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CSO PROVIDES DATA PUZZLE: INFLATION AND GROWTH ARE IN COMPLETE VARIANCE

CPI inflation eased to almost 18-month low to 2.19% (SBI: 1.97%) in Dec'18 mostly by deflation in food and beverages prices. Strangely, and that defies all logical explanations, Core CPI inflation increased to 5.73% in Dec18 due to huge jump in health (9.0%) and education (8.4%) inflation. The most puzzling aspect of the inflation data is the increase in rural health and education inflation at the time when rural demand is collapsing. A deep analysis of this completely contrarian behavior is warranted, however, as of now it seems that it could be a combination of methodological changes in data collection and implementation of Aayushman Bharat Scheme which might have led to an upgradation of health services at least in rural areas. However, even then the jump in healthcare costs is happening mostly because of jump in medicine costs from non-institutional sources, that begs explanation. Another baffling aspect is the jump in education inflation in rural areas. Clearly, the CSO should clarify the doubts of such a significant increase in service costs in rural areas since October 2018. Is it a data error? We don't know yet.

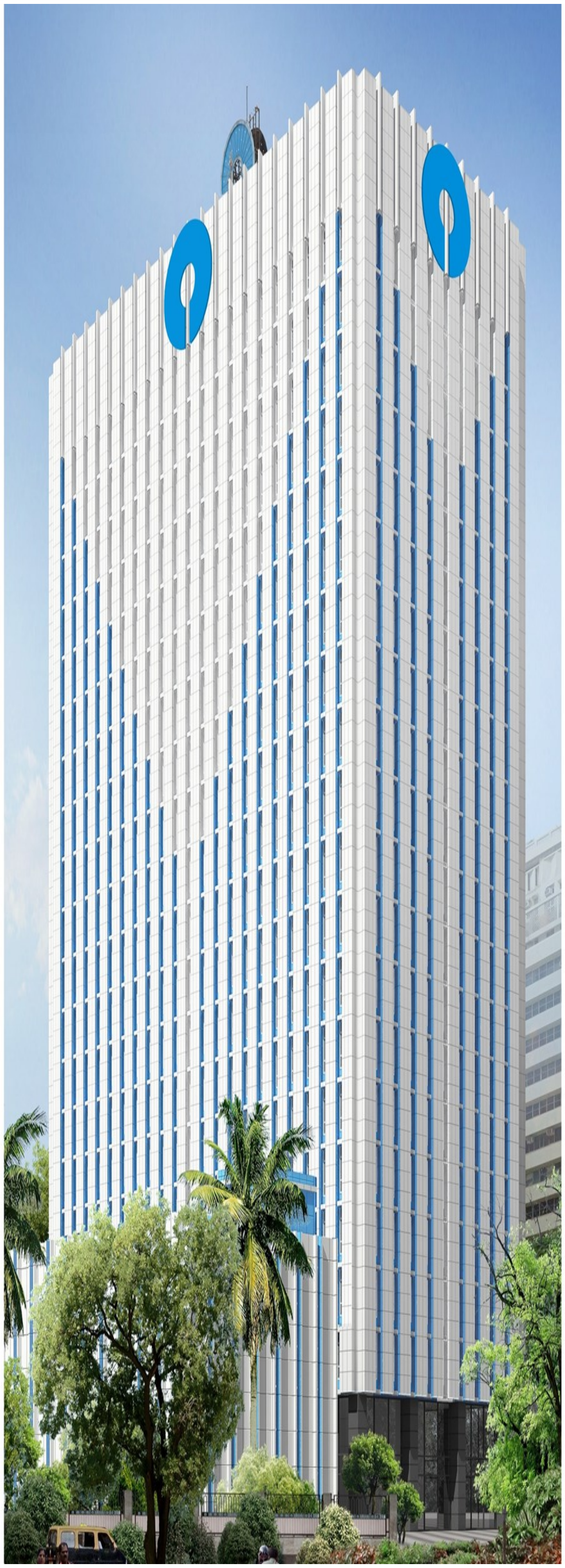
In a similar vein, it is perplexing that the wholesale market (in Mandi) prices are declining but that is not translating one-to-one in retail market. We don't have an answer yet.

