Ecowrap

'Be the Bank of Choice for a Transforming India'

CPI NUMBERS IN LINE WITH MARKET EXPECTATIONS: OCTOBER RATE CUT A POSSIBILITY

Issue No. 31, FY20
Date: 13 August 2019

CPI inflation decreased marginally to 3.15% in Jul'19 as compared to 3.18% in Jun'18 and 4.17% a year ago. Despite the decline in overall CPI, the core CPI has shown an upward momentum to 4.28% in Jul'19 from the revised number of 4.14% in Jun'19 (old: 4.09%) , which mainly is due to the rise in prices of gold. We believe this is a temporary phenomenon and core inflation will ease going forward and converge towards headline CPI. When we look at the weighted contribution calculation of CPI numbers, it is visible that in the past months too the inflation number arrived at through weighted contribution is different from the printed headline number. Last month the difference was of 1 bps and this has swelled to 10 bps this month. If we go by the weighted contribution numbers then CPI is probably overstated by 10 bps. However, this is more or less a statistical artefact due to **aggregation problem**.

Meanwhile, industrial production has again disappointed by registering a growth of 2% in June'19 as against the previous month growth of 4.6% and year before growth of 7%. It has brought down the 3-months moving average growth to 3.6% as against the previous level of 3.9%.

Capital goods and consumer durables have acted as a drag with negative yearly growth during the month. This does not augur well for the domestic demand as in the absence of export led growth, it is the growth in these segments, which can drive up the GDP growth of the economy. The automobile sector slowdown is quite visible with Auto components/ spares and accessories and Two-wheelers (motorcycles/ scooters) among the highest negative contributors to IIP. India's exports growth moves in tandem with world exports growth. With world exports slowing down, Indian exports are also facing turbulence, which is also stunting the industrial growth. The global demand is as such suffering on account of the continued escalation in trade wars between US and China and Japan and South Korea. However, some hope has revived with the recent telecon between China and USA, the outcome of which is likely to be China not imposing 10% tariff on certain products effective 1 Sep. In this context the general trend among the central banks is to cut rates to support growth. Federal Reserve is expected to cut rates in response to evolving situation at least once more given that 2020 will be an election year in the US .

The RBI has already cut the Repo rate by 35 bps to 5.40% in its 3rd monetary Policy review and also decided to maintain the accommodative stance of monetary policy. It is a rate easing cycle across global central banks and the support required to the market to come back on the growth trajectory seems to be more pronounced than what was in 2008. The good part is that, we are seeing the transmission in India is happening quicker and by a larger magnitude than before. We also expect that more banks will take the initiative in coming days. In such a situation, we believe that RBI may not pause the rate cut cycle as of now, but the magnitude of rate cuts would depend on the GDP numbers.

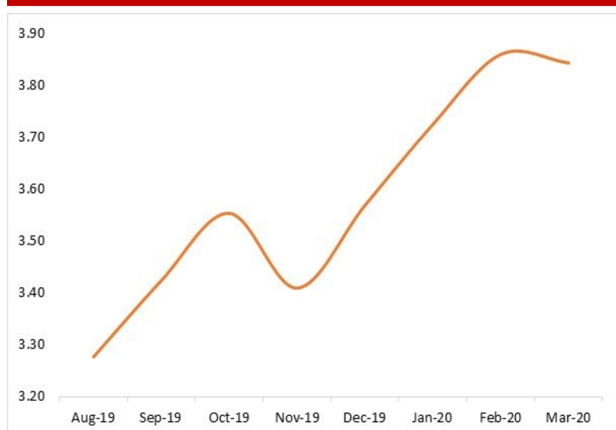
CPI INFLATION DECREASED MARGINALLY TO 3.15% IN JUL'19

- Overall CPI inflation declined to 3.15% in Jul'19, from 8-month high of 3.18% in Jun'18 and 4.17% a year ago. The marginal decline in inflation is due to ease in food prices. It had last shown a decline in Jan'19 and had been rising gradually ever since.
- Despite the decline in overall CPI, the core CPI has shown an upward momentum to 4.28% in Jul'19 from the revised number of 4.14% in Jun'19 (old: 4.09%) , which mainly due to the rise in prices of gold, housing etc. We believe this is a temporary phenomenon and the core inflation will ease going forward.
- 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 12 months now. We expect FY20 CPI to average at 3.4%.

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 11 bps. Overall the net impact was -151 bps. However, during the first 7 months this year (Jan'19-Jul'19) the trend is reversed in many states and the combined net impact on CPI has become positive at 95 bps.
- This reversal in trend is particularly on account of rising food inflation. For instance, in UP inflation declined by 22 bps during Aug'18-Dec'18, while it increased by around 18 bps this year during Jan'19-Jul'19.

