

AUGUST 08, 2018
ISSUE NO:35, FY19**MSP PATHFINDER TO TRACK INFLATION
TRAJECTORY**

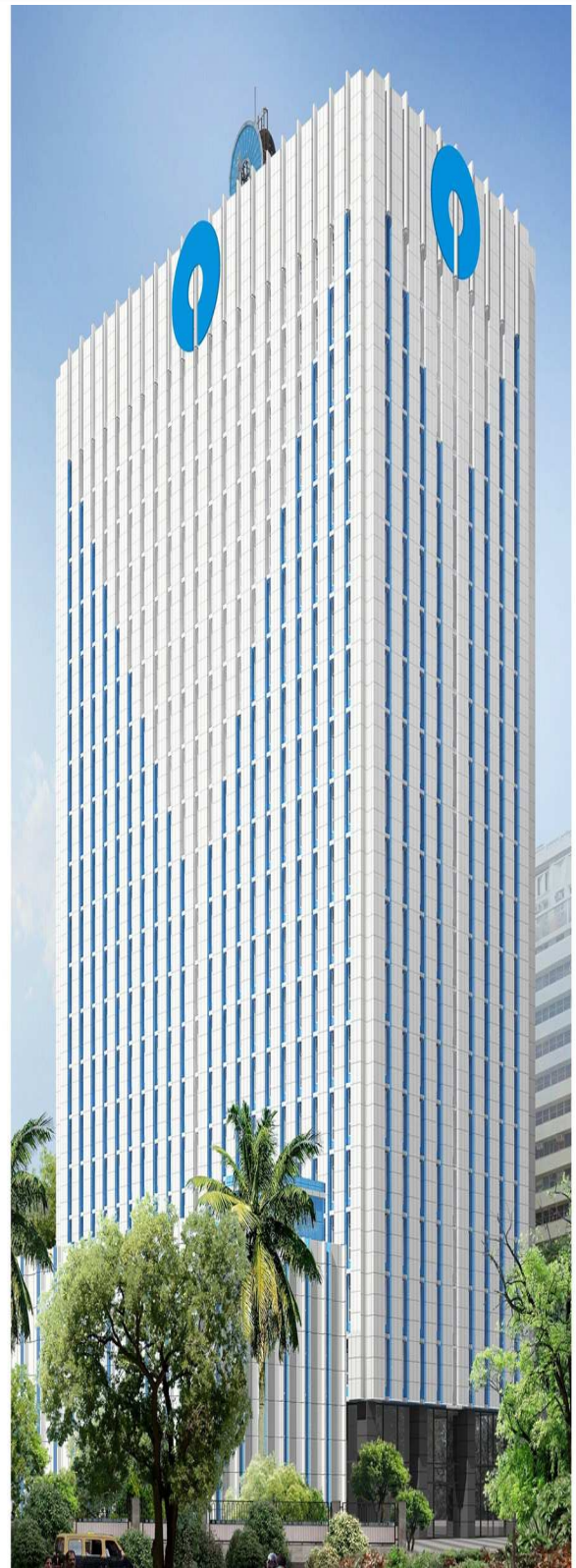
For a better understanding of the impact of MSP on CPI Headline inflation, we have now constructed a **MSP Inflation Pathfinder** to estimate the realised impact of MSP increase on CPI inflation Trajectory on a real time basis. The MSP Inflation Pathfinder will quantify both Direct and Indirect Impact on a realised basis based on CPI data to be released from August onwards.

The **MSP Direct Pathfinder**: This will quantify the direct impact of food items linked with MSP. The weight of this index is 15.61% in overall CPI

The **MSP Indirect Pathfinder**: We have listed all the items where MSP announced products are used as inputs. For example, some food grains are used as inputs in cooked meals, prepared sweets, cake, pastry, cooked snacks, etc. We also included items prepared using cotton, jute, etc. as inputs. The weight of this index is 11.1% in overall CPI.

Though July'18 CPI data is yet to be published we can still get an rough estimate of MSP's Direct Pathfinder using Mandi prices. If we look at the weekly Mandi prices trend as well as the monthly figure of all the Kharif crops in July'18, the price has increased in the range of 1% to 18%. The highest increase has been seen in crops like Bajra, Maize, Groundnut and Sesamum. The combined inflationary impact of these Kharif crops witnessing more than 10% increase on CPI is around 8 bps.