Rural demand continues to remain weak. We believe Niti Aayog should have taken an active role in both procurement and facilitating Land Leasing Act for betterment of rural sector.

Reconciling this data with the CSO numbers on growth looks an onerous task indeed. In fact, the demand story for the second half of FY19, with Q3 GDP growth at 6.7% and Q4 GDP growth at 6.9%, is not looking very promising if we look at some of the leading indicators' data. Total quarterly Automobile sales growth has been slowing down with 23% y-o-y growth in Q4FY18 to 6.7% y-o-y growth in Q3FY19. The slow-down is broad-based with sub-components like passenger and medium and heavy commercial vehicles having in fact registered de-growth in the December quarter. The oil product consumption also is showing slow growth. From 9% y-o-y growth in Q4 FY18, all petroleum products consumption growth in volume terms, has come down to 1.8% in Q3 FY19.

The investment outlook as evinced by the public sector players' orders is also not very positive. Overall q-o-q there is de-growth of 13% in orders and contracts awarded, with electricity and water sectors showing maximum decline. Cement production which has been an indicator of construction activity has reached 12-month low of 8% in Nov'18 (y-o-y basis).

We now expect RBI to change stance in February, but will remain on a pause mode. The first cut might happen in April 2019, but it should be a shallow rate cut cycle.



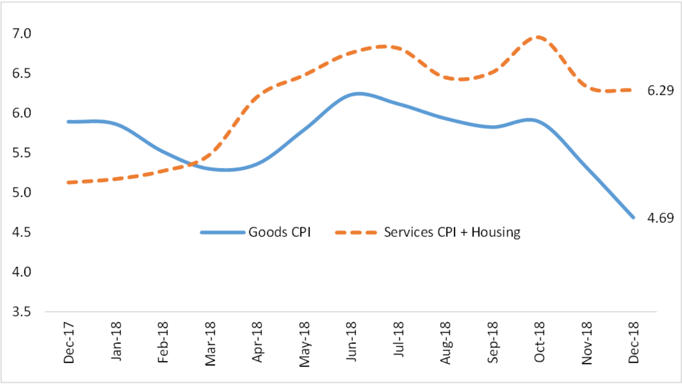
CPI INFLATION EASED TO ALMOST 18-MONTH LOW AT 2.19% IN DEC'18

- CPI inflation eased to almost 18-month low to 2.19% (SBI: 1.97%) in Dec'18 mostly by deflation in Pulses and products (-7.1%) and Vegetables (-16.1%), Sugar and Confectionery (-9.2%) and Eggs (-4.3%). Fuel and light inflation also moderated to 4.5% due to deceleration in crude oil prices in Dec compared to Nov. Core CPI inflation increased to 5.73% in Dec18 due to huge jump in health (9.0%) and education (8.4%) inflation, which is quite puzzling.
- The most puzzling aspect of the inflation data is the increase in rural health and education inflation at the time when rural demand is collapsing. A deep analysis of this completely contrarian behavior is warranted, however, as of now it seems that it could be a combination of methodological changes in data collection and implementation of Aayushman Bharat Scheme which might have led to an upgradation of health services at least in rural areas. However, even then the jump in healthcare costs is happening mostly because of a jump in medicine costs from non-institutional sources, that begs explanation. Another baffling aspect is the jump in education inflation in rural areas. Clearly, the CSO should clear the doubts of such a significant increase in service costs in rural areas since October 2018. Is it a data error? We don't know yet.

