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CPI COOLS BUT OCTOBER RATE HIKE IS IMMINENT

CPI inflation at 3.69% was in line with market expectations. Our MSP Inflation Pathfinder shows the realised value of MSP Direct Pathfinder during Jul'-Aug'18 is now 12 bps.

Even though CPI inflation has cooled off, we believe October rate hike of 25 bps is imminent, but the question is whether the magnitude of rate hike could be even higher by 25bps (say 50 bps). A currency crisis by logic calls for a bigger rate intervention, but given that RBI is now an inflation targeting central bank it will be really difficult to justify such action with inflation numbers continuing to be in 4-4.7% range through current fiscal, with the downside at sub 3.5% in November'18. Clearly, the RBI is now caught between Scylla and Charybdis!

We still believe talking down the rupee as was done recently by officials (but later reversed) when the markets were volatile has been counterproductive and thus the pace of depreciation has become frantic in the last week or so.

Meanwhile, we heartily welcome the new procurement policy under the Umbrella Scheme "Pradhan Mantri Annadata Aay SanraksHan Abhiyan' (PM-AASHA) announced by the Government today. The Scheme is aimed at ensuring remunerative prices to the farmers for their produce as announced in the Union Budget for 2018. The new Umbrella Scheme comprises of (a) Price Support Scheme (PSS) (b) Price Deficiency Payment Scheme (PDPS) and (c) Pilot of Private Procurement & Stockist Scheme (PPPS). Interestingly, if the PDPS scheme is implemented only for oilseeds (Soybean, Groundnut, Sunflower seed, Sesamum & Niger seed) we estimate the total cost will be **Rs 8472 crore**. The cabinet has increased the budget provision for overall procurement cost at **Rs 15,053 crore**, and simultaneously an off-balance sheet additional government guarantee of **Rs.16,550 crore**. Hence there is an additional fiscal cost as envisaged. We also believe that the Government should do a more effective procurement for pulses, prices of which are continuing to decline every month even after MSP hike!

Meanwhile, IIP growth expanded by 6.6% in July though it is expected to revert to around 4% over the next few months as base effect turns adverse. The good thing is that the growth rate of export-oriented sectors (under manufacturing) has rebounded during Jan-July 2018 from negative growths in the corresponding period. Textiles, Leather, Chemicals and IT have shown positive momentum with IT leading the pack and we hope this is sustained. Additionally, 305 Projects worth Rs 73483 crore are completed during 1st quarter of FY19 and are ready to go on steam this year.



CPI INFLATION EASED

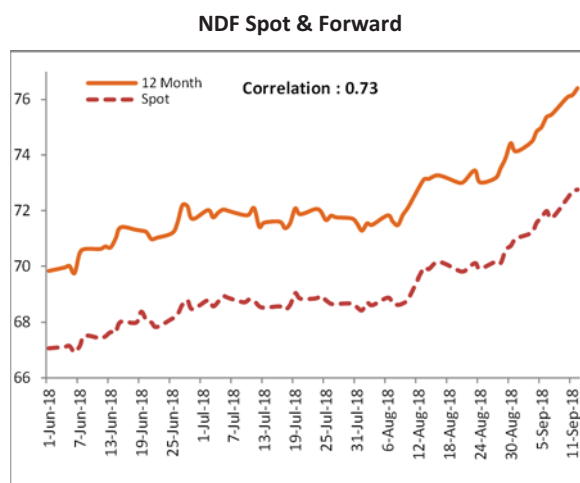
- ◆ CPI inflation further eased to 3.69% in Aug'18 from 4.17% in Jul'18, driven mostly by declining food and beverages component. All the other components except fuel and light have also moderated. When compared to Aug'17, too, moderating food prices have driven the decline in inflation.
- ◆ In the miscellaneous component, while other components have seen decline in prices m-o-m, Education, which has been continuously growing this fiscal has shown an increase in Aug'18 too.
- ◆ The Core CPI inflation declined to 5.87% compared to 6.29% in Jul'18. Our projection for CPI FY19 is at 4.3-4.4%.
- ◆ For a better understanding of the impact of MSP on CPI Headline inflation, last month we constructed **MSP Inflation Pathfinder** to estimate the realised impact (both direct + indirect) of MSP increase on CPI inflation Trajectory on a real time basis. We estimate that the realised value of MSP Direct Pathfinder during Jul'18 was 7 bps and for Aug'18 it was 5bps, hence the combined impact is now 12 bps. The realization of MSP Indirect Pathfinder will however take time.