CPI Inflation Trajectory (P)



Source: SBI Research

CPI (weighted contribution)			
		Dec'18 over Aug'18	Jul'19 over Jan'19
Inflation Increased	Number of States	5	21
	Total weighted contribution(bps)	11	101
Inflation Declined	Number of States	23	7
	Total weighted contribution(bps)	162	7
Net Impact		-151	95
YoY Inflation Difference		(2.11-3.69)	(3.18-1.97)

Source: SBI Research

LIQUIDITY

- Current liquidity as indicated by Net LAF operations of RBI is a surplus of Rs 1.60 lakh crore. It has remained in the surplus mode since the past 56 days with a daily average of Rs 1.00 lakh crore since 31 May'19 and an average for this fiscal at Rs 0.29 lakh crore. RBI's OMO purchase of Rs 27,500 crore in June, forex market operations, drawdown of excess CRR balances by banks and coming back of currency to the banking system have also supplemented system liquidity.

RATE CUT CYCLE TO CONTINUE

- The RBI had cut the Repo rate by 35 bps to 5.40% in its 3rd monetary Policy review and also decided to maintain the accommodative stance of monetary policy.
- It is a rate easing cycle across global central banks and the support required to the market to come back on the growth trajectory seems to be more pronounced than what was in 2008. The trade wars has impacted the global trade and domestic growth has also weakened in emerging economies.
- The good part is that, we are seeing the transmission happening quicker and by a larger magnitude than before. A look on the MCLR cuts announced by the major banks gives a picture rate transmission.
- In such a situation, we believe that RBI may not pause the rate cut cycle as of now, but would take a calculated move based on the inflation picture and growth parameters such as exports, IIP etc. a cut may not be ruled out but the magnitude would depend on the aforesaid indicators.

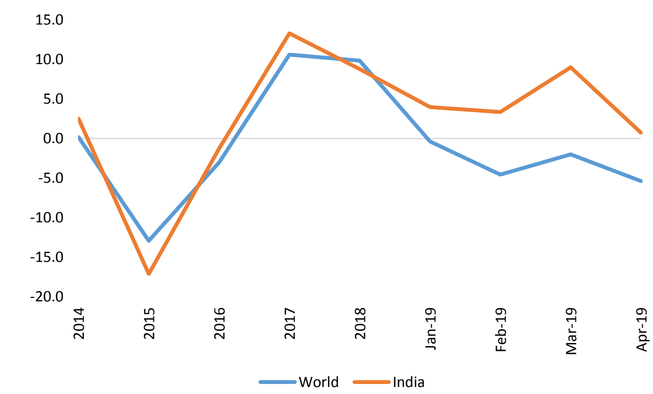
IIP GROWTH AT 4-MONTH LOW

- Industrial Production growth for Jun'19 slowed down to 2.0% y-o-y (May'19: 4.6%, Jun'18: 7.0% y-oy) dragging down the 3-month moving average to 3.6% from 3.9% previously. Compared to May'19, mining and manufacturing both decelerated, however electricity growth provided some support.
- As per the use-based classification, capital goods and consumer durables both acted as a drag with negative yearly growth during the month. This does not augur well for the domestic demand.
- The automobile sector slowdown is quite visible with Auto components/ spares and accessories and Two-wheelers (motorcycles/ scooters) among the highest negative contributors to IIP.
- Declining crude prices have also impacted IIP with diesel, which has 5% weight, contributing negatively by –0.5% to the overall IIP growth.

GLOBAL TURBULENCE & INDIA'S EXPORTS

- The escalation in trade wars between US and China and Japan and South Korea have further clouded the growth outlook. The fall in demand for oil indicates that sentiment factored in by market participants. In this context the general trend among the central banks is to cut rates to support growth. Federal Reserve is expected to cut rates in response to evolving situation at least once more given that 2020 will be an election year in the US .
- India's exports growth moves in tandem with world exports growth. With world exports slowing down, Indian exports are also facing turbulence. In June again Indian exports growth has turned negative and with lingering US-China trade spat, prospects for July also don't hold much promise.

Export Growth (% yoy)



Source: SBI Research

1Y MCLR of Select Banks (%)			
Public Sector Banks	Jan'19	Latest	Change (bps)
Bank of Baroda	8.65	8.45	-0.20
Canara Bank	8.70	8.50	-0.20
Punjab National Bank	8.50	8.30	-0.20
Union Bank of India	8.85	8.50	-0.35
Andhra Bank	8.75	8.45	-0.30
Allahabad Bank	8.75	8.40	-0.35
Bank of India	8.70	8.35	-0.35
State Bank of India	8.55	8.25	-0.30
Private Sector Banks			
HDFC Bank	8.75	8.60	-0.15
ICICI Bank	8.80	8.65	-0.15
Kotak Mahindra	9.00	8.85	-0.15
Yes Bank	9.85	9.70	-0.15
Axis Bank	8.85	8.65	-0.20
IDBI Bank	8.95	8.50	-0.45
Memo:			
RBI Repo	6.25% (Mar'19)	5.40% (Current)	**85 bps Reduction**
SBI RLLR	**8.50% (at the time of linking)**	**7.65% (as of 1st Sep'19)**	
Source: SBI Research			

Contact Details:

Dr. Soumya Kanti Ghosh
Group Chief Economic Adviser
State Bank of India, Corporate Centre
M C Road, Nariman Point
Mumbai - 400021
Email: soumya.ghosh@sbi.co.in
gcea.erd@sbi.co.in
Phone:022-22742440