

‘Be the Bank of Choice for a Transforming India’

FEBRUARY 12, 2019
ISSUE NO:87, FY19

INFLATION DOWNTURN SURPRISES THE MARKET: APRIL RATE CUT MIGHT BE OF LARGER MAGNITUDE

CPI inflation unexpectedly eased to 19-month low to 2.05% in Jan'19. We are surprised that such continued decline in food prices have been missed in inflation forecasts and even MPC continues to flag non-existent inflation risks.

Consider this statement by Pami Dua in Dec'18 MPC committee meeting when everybody was aware that MSP prices have completely failed to lift market prices, but this was still flagged as a risk! *"Upside risks associated with an increase in minimum support prices (MSPs) still persist.In sum, while inflation has softened, upside risks to inflation remain."*

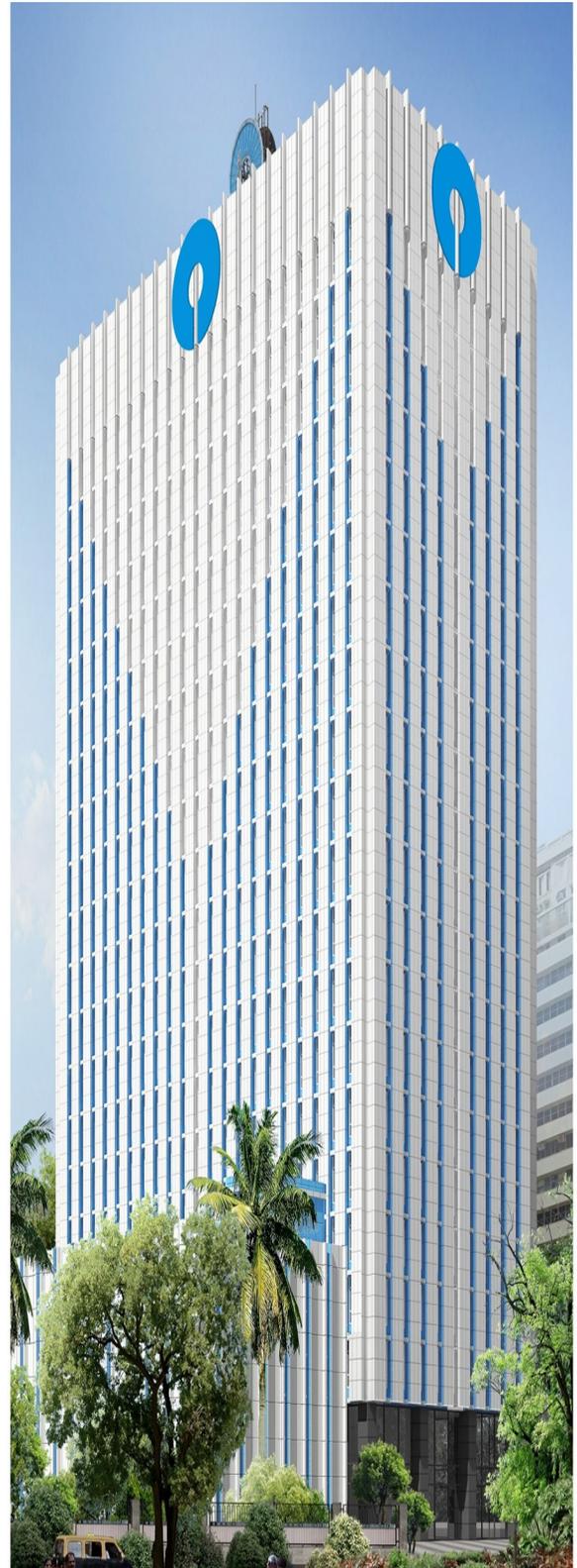
We believe time has now come to meaningfully analyse the continued decline in food prices. Interestingly recent data released by CSO shows that % share of food expenditure in total consumption expenditure is at 30% down from 40% in FY05.

The other good thing is that Health and Education Inflation softened significantly in Jan'19, specifically the Rural components. Rural Core has now declined to 5.87% in Jan'19 from a downwardly revised 6.20% (previous 6.34%) in Dec'18! Urban Core continues to decline and has now slipped below 4.95%. Overall Core is now at 5.38%. **We expect February Core to drop decisively below 5%**, if Health and Education gain do not show an aberration again!

Interestingly, **any outlier movement in Rural Core CPI beyond Jan'19 would mean a decisive structural break / data issues! If this does not happen, then CSO possibly made a data error!**

Looking at the global practices, the timing of CPI release of some major countries is before noon, which is the most important factor in deciding the key policy rate by central bank. Even the RBI has now decided to announce the MPC's policy rate decision at 11:45 am instead of 2:30 pm previously. Hence there is no reason to stick to 5:30 pm deadline of data release fixed in 2013!

