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भारतीय स्टेट बैंक
STATE BANK OF INDIA

'Be the Bank of Choice for a Transforming India'

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CPI AS EXPECTED; IIP DISAPPOINTS

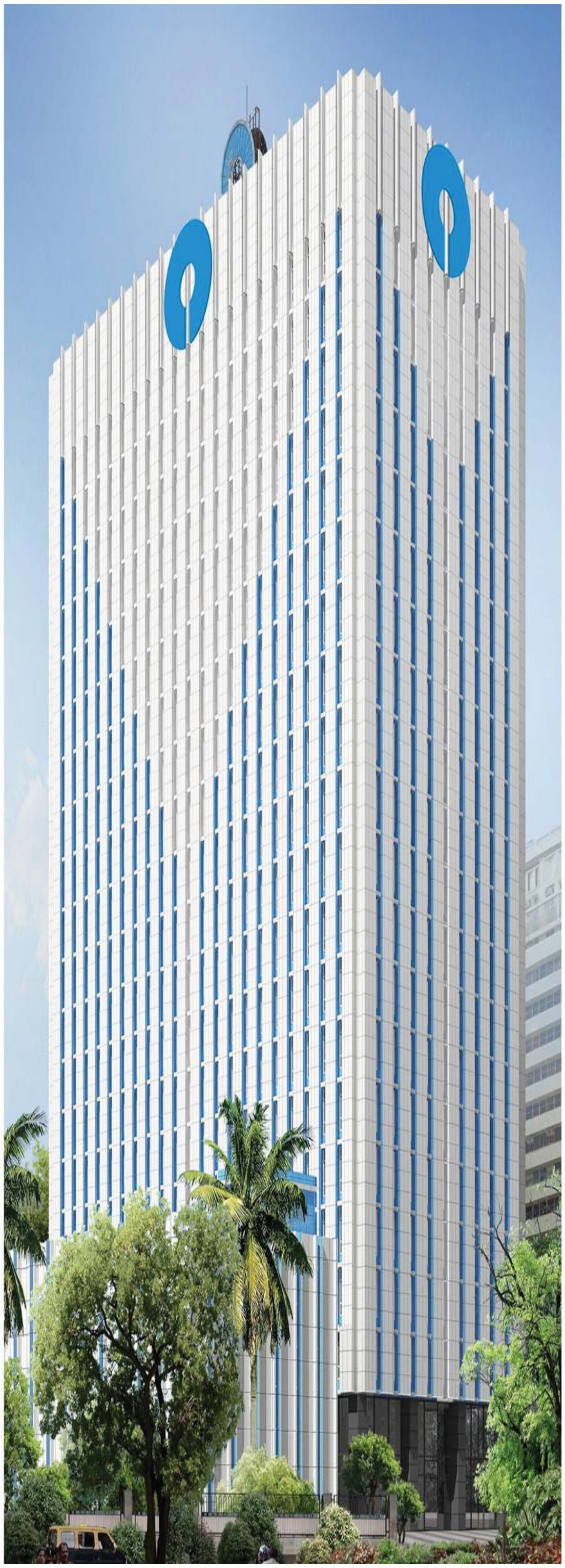
As expected, CPI inflation rose to 5-month high of 5.0% in Jun'18 compared to 4.87% in May'18 and 1.46% in Jun'17. Core inflation rose to 6.45%. We believe that the actual inflation figures for H1 FY19 will undershoot RBI inflation projections given in April policy by almost 50 bps and by around 30 bps in June Policy's maximum point. The outlook for inflation is evenly balanced till now and the impact of MSP on inflation will largely depend upon how the procurement will happen.

Various estimates suggest that the Government decision to hike the minimum support price (MSP) of 14 Kharif (summer sown) crops will impact CPI inflation by 50-100 bps. However we believe, such estimated inflation impact could just be a statistical artefact and will only transpire if there is procurement by Government. It is well known that when the public agency starts procuring the crops at MSP, it ensures a convergence between market prices and MSP thereby impacting inflation. For the statistically minded, our estimate suggests that, post announcement of MSP with 150% hike in cost of production, the CPI inflation could increase by 73 bps and materialize in one or two quarters but it is purely subject to procurement by the Government /State Government. Without procurement the impact could be much lower (almost half of the 73 bps).