Impact of Incremental MSP on CPI inflation			
Kharif Crops	Modeled Inflation during Jul to Dec (in bps)	Realised Inflation in Jul (in bps)	Realised Inflation in Aug (in bps)
Cereals	-	2.0	1.0
Jowar-Hybrid	4.1	0.0	0.0
Bajra	3.7	-0.1	0.0
Ragi	1.5	0.0	0.0
Maize	1.6	0.0	0.0
Arhar	18.3	2.1	1.0
Moong	19.5	2.0	0.5
Urad	5.5	1.2	0.5
Groundnut	6.5	0.0	1.0
Sunflower Seed	11.7	0.4	1.0
Soyabean (Yellow)	-	-	-
Sesamum	-	-	-
Nigerseed	0.2	-	-
Cotton Medium	0.5	-	-
Total	73	7	5

Source: AGMARKNET, CACP, SBI Research

RATE HIKE IMMINENT THOUGH INFLATION COOLS OFF: THE QUESTION IS OF MAGNITUDE

- ◆ Everyday rupee is touching new lows. A 'million-dollar question' in this regard is till where rupee will go. Former RBI Governor YV Reddy in a recent conversation with Bloomberg Quint on the 10-year anniversary of the collapse of Lehman Brothers, cautioned against letting the market believe that depreciation is due. He said that, "You should never allow the markets to have a dominant feeling that some depreciation is required. The expectation should be more appreciation than depreciation. If the depreciation is forced by the market... you should handle the sentiment when it starts and not when it fully expresses".
- ◆ Our views are perfectly in sync with Dr. Reddy's views and we believe that in the hope of a better export growth, talking down the rupee as was done recently by officials (but later reversed) when the markets were volatile has been counterproductive and thus the pace of depreciation picked up frantic pace in the last week or so. In this context, the statement by FM and the news of PM taking stock on economy during weekend was most welcome and timely one as it has provided an immediate succour to battered market sentiments. The RBI could also chip in with a message that could be most comforting under the current circumstances. It may be noted that RBI intervention in the foreign exchange market recently have been limited given the costs associated with such.
- ◆ The value of Rupee in NDF 12-month forward market has already touched 76 and the strong and positive correlation (0.73) between spot and forward NDF rate indicate that rupee is still under pressure though it has rebounded.
- ◆ We believe October rate hike of 25 bps is imminent, but the question is whether the magnitude of rate hike could be even higher by 25bps (say 50 bps). A currency crisis by logic calls for an bigger rate intervention, but given that RBI is now a inflation targeting central bank it will be really difficult to justify such action with inflation numbers continuing to be in 4.-4.7% range through current fiscal, with the downside at sub 3.5% in November'18. Clearly, the RBI is now caught between Scylla and Charybdis!



Source: SBI Research

GOVERNMENT NEW PROCUREMENT POLICY IS MOST WELCOME

- ◆ The recent GVA data on agriculture growth is not encouraging. Though the agriculture GVA increased to 5-quarter high to 5.3%, but this is a statistical artefact as the growth was primarily due to “non-agriculture” components. This low growth in agriculture along-with (i) Rising agriculture NPA, (ii) Low credit growth, and (iii) Deficit Monsoon, and (iv) Price decline, will lead to pressure on food inflation going forward.
- ◆ We have analyzed agriculture NPA (as % of agriculture advances) of the Jun’18 and Mar’18 quarters for select banks and found that in most of the banks agriculture NPA increased in Jun’18 quarter compared from Mar’18 quarter. This increase in agriculture NPA along with low credit growth is a cause of worry. The growth in credit to agriculture decelerated during 2017-18 (3.8%) when compared to a year ago (12.4%).
- ◆ Deficit monsoon (8% below normal) is also one of the concern for food inflation going forward.
- ◆ There is a consistent decline in wholesale prices for major food grains in last four months (Apr’18 to Aug’18) particularly in pulses i.e., Arhar, Urad, moong and Masur), and in oilseeds i.e., Soyabean and groundnut across various States. To address the price distress and doubling farmer income, in Jul’18, Government announced MSP for all Kharif crops by raising it 1.5 times of cost of production.
- ◆ Against this background, the new procurement policy under the Umbrella Scheme “**Pradhan Mantri Annadata Aay SanraksHan Abhiyan’ (PM-AASHA)**” is most welcome. The Scheme is aimed at ensuring remunerative prices to the farmers for their produce as announced in the Union Budget for 2018. The new Umbrella Scheme includes the mechanism of ensuring remunerative prices to the farmers and is comprised of (a) Price Support Scheme (PSS) (b) Price Deficiency Payment Scheme (PDPS) and (c) Pilot of Private Procurement & Stockist Scheme (PPPS).
- ◆ The Price Deficiency Payment Scheme (PDPS) will address the price distress in oilseeds through **Price Compensation Scheme** in line with “Bhavantar Bhugtan Yojana” which is already implemented in Madhya Pradesh. In addition to this, cabinet has also approved by allowing States to rope private players in the procurement programme. Apart from this, as agriculture comes under “State list” in Indian constitution, so the state government will be given an option to choose multiple schemes to protect the farmers.
- ◆ If this programme is implemented only for oilseeds (Soybean, Groundnut, Sunflower seed, Sesamum & Niger seed) the total cost will be **Rs 8472 crore**. This will be an additional fiscal cost for the Government.