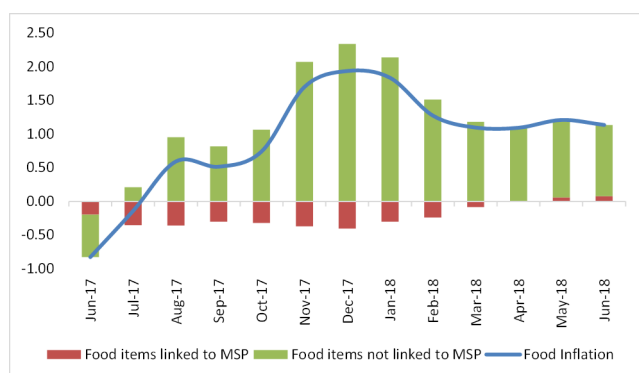
We estimate CPI Headline inflation for July 2018 will come in below 4.5%. Core CPI that has been on an upward trajectory since July 2017 is likely to have stayed at same level of 6.45% or may have declined marginally in July. We expect Core CPI to decelerate meaningfully from August onwards on the back of a favourable base effect. We still maintain that the jump in core inflation is because of service inflation that has leapfrogged goods inflation in the last couple of months. Whether such increase in service inflation is because of structural changes or demand pressures or even a statistical artefact (housing and transport contribution at more than 60%) will be keenly watched from hereon in terms of whether base impact outweighs the incremental impact or vice versa. If the former is true, this will also mean that the increase in Core CPI till date was indeed influenced by adverse base, as we have been constantly arguing.



INTRODUCING MSP INFLATION PATHFINDER

- ◆ In the last two Monetary policy review, RBI cited that the risks of rising inflation is the main reason to tighter the policy repo rate. Though there are a variety of reasons for the rising inflationary pressure but RBI has highlighted that MSP would be the prime one and said that, “increase in MSPs for Kharif crops, which is much larger than the average increase seen in the past few years, will have a **direct impact on food inflation and second round effects on headline inflation.**”
- ◆ On the basis of the above assessment, RBI has revised their CPI inflation estimates at 4.6% in Q2, 4.8% in H2 FY19 and 5.0% in Q1 FY20.
- ◆ For a better understanding of the impact of MSP on CPI Headline inflation, we have now constructed a **MSP Inflation Pathfinder** to estimate the realised impact of MSP increase on CPI inflation Trajectory on a real time basis. The MSP Inflation Pathfinder will quantify both Direct and Indirect Impact on a realised basis based on CPI data to be released from August onwards.
 - ⇒ **MSP Direct Pathfinder:** This will quantify the direct impact of food items linked with MSP. The weight of this index is 15.61% in overall CPI.
 - ⇒ **MSP Indirect Pathfinder:** We have listed all the items where MSP announced products are used as inputs. For example, some food grains are used as inputs in cooked meals, prepared sweets, cake, pastry, cooked snacks, etc. We have also included items prepared using cotton, jute, etc. as inputs. The weight of this index is 11.1% in overall CPI.
- ◆ Since, MSP has been implemented in Jul’18, the realization of MSP Indirect Pathfinder will however take time.
- ◆ Though Jul’18 CPI data is yet to be published we can still get an rough estimate of MSP’s Direct Pathfinder using Mandi prices. If we look at the weekly Mandi prices trend as well as the monthly figure of all the Kharif crops in Jul’18, the price has increased by in the range of 1% to 18%. The highest increase has been seen in crops like Bajra, Maize, Groundnut and Sesamum.
- ◆ The inflationary impact of these Kharif crops witnessing more than 10% increase, their combined impact on CPI will be 8 bps.
- ◆ Interestingly, food items linked to MSP has been witnessing a negative weighted contribution to Headline Inflation consistently since June 2017. This has turned only positive beginning May 2018, and we will closely track this. Even, the food items not linked to MSP has been witnessing a deceleration in prices.

Graph 1: MSP Food Inflation Pathfinder (%)



Source: SBI Research

Impact of MSP on Mandi Prices						
Crops	Weight (%)	MSP 2018-19	Pre MSP: Mandi Price (Jun'18)	Post MSP: Mandi Price (Jul'18)	Growth %	CPI Impact (in bps)
1	2	3	4	5	6	7=2*6
Bajra	0.11	1950	1287	1516	18%	2.0
Maize	0.06	1700	1305	1496	15%	0.9
Groundnut	0.33	4890	3458	3980	15%	5.0
Sesamum	0.01	6249	7196	7918	10%	0.1
Total Inflation Impact						8

Source: Agmarket; 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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