

CPI INFLATION TO REMAIN ELAVATED AS SUPPLY DISRUPTION WEIGHS: DATA SUPPORTS NO CUTS BEYOND DECEMBER

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The jump in CPI inflation in Oct'19 was primarily driven by food. We estimate that nearly 55% of the weighted contribution in food prices for the 12 month period ended Oct'19 has been contributed by onions and tomatoes. Core CPI, which has shown decelerating trend for the last one year, plunged to 3.47% in Oct'19 from 4.02% in Sep'19 and 6.19% in Oct'18. The decline in core CPI is primarily due to a sharp decline in health and personal care items (stripping aside gold), mostly under Rural Core. The deceleration in Rural core CPI (Health and Personal Care) is more sharp compared to deceleration in Urban Core CPI indicating demand slowdown in rural areas. The continuous decline in weighted contribution from health (medicines) is heartening and it remains to be seen whether the availability of such medicines under Ayushman Bharat may have contributed to such a decline.

Five states, namely Rajasthan, Madhya Pradesh, Maharashtra, Gujarat, and Karnataka bore the brunt of excess rainfall in 2019 and were affected by severe floods. This surplus rainfall during the month of August and September has seriously damaged many Kharif crops. Going forward, thus, food and vegetable prices could remain elevated and inflation prints in November still may be on a higher side due to the low base in 2018. We expect FY20 CPI to now average closer at 4.0%. Even as food CPI will remain elevated, core CPI will go below 3%. We expect a December rate cut, but beyond December it will be close decision (as inflation prints beyond October will remain elevated). Thus, it will be better if the rate cut is frontloaded in December.

Meanwhile, the Sep'19 IIP numbers have thrown up interesting facts. First, since Apr'13, this is the first instance when consecutively the deceleration in capital goods has been above 20%. Second, looking at the data for a month prior to Diwali, this is the highest decline since 2013. Third, this is the 9th consecutive month in which capital goods' growth has decelerated (just short of 11 months degrowth during Jan'09– Nov'09).

In another sign of demand slowdown, increase in currency in circulation during the Diwali week shows that there has been only a marginal uptick in Currency in Circulation this year. It was only in 2009 (the time of global crisis) when CIC had decreased, while all the other years have seen sizeable increase in CIC during the Diwali week. Such marginal increase in CIC reaffirms our contention that demand remains a significantly laggard and the jump in CIC prior to the Diwali week could have just been a one-off affair.

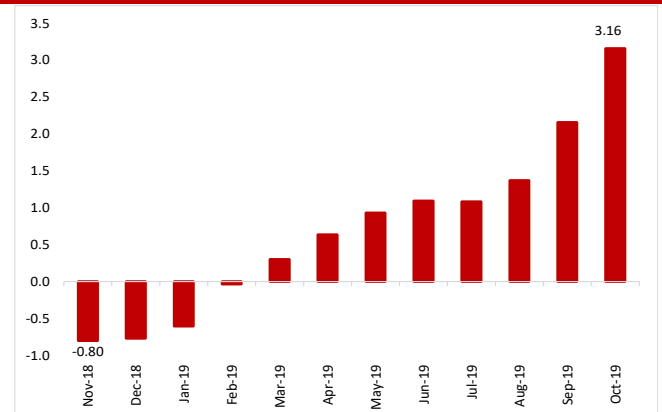
CPI INFLATION INCREASED TO 4.62% IN OCT'19