Agriculture NPA (% of Agri advances)		
Banks	Mar-18	Jun-18
Bank of India	11.2	13.5
BoB	13.6	11.7
Canara Bank	4.6	4.9
Central Bank	7.4	7.9
Corporation Bank	7.8	8.1
IDBI	19.0	12.4
Indian Bank	2.0	2.6
OBC	13.2	16.1
SBI	11.3	11.6
Syndicate Bank	11.0	14.5
Uco Bank	14.5	16.0
Union Bank	6.1	6.9
Vijaya Bank	3.6	4.1

Source: SBI Research

SBI estimate of PCS for Oilseeds	
Crops	Cost (Rs Cr)
Sunflower seed	60
Groundnut	4210
Soyabean	3799
Sesamum	403
Niger Seed	-
Oilseeds	8472

Source: SBI Research

IIP GROWTH: EXPORT ORIENTED INDUSTRIES GAINING MOMENTUM

- ◆ IIP grew by 6.6% in Jul’18 due to 7% growth in Manufacturing and 6.7% growth in Electricity. Mining grew by 3.7% only. As per Use-based classification, Primary goods increased by 6.9%, Capital goods by 3.0%, Intermediate goods by 1.2% and Infrastructure/ Construction Goods by 8.4%. The Consumer durables and Consumer non-durables have recorded growth of 14.4% and 5.6% respectively.
- ◆ In terms of industries, twenty out of the twenty three industry groups in the manufacturing sector have shown positive growth during Jul’18.
- ◆ One of the perceived benefit of rupee depreciation is increase in exports and that will lead to increase in production of that industries that are export-oriented. We have analysed the growth rate of export-oriented sectors (under manufacturing) for Jan-Jul period during 2017 and 2018 and found that depreciation may have lead to increase in growth in 2018 for price sensitive segments. Out of four such industries, three industries exhibited negative growth in 2017 (Jan-Jul) and during 2018 they started rebounding.

Performance of Export-Oriented Industries since Rupee Depreciation		
Industries	Jan-Jul (Average, %)	
	2017	2018
Textiles	-2.0	1.2
Leather and related products	-2.5	1.6
Chemicals and chemical products	-1.5	3.1
Computer, electronic and optical products	6.2	27.2

Source: SBI Research

PROJECTS COMPLETED IN Q1 FY19

- ◆ 305 Projects worth Rs 73483 crore are completed during 1st quarter of FY19 and are ready to go on steam this year. Major sectors where projects were completed include LNG Storage & Distribution, Shipping Infrastructure, Iron & Steel, Shipping, Gas distribution. Irrigation, Cement, Hydrel based Power etc.
- ◆ In metals, we have seen a major copper producer mired in environmental clearance. The Tuticorin plant of Sterlite Copper (Division of Vedanta Ltd) was ordered closure by the Tamil Nadu state government in May 2018. Since then the company has been facing trouble to restart its operations. The copper division also has refining copper unit in Silvassa, Gujarat. In Q1FY2019, Vedanta reported production of copper rods / cathodes of 24 million units yielding a revenue of Rs.2797 crore (EBIDTA loss of Rs.87 crore). The corresponding figure for Q1FY2018 stood at Rs 5322 crore (EBIDTA Rs 213 crore). The production of phosphoric acid during Q1 FY2019 was nil while for sulphuric acid it was 2 kt.

Projects completed in Q1FY19		
Sectors	Projects	Amount Rs in Cr
Iron & Steel	15	19,968
Roadways	79	14,013
Shipping Infrastructure	1	10,000
LNG Storage & Distribution	1	5,200
Irrigation	3	4,214
Cement & Asbestos	7	2,291
Hydel Based Power	2	1,583
Electrical Machinery	7	1,450
Gas Pipeline	2	1,132
Fertilisers	1	976
Non Conventional Energy	9	879
Food Products	8	550
All Sectors	305	73,483

Source: Projects Today; 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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