

NEED FOR SOME SERIOUS REPAIR

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The CPI inflation has increased to 3.05% in May'19, compared to 2.99% in Apr'19, due to rise observed in food and vegetable prices. The CPI inflation, as in the previous months has remained comfortably within the RBI's target level of 4%(+/-2%), and we expect FY20 CPI to average at 3.5%. The core CPI has declined to 22-month low of 4.21% in May'19, with the decline in miscellaneous items like household goods, health etc. Going forward, core CPI will go down and the headline CPI will increase, leading to convergence in coming months. It may be noted, that the inflation numbers have come after the 25 bps rate cut by the RBI as also when the MPC has changed its stance to accommodative.

Industrial Production growth for Apr'19, surpassing expectations of de-growth, accelerated to 3.4% y-o-y (Apr'18: 4.5% y-o-y). Impetus was given by Mining and Electricity sectors which displayed growth rates of 5.1% and 6.0% respectively. With the Q4GDP numbers a disappointment, we have to see if this IIP growth is temporary or not.

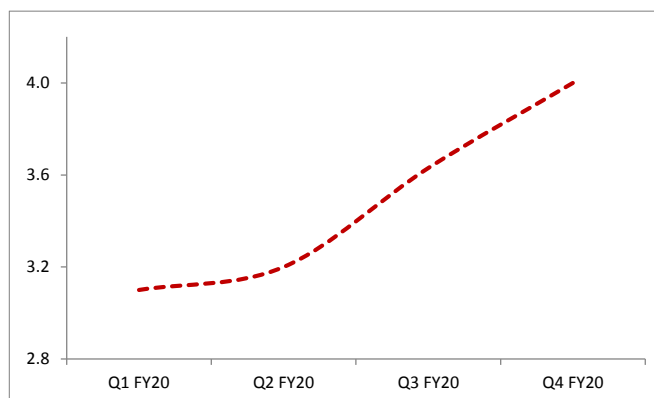
While monetary policy support is most welcome and we expect more rate cuts, questions are being raised regarding the limited fiscal space for revving up growth. We believe that the Government could use the budget to address sector specific measures. Addressing the issues in the NBFC sector in tandem with RBI is now of utmost importance in reviving the fortunes of the financial system.

With consumption slowing down markedly as indicated by persistent negative growth in car sales, it is imperative that we revive demand. On a y-o-y basis (fy19/fy18), Government Expenditure has also seen a significant compression. On a q-o-q basis, investment has declined significantly. Our expectations are such that the Government would do better with reasonable fiscal deficit assumptions and should be very clear of the fiscal consolidation path. There may be, however, some limiting factors. For instance, FCI borrowings from NSSF (small savings) is already be in excess of Rs 2 tn or 1% of GDP. We believe fiscal channel in India is more direct and quicker and Indian financial system is in need of some serious repair. To us, a easy monetary policy with a reasonable tight fiscal deficit will be ineffective in addressing the existing demand slowdown.

CPI INFLATION INCREASED TO 3.05% IN MAY'19

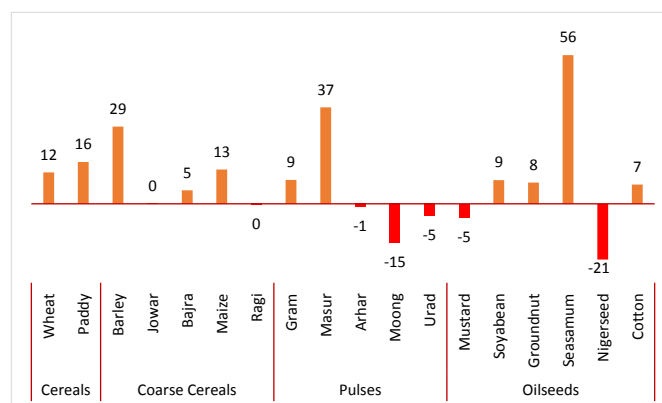
- ◆ CPI inflation rose to 3.05% (SBI Estimate:3.05%) in May'19, compared to 2.99% in Apr'19, due to growth observed in food and vegetable prices. The inflation rate for vegetables is at 5.46%, while the price of cereals and products grew at the same rate of 1.24%. Prices of health products rose 8.01% while meat and fish cost 8.12% more.
- ◆ The CPI inflation, as in the previous months has remained comfortably within the Reserve Bank of India's target level of 4%(+/-2%). Retail inflation remained well within the RBI's comfort level of 4% for about 10 months now. We expect FY20 CPI to average at 3.5%.
- ◆ The core CPI has declined to 22-month low of 4.21% in May'19, with the decline in miscellaneous items like household goods, health, education transport & communication. The softening trend is merging into the core inflation. It can be, however, said that a relatively weaker demand condition would not allow the pricing power of the manufacturers and the overall industry to get restored.
- ◆ The consumption demand is as such, not showing strong signs of recovery. The automobile sector has been showing poor performance with sales and export all witnessing deceleration in growth.
- ◆ The good thing was that the agricultural price deflator, an indicator of rural purchasing power has finally recovered in Q4 after 2 successive quarters of de-growth. In fact, our estimates suggest that since the MSP increase in July'18 (the month MSP announced for Kharif crops), wholesale prices of 18 major crops (includes cereals, pulses and oilseeds) have recovered from lows and are now on an average 9% higher than MSP. However, the impact of such rise in Mandi prices has no material impact on retail food inflation which seems to have declined even as wholesale inflation has moved up substantially. Such divergence may be due to less output being routed through Mandis or decrease in commission, which is indeed a matter of debate, but one thing looks to be sure that low inflation now seems entrenched in India's psyche.