Interestingly, historical trends suggest that with no Government procurement, market prices have often fallen below MSP due to demand-supply dynamics. To make the MSP effective, it is thus absolutely imperative that the Government either procures/ supplements through price differential scheme /PDS.

IIP is likely to remain on higher side in the next month owing to the base effect. A clearer picture should emerge post June, when the IIP series will be devoid of any base impact. We foresee an investment recovery in H2 FY19, once consumption growth gains momentum.

Against the backdrop of rising oil prices (with Indian crude basket is likely to average $76 per barrel in FY19) and falling rupee (marching towards Rs 70/$), raw material input cost might increase for some industries like Fertiliser, Plastic Products, Textiles and Pharmaceuticals.



CPI INFLATION INCREASED

- CPI inflation increased moderately to 5.00% in Jun’18 from 4.87% in May’18, with increase in prices of all components except food and beverages. Meanwhile, the Core CPI inflation rose to 6.45% compared to 6.23% in May’18. Rural inflation (5.00%) has again grown faster than urban inflation (4.85%).
- We believe that the actual inflation figures for H1 FY19 will undershoot RBI inflation projections given in April policy by almost 50 bps and by around 30 bps in June Policy’s maximum point. The outlook for inflation is evenly balanced till now and the impact of MSP on inflation will largely depend upon how the procurement will happen.

RBI Projection vs Actual CPI (%) for H1 FY19				
		Min	Max	Mid point
RBI Policy	April	4.70	5.10	4.90
	June	4.80	4.90	4.85
Actual + SBI projection			**4.6**	

Source: SBI Research, Q1: 4.82 (Actual), Q2: 4.4 (SBI Pojection)

- We believe that the trend which appeared in weekly Mandi prices in the 1st week of July will continue in the subsequent weeks and July CPI inflation will be less than the June inflation. CPI will be sub-4% in Q3 FY19.

IMPACT OF MSP ON INFLATION

- Recently, Government hiked the minimum support price (MSP) of 14 Kharif (summer sown) crops by at least 1.5 times of the cost of production to address farmer’s distress in India. Out of 14 crops, seven crops witnessed hike of more than 20% compared to last year.
- Various estimates suggest that this decision will impact CPI inflation by 50-100 bps. However we believe, such estimated inflation impact could just be a statistical artefact and will only transpire if there is procurement by Government. It is well known that when the public agency starts procuring the crops at MSP, it ensures a convergence between market prices and MSP thereby impacting inflation. For the statistically minded, our estimate suggests that, post announcement of MSP with 150% hike in cost of production, the CPI inflation could increase by 73 bps and materialize in one or two quarters but it is purely subject to procurement by the Government/State Government.
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Weekly Trend in Mandi Prices (%WoW)					
Item	Jul-18	Jun-18			
	1st Week	4th Week	3rd Week	2nd Week	1st Week
Cereals	0.5	-12.8	1.2	-0.4	4.4
Pulses	-1.8	0.1	-1.4	-0.6	-0.4
Vegetables	-3.8	16.5	-2.8	6.3	7.3
Potato	-4.3	0.4	-2.5	1.8	-10.9
Onion	-2.2	18.8	-0.8	7.7	3.1
Peas (Green)	-1.6	13.8	-2.4	0.9	9.4
Tomato	-2.5	16.2	-1.5	18.7	9.7
Cauliflower	-1.6	41.9	-0.4	13.9	7.8

Source: Agrimarket & SBI research

Impact of incremental MSP on inflation					
Kharif Crops	MSP 2018-19	Average Wholesale Prices**	Growth (%)	Weight (%)	Inflation (in bps)
Paddy Common	1750	1999	-0.14	4.38	-
Jowar-Hybrid	2430	1997	0.18	0.23	4
Bajra	1950	1296	0.34	0.11	4
Ragi	2895	2000	0.31	0.05	2
Maize	1700	1252	0.26	0.06	2
Arhar	5675	4375	0.23	0.80	18
Moong	6975	3206	0.54	0.36	19
Urad	5600	4453	0.20	0.27	6
Groundnut	4890	3934	0.20	0.33	6
Sunflower Seed	5388	3279	0.39	0.30	12
Soyabean (Yellow)	3399	3427	-0.01	0.30	-
Sesamum	6249	6768	-0.08	0.01	-
Nigerseed	5877	4440	0.24	0.01	0.2
Cotton Medium	5150	4657	0.10	0.05	0.5
Total					**73**