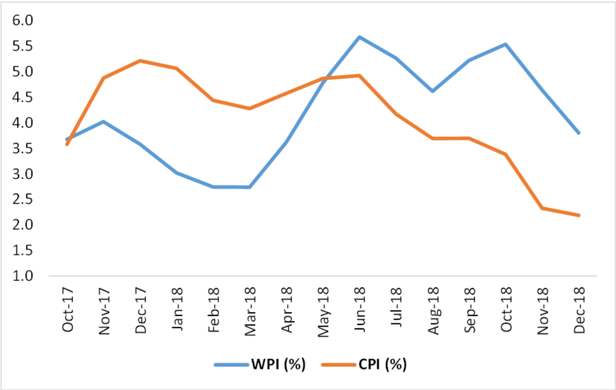
SERVICES INFLATION RISES FASTER THAN GOODS INFLATION

- When analyzing economic activities, it is common to distinguish between services and goods. Globally, the services inflation is higher than the goods inflation and in India the gap is also diverging recently. The services CPI+ housing (weightage 30.69) is continuously rising from Mar'18 and remained above the goods CPI and they have a difference of 160bps in Dec'18. Similarly, if we look at only services CPI, the story remain the same and they are diverging from each other. The gap between goods and services CPI is continuously increasing and it reached to 212bps.
- The increase in service inflation dynamics indicates that the relation between inflation and output gap does not seem sacrosanct in Indian context and hence the arguments of output gap almost closed needs to be validated.

Movement CPI Inflation: Goods vs Services



Diversion between CPI & WPI (%)



Source: SBI Research

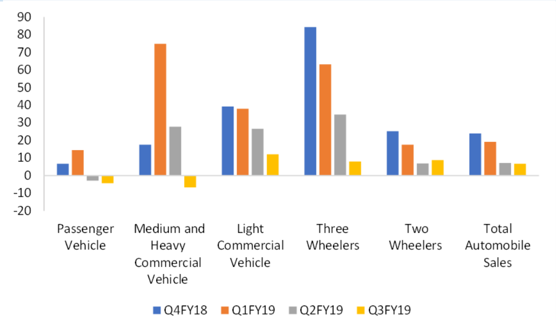
DIVERGENCE BETWEEN CPI & WPI

- In the recent period, both WPI and CPI moved in tandem till Oct'17. After that there was huge divergence between two series and in Jan'18 diversion was as large as 205 bps. Though in May'18, the gap plunged to only 9 bps. Post May'18 again divergence is gaining momentum and in DEc'18 the gap between CPI and WPI was 161 bps.
- One of the possible reason for this diversion is the market imperfection. In the wholesale market (in Mandi) prices are declining but that is not translating one-to-one in retail market. The decline in wholesale market is more sharp than the retail market. This imperfection needs to be corrected.

GROWTH REMAINS SIGNIFICANTLY MUTED

- The demand story for the second half of FY19, with Q3 GDP growth at 6.7% and Q4 GDP growth at 6.9%, is not looking very promising if we look at some of the leading indicators' data. Total quarterly automobile sales growth has been slowing down with 23% y-o-y growth in Q4FY18 to 6.7% y-o-y growth in Q3FY19. The slow-down is broad-based with sub-components like passenger and medium and heavy commercial vehicles having in fact registered de-growth in the December quarter.
- The oil product consumption also is showing slow growth. From 9% y-o-y growth in Q4 FY18, all petroleum products consumption growth in volume terms, has come down to 1.8% in Q3 FY19.
- The GDP data also corroborates the story of slowing private consumption expenditure growth, with H2FY19 PFCE coming in at 5.2% vis-à-vis H1FY19 growth of 7.8%. Government consumption expenditure growth is also expected to be lower.

Automobile Sales Growth (% Y-o-Y)



Source: SIAM, SBI Research

Growth Rate of Expenditures of GDP In FY19 (YoY%)		
	H1	H2 (P)
Private Final Consumption Expenditure	7.8	**5.2**
Government Final Consumption Expenditure	10.1	8.1
Gross Fixed Capital Formation	11.3	13.0
Change in Stocks	6.1	5.5
Valuables	5.3	10.3
Exports	13.1	11.1
Less Imports	19.0	9.7
GDP At Market Price	**7.6**	**6.8**

Source: MOSPI, SBI Research,P: CSO Advance Estimate

- The investment outlook as evinced by the public sector players' orders and contracts awarded data is also not very positive. Overall q-o-q there is de-growth of 13% in orders and contracts awarded, with electricity and water sectors showing maximum decline.