- ◆ CPI inflation rose sharply to 4.62% in Oct'19 as against 3.99% in the month of Sep'19 solely on account of huge jump in food prices. The food & beverages inflation rose to 6.93% in Oct'19 as compared to 4.70% in previous month. Prices of vegetables (26.1%) including onion rose significantly in the previous month.
- ◆ Core CPI, which has shown decelerating trend for the last one year, plunged to 3.47% in Oct'19 from 4.02% in Sep'19 and 6.19% in Oct'18. The decline in core CPI is primarily due to a sharp decline in health and personal care items, mostly under Rural Core. The deceleration in Rural core CPI is sharper compared to deceleration in Urban Core CPI indicating demand slowdown in rural areas.
- ◆ Though, the headline CPI inflation has been increasing since Jan'19 it has remained within RBI's target level of 4%(+/-2%). Five states, namely Rajasthan, Madhya Pradesh, Maharashtra, Gujarat, and Karnataka bore the brunt of excess rainfall in 2019 and were affected by severe floods. According to IMD from June 1-September 30, Madhya Pradesh ended up recording a surplus of 44%, Gujarat 43%, Rajasthan 40% and Maharashtra 32%.
- ◆ This surplus rainfall during the months of August and September has seriously damaged many Kharif crops. Madhya Pradesh which is the biggest producer of pulses and soybean in the country, is impacted due to the excess rainfall this year. Similarly, the floods in Maharashtra damaged crops on over 4 lakh hectares in western and northern parts of the state. Sugarcane, cotton, rice, soybean, tur dal, groundnut were among the worst hit in the State. In Gujarat, excess rains in late September has adversely impacted both the yield and the quality of groundnut.
- ◆ Going forward, thus, food and vegetable prices could remain elevated and inflation prints in November till may be on a higher side due to the low base in 2018. We expect FY20 CPI to now average closer at 4.0%.

CURRENCY MOVEMENT

- ◆ Increase in currency in circulation during the Diwali week shows that there has been only a marginal uptick in CIC this year. It was only in 2009 (the time of global crisis) when CIC had decreased, while all the other years have seen sizeable increase in CIC during the Diwali week.
- ◆ Such marginal increase in CIC reaffirms our contention that demand remains a significantly laggard and the jump in CIC prior to the Diwali week could have just been a one-off affair.

Food Inflation (Weighted Contribution in CPI) in %



Source: SBI Research

Weighted contribution of major items to Food Inflation (in bps)	
Items	Oct-19/Nov-18
Onion	132
Garlic	34
Tomato	85
Arhar (Pulses)	19
Fish & Chicken	14
Sugar	11
Milk	16
Brinjal	14
Cauliflower	11
Cabbage	13
Food and beverages	396

Source: SBI Research

States with Excess Rainfall (Jun-Sep'19)		
States	% Departure	Major Crops
Rajasthan	40%	Pulses, Oilseeds, Sugarcane, Rice
Madhya Pradesh	44%	
Gujarat	43%	
Maharashtra	32%	
Karnataka	24%	

Source: SBI Research

Increase in Currency in Circulation during Diwali Week	
Year	Amount (Rs Billion)
2009	-9.35
2010	105.89
2011	147.90
2012	242.95
2013	244.01
2014	190.29
2015	402.95
2016	201.65
2017	281.67
2018	494.20
2019	5.76

Source: SBI Research

IIP DE-GROWTH WORRIES

- ◆ IIP in September contracted by 4.3%, all time low in 2011-12 base, mainly due to poor performance in the manufacturing sector and a deepening slowdown in capital goods production pulling down growth. This was a second straight month of contraction, after a decline of 1.4% (revised) in August 2019. In September 2018, IIP had expanded 4.6%. In Sep'19, manufacturing output contracted by 3.9%, mining by 8.5% and electricity by 2.6%, compared to last year growth of 4.8%, 0.1% and 8.2% respectively. Cumulatively (Apr-Sep), IIP grew by 1.3% in 2019, compared to last year growth of 5.2% in 2018.
- ◆ Among the components of manufacturing IIP which constitute around 52% of the total weight in IIP, the basic metals is the only component whose weighted contribution has increased this fiscal. All the other major components' weighted contribution has turned negative, except for food products, which although positive has declined in the past two months. If the other components are looked at, electrical equipment, paper and tobacco are other industries which have witnessed increase in weighted contribution in IIP between Apr-Sep'19 however their weights in IIP is quite low.
- ◆ Since Apr'13, this is the first instance when consecutively the deceleration in capital goods has been above 20%. It was only in Oct'14 that capital goods de-growth had gone below -10%. Also looking at the data for a month prior to Diwali, this is the highest decline since 2013.
- ◆ This is the 9th consecutive month in which capital goods' growth has decelerated. However if we look at the 2004-05 base capital goods had seen negative growth for consecutive 11 months during Jan'09–Nov'09.