Source: AGMRKET, CACP, SBI Research, **Average mandi Prices in March, April, May

IIP GREW BY 3.2% IN MAY’18

- The Index of Industrial Production (IIP) grew by 3.2% in May’18, compared to a revised 4.8% in Apr’18. Low growth in Manufacturing (2.8%) dragged the industrial performance. Meanwhile, Mining and Electricity grew by 5.7% and 4.2% respectively in May’18.
- As per use based classification, Capital goods grew by 7.6%, Primary goods by 5.7%, intermediate goods by 0.9% and Infrastructure/ Construction goods by 4.9%. The Consumer durables have recorded a growth of 4.3% while Consumer non-durables exhibited negative growth of 2.6%. Out of 23 industry groups in the manufacturing sector, 13 have shown positive growth during May’18 as compared to the corresponding month of the previous year.

INTERMEDIATE GOODS ACTING AS A DRAG ON IIP

- Among the use based industries, primary goods which have the greatest weight in the overall IIP have shown moderately slow growth in the recent months, with electricity and diesel witnessing a slowdown.
- Meanwhile, it is the significant decline in the performance of the intermediate goods (growth rate falling from 7.5% yoy in Dec'17 to a mere 0.9% yoy growth in May'18) which has been acting as a drag on the overall IIP growth. Within intermediate goods, naptha, cotton yarn, copper bars and rods and industrial valves have shown de-growth in the past few months.
- Even the consumer non-durables' growth has declined from 16.8% in Dec'17 to −2.6% in May'18 owing to negative growth in detergent & washing soap, antibiotics, medical & surgical accessories, anti-malarial drugs and paper among others. However production of sugar, rice, vaccine for veterinary medicine, Anti-pyretic, analgesic/anti-inflammatory API & formulations and milk continue to grow. Among the consumer durables, growth of readymade garments (not knitted), gold jewelry, electrical apparatus, footwear has declined over the past few months.
- Auto components and two-wheelers have also decelerated, nevertheless they continue to grow in double digits. In the capital goods industries, commercial vehicles continue to show robust growth.

CORPORATE RESULTS

- With oil prices to stay at a higher level, the Indian crude basket is likely to average USD 76 per barrel in 2018-19. Also, the rupee dollar exchange rate is marching towards Rs 70 compounding the effect on raw material input cost. Sustained pressure on rupee is likely to keep the cost of inputs at an elevated level. Fertiliser companies are likely to face increased cost due to rise in raw materials. Prices of DAP are currently 20% higher at Rs 1290 per 50 kg bag, MoP Rs 700 per bag (+13%) and NPK (Nitrogen, Phosphorous and Potash) ~ Rs 1000 (+12% or so) as compared to prices in last rabi season. In textiles, apparel exports are witnessing lower exports. Plastic Products, Textiles and Pharmaceuticals are sensitive to petrochemical prices and Q1FY2019 results may reflect the outlook.
- In textiles, total readymade garment export in May this year was around $1.34 billion while it was $1.6 billion in the same month last year. Overall, with some industries dependent on key imported raw materials, the immediate outlook does not augur well.
- We expect another strong earnings performance from metals space led by solid realisations supported by steady volumes. Auto sector is likely to be one of the strongest performers on account of strong volume growth across different segments.
- In Media, print companies are likely to get impacted by higher newsprint prices while broadcasters would see double digit subscription revenues growth on the back of digitization. For cement sector, while demand remained buoyant, price recovery has been weak across most markets and input cost inflation has firmed up and we see aggregate margin compression.
- We expect the pharma sector earnings to be strong led by recovery in the domestic market after successful GST implementation, positive development on regulatory front from US FDA, softening of pricing pressure in the US generic market and weak rupee.

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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!

DISCLAIMER

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