Orders and Contracts Awarded during Q1, Q2 and Q3FY19								
Major Sector	Q1FY19		Q2FY19		Q3FY19		Growth (%) over Q2	
	Projects	Amount	Projects	Amount	Projects	Amount	Projects	Amount
Manufacturing	108	2,502	69	5,146	59	10,881	(14)	111
Mining	10	3,443	17	805	15	1,497	(12)	86
Electricity & Non Conventional Energy	93	8,158	70	9,432	52	4,302	(26)	(54)
Water & Sewerage Pipeline & Distribution	121	3,060	101	6,532	47	3,352	(53)	(49)
Roadways	641	27,778	837	43,155	430	28,627	(49)	(34)
Railways	58	3,059	54	5,446	69	8,382	28	54
Airways (Aviation Infrastructure)	25	1,820	38	6,693	29	3,591	(24)	(46)
Shipping Infrastructure	10	1,825	9	269	5	2,438	(44)	806
Power Distribution	90	13,515	49	969	48	3,769	(2)	289
Real Estate	68	18,527	57	1,606	53	4,852	(7)	202
Irrigation	53	13,839	59	7,043	27	4,709	(54)	(33)
All Sectors	1,642	110,464	1,595	105,527	**1,071**	**92,104**	**(33)**	**(13)**

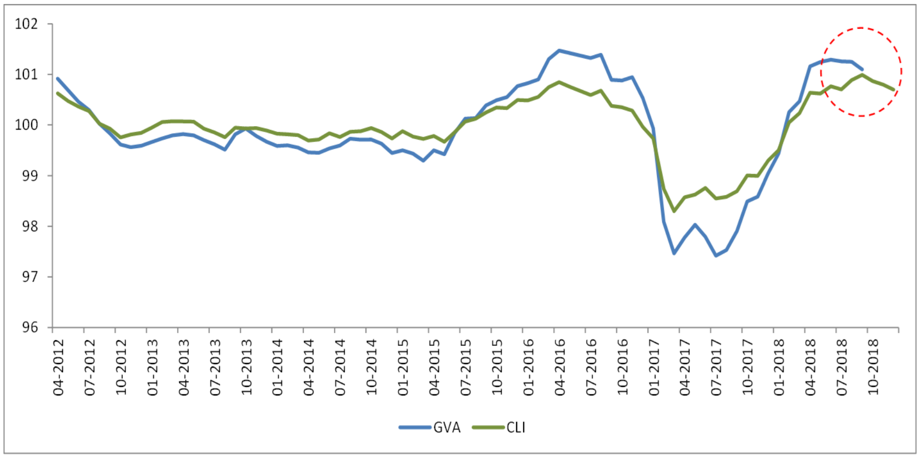
Source: Projects Today; SBI Research, figures in paranthesis indicate negative

- The PM-AASHA scheme, aimed to ensure fair prices to farmers, has also not led to increased procurement. Touted as key to lifting rural sentiments with improved procurement prices, the scheme performance is lack-lustre, forcing the Government to think of other ways to help farmers.
- With respect to lessee cultivators (tenant farmers), the NITI AAYOG had formulated Model Agricultural Land Leasing Act, 2016 to provide a legal and institutional framework for legalisation of agricultural land leasing. This is with a view to facilitate financial institutions to advance agricultural loans to lessee cultivators. Following NITI AAYOG's Model Act, Uttarakhand and Uttar Pradesh have legalised land leasing. However, the overall performance is lackluster and there are not many takers for the scheme.
- We believe Niti Aayog should have taken an active role in both procurement and facilitating Land Leasing Act.

COMPOSITE LEADING INDICATOR IS SHOWING A DECLINING TREND

- Our Composite Leading Indicator (CLI) is signaling that the economic activity for Q3 FY19 has slowed down and the GDP growth to be below 7% in H2FY19 Our CLI Index (a basket of 32 leading indicators) based on monthly data to find out the early signals of turning-points in economic activity is showing a downturn.
- Passenger vehicle sales growth which is an indicator of urban demand has slowed down and sales of Commercial vehicle has also slowed down significantly in Nov'18. Domestic air passenger traffic – another indicator of urban demand – has also shown a declining trend in Nov'18.
- Cement production, an indicator of construction activity, has reached a 12 month low of 8% in Nov'18 (y-o-y basis) from previous month of 18%. Besides, IIP Manufacturing activity which has shown de-growth of 0.4% in Nov'18 further reveals that both consumption and investment demand has slowed down in the economy.

CLI vis-a-vis GVA



Source: SBI Research

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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!

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