CORPORATE RESULTS

- ◆ As per the Q2FY20 results declared by 1443 listed entities, we observed top line contraction of around 2%, whereas bottom line and EBIDTA grew by around 22% and 9.79% respectively.
- ◆ Excluding BFSI and refineries, 1205 entities reported top line de-growth by 3.12%. Further, though the EBIDTA grew by less than 1% only, PAT reported a growth of more than 20%, mainly because of corporate tax cut.
- ◆ Some of the sectors reported all-round growth includes Healthcare, Agro Chemicals, Retail, Pharmaceuticals etc. Top 5 performing sector tabulated as mentioned in the table.
- ◆ Sector reported negative growth across key parameters includes Automobile, Constructions, Auto Ancillaries, Steel etc. Bottom five sector by revenue growth tabulated in the adjacent table.

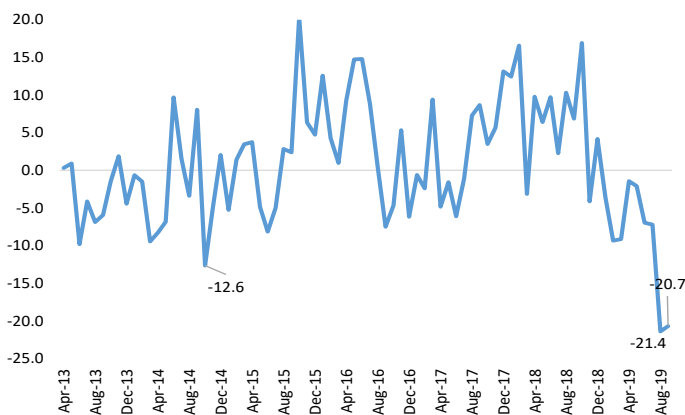
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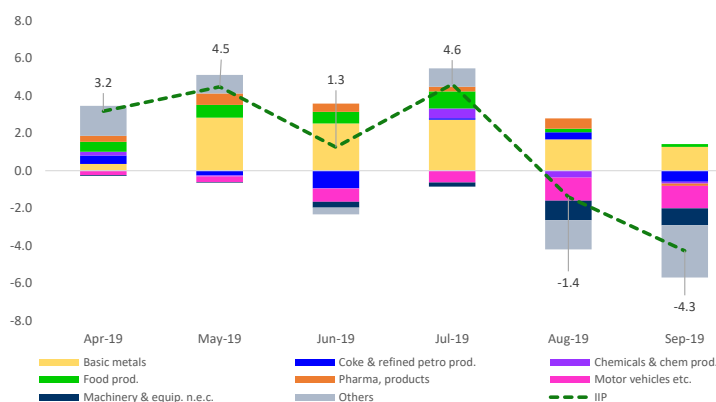
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Capital Goods Y-o-Y Growth %



Source: SBI Research

Weighted Contribution of Components in IIP(%)



Source: SBI Research

Top five Sectors reported growth in key parameters in Q2FY20 vis-à-vis Q2FY19

Sector	No of Companies	Net Sales	EBIDTA	PAT
Cables	5	23	24	76
Retail	8	17	80	10
Agro Chemicals	11	17	12	17
Healthcare	16	16	41	86
Pharmaceuticals	68	14	67	104

Source: Cline; SBI Research

Bottom five Sectors reported negative growth in revenue in Q2FY20 vis-à-vis Q2FY19

Sector	No of Companies	Net Sales	EBIDTA	PAT
Petrochemicals	13	-26	-13	26
Automobile	12	-25	-44	-39
Construction	25	-23	-32	-54
Auto Ancillaries	55	-17	-28	-32
Steel	55	-14	-16	111

Source: Cline; SBI Research