Meanwhile, we find that growth momentum is decisively slowing down. An indicator of such is the accretion in Current Account Deposits of Banks. **With inflation now set to be below 4% for most of 2019, a rate cut in April looks a certainty and it will now be a choice between a 25 or a 50 bp rate cut. Expect 10 year yields to open below 7.5% tomorrow!**



SO CSO ADMITS HEALTH AND EDUCATION INCREASE A DATA ABERRATION?

- ◆ CPI inflation unexpectedly eased to 19-month low to 2.05% in Jan'19 mostly by deflation in Pulses and Products (-5.5%) and Vegetables (-13.3%), Sugar and Confectionery (-8.2%) and Eggs (-2.4%). Fuel and light inflation also moderated significantly to 2.2% compared to 4.5% in Dec'18, though the crude oil prices increased marginally in Jan'19 compared to Dec'18. Core CPI inflation moderated to 5.38% in Jan'19 from 5.73% previous month due to decline in Clothing (2.93%), Personal Care (4.32%) and Housing (5.20%) inflation.
- ◆ We are surprised that such continued decline in food prices have been missed in inflation forecasts and even MPC continues to flag non existent inflation risks. **Consider this statement by Pami Dua in Dec'18 MPC committee meeting when everybody was aware that MSP prices have completely failed to lift market prices, but this was still flagged as a risk!** *"Upside risks associated with an increase in minimum support prices (MSPs) still persist. Risks due to an increase in state level HRAs and input prices also prevail. Thus, there is considerable uncertainty with respect to the inflation outlook and movements in both food inflation and crude oil prices have to be watched closely. In sum, while inflation has softened, upside risks to inflation remain."*
- ◆ **We believe time has now come to meaningfully analyse the continued decline in food prices. Interestingly recent data released by CSO shows that % share of food expenditure in total consumption expenditure is at 30% down from 40% in FY05.**
- ◆ The good thing is that Health and Education Inflation softened significantly in Jan'19, specifically the Rural components. We had observed that there was possibly a clear-cut case of data aberration in CPI-Rural (Health and Education Category) in the Dec'18 month data release. The CPI Rural Health having a M-o-M/ sequential average of 0.5% suddenly jumped to 3.43% in Oct'18 and 3.09% in Dec'18. The Oct and Dec numbers were way above the average + 3*standard deviation, indicating an occurrence probability of once in 333 months (27.7 years)! The January sequential numbers indicate a return to trend growth rates.
- ◆ Rural Core has now declined to 5.87% in Jan'19 from a downwardly revised 6.20% (previous 6.34%) in Dec'18! Urban Core continues to decline and has now slipped below 4.95%. Overall Core is now at 5.38%. **We expect February Core to drop decisively below 5%**, if Health and Education gain do not show an aberration, as has been the trend in alternate months.
- ◆ Interestingly, we need to observe this trend in Rural Core may be for one last time in February 19, as purely going by past Rural and Urban Core for maximum 4-5 months, and February is the fifth month taking September as the point of data aberration! **By this logic, any outlier movement in Rural core CPI beyond Jan'19 would mean a decisive structural break / data issues. We hope this does not happen! If such is true, CSO could have made a data aberration. Thankfully, this did not obfuscate policy choices and the RBI correctly cut the rate by 25 bps on Feb 7.**

M-o-M Change in Health and Education Inflation (%)								
	Apr-11 to Sep-18 (90 months)				Oct-18	Nov-18	Dec-18	Jan-19
	Max	Min	Average	Standard Deviation	Actual			
Rural CPI Health	1.37	-0.31	0.49	0.27	3.43	0.41	2.89	0.07
Rural CPI Education	2.55	-1.36	0.58	0.49	0.27	1.49	3.26	0.00
<i>Memo:</i>								
Urban CPI Health	1.57	0.09	0.46	0.24	0.37	0.44	0.37	0.36
Urban CPI Education	2.35	-0.33	0.56	0.62	0.21	0.41	0.27	0.07

Source: SBI Research

CURRENT ACCOUNT DEPOSITS OF BANKS DECLINING

- ◆ The ASCB data for the fortnight ended 18 Jan'2019 indicates that on YTD basis, Aggregate deposits grew by 4.9% or Rs 5604 billion (2.1% or Rs 2203 billion last year) and Advances by 8.2% or Rs 7062 billion (4.2% or Rs 3279 billion). **This is the second consecutive fortnight when the credit growth has declined.**
- ◆ The worrying thing is that **out of the YTD aggregate deposits growth of 4.9% or Rs 5604 bn, time deposits (TD) grew by Rs 7134 bn (7.1%) but Demand (current and savings A/cs) deposits (DD) declined by Rs 1531 bn (-11.2%), and this was primarily due to marginal growth in current account deposits.** The Bank wise current accounts deposits growth YoY are given in the adjacent table.

NEED TO CHANGE DATA RELEASE TIMINGS

- ◆ India has always been a pioneer in adopting international best practices in each and every sphere of policy making, governance and regulation. However, in one key area, i.e., CPI and IIP Data