Graph 1: CPI Inflation Trajectory (P)



Source: SBI Research

Graph 2: Growth of Wholesale Prices in May'19 over MSP



Source: AGMARKNET, SBI Research

- We expect pick up in WPI food is unlikely to translate in CPI food. Though both the series are positively related, the increase/decrease in WPI inflation is always more sharp than the CPI inflation. An increase in WPI food doesn't indicate that CPI food also increase in the same magnitude. Further the volatility in WPI food is more than the CPI food.

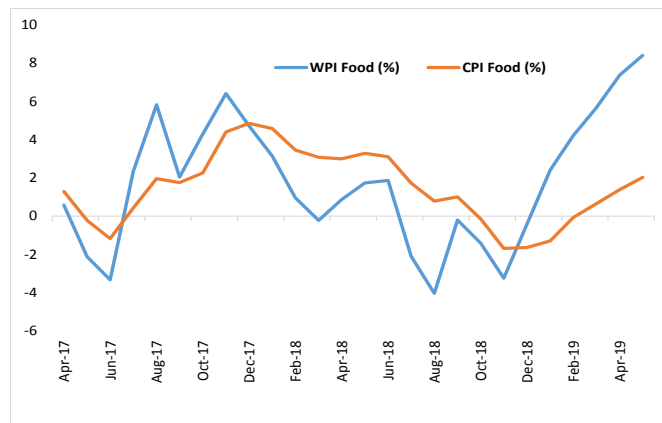
STATE WISE INFLATION

- State wise data on CPI inflation since Aug'18 (MSP fixed at 1.5 times of cost of production in Jul'18) shows that out of 28 States, 23 States had seen a decline in consumer prices during 5 months till Dec'18 whereas in 5 States, the CPI inflation had increased and their weighted contribution to CPI was 14 bps. Overall the net impact was -148 bps. However, during the first 5 months this year (Jan'19-May'19) the trend is reversed in many states and the combined net impact on CPI has become positive, 99 bps
- This reversal in trend is particularly on account of rising food inflation. For instance, in Uttar Pradesh inflation declined by 22 bps during Aug'18-Dec'18, while it increased by around 18 bps this year during Jan'19-May'19. Interestingly, food inflation increased by 3.7% in UP during Jan'19-May'19.

IIP GROWTH SURPRISES

- Industrial Production growth for Apr'19, surpassing expectations of de-growth accelerated to 3.4% y-o-y (Apr'18: 4.5% y-o-y). Impetus was given by Mining and Electricity sectors which displayed growth rates of 5.1% and 6.0% respectively. Manufacturing grew by 2.8%. Mar'19 IIP has been revised upward from -0.1% to 0.4%, as manufacturing de-growth of -0.4% was revised upward to 0.1%.
- In terms of industries, fourteen out of the twenty three industry groups (as per 2-digit NIC-2008) in the manufacturing sector have shown positive growth, with 'Manufacture of wearing apparel' showing the highest positive growth of 33.6%, owing to base effect. However, 'Manufacture of textile' which has a higher weightage is still declining. The y-o-y growth of 'Manufacture of electrical equipment' and 'Manufacture of machinery and equipment n.e.c.' has turned positive.
- As per use-based classification, the y-o-y growth rates in Apr'19 are 5.2% in Primary goods, 2.5% in Capital goods, 1.0% in Intermediate goods and 1.7% in Infrastructure/ Construction Goods. The Consumer durables and Consumer non-durables have recorded growth of 2.4% and 5.2% respectively. When we look at last month's growth of these goods, we find that besides Infrastructure/ Construction Goods, the growth this month has improved.
- Two wheeler sales, however, are the highest negative contributor to IIP growth. The slump in the auto industry is very real and needs urgent attention.

Graph 3: CPI Food and WPI Food (%)

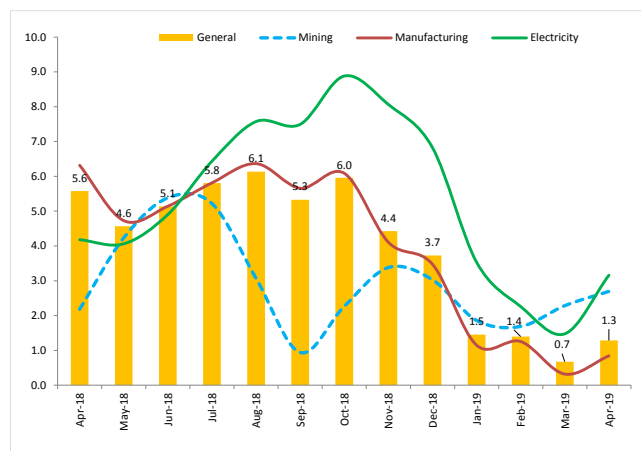


Source: SBI Research

CPI (weighted contribution)			
		Dec18-Aug18	May19-Jan19
Inflation Increased	Number of States	5	24
	Total weighted contribution(bps)	14	107
Inflation Declined	Number of States	23	4
	Total weighted contribution(bps)	162	8
Net Impact		-148	99
YoY Inflation Difference		(2.11-3.69)	(3.05-1.97)

Source: SBI Research

Graph 4: 3-month moving average IIP growth (%)



Source: SBI Research

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