods, imported core registered the maximum decline. But the worrying thing is the decline in domestic core indicating loss in momentum of pricing power.
- ◆ Specifically, the imported core inflation, with a weightage of 34.6% plays equally important role as compared to the domestic core (weight 20.4%). The imported core inflation has registered a decline of 1.71% from 4.4% in Dec'18 to 2.4% in Jan'19. This holds key to a large extent and gets corroborated by the weakening global demand and dumping of goods in India. The possible reasons for the decline in metal inflation within imported core could be that the slower economic growth in large metal consuming geographies (Europe, the US and China) is leading to subdued demand in the year 2019. The third quarter may mark the start of a margin slide at Indian steel companies. The full impact of the fall in steel prices would be reflected in the running quarter. Demand has weakened in China also due to slowdown in the real estate and automotive sectors amid the Sino-American trade war. Though there are strong fundamentals for base metals, coupled with falling inventories, prices may remain on a lower side in 2019 on account of weaker demand.
- ◆ It is quite known that the demand has weakened in China due to slowdown in the real estate and automotive sectors due to the trade war between China and the USA. Though there are strong fundamentals for base metals, coupled with falling inventories, prices may remain on a lower side in 2019 on account of weaker demand.
- ◆ Considering the scenario ahead, we believe that if similar situation continues the core inflation would continue to rule at lower levels. We are also overtly concerned that domestic core has declined too.



Source: SBI Research

## ABOUT US

The Economic Research Department (ERD) in SBI Corporate Centre is the successor to the Economic and Statistical Research Department (E&SRD). The latter came into being in 1956, immediately after the State Bank of India was formed, with the objective of “tendering technical advice to the management on economic and financial problems in which the Bank has interest and which required expert analysis”.

After the first reorganization of the Bank, when specialized departments like Management Science, Management Information Systems, Planning and Market Segment Departments took over the statistical work of E&SRD, the Department was renamed as ERD.

However, with the ERD team now taking on multidimensional functionalities in the area of risk management , corporate analytics, strategy and so on, who knows, the time may have come to rename it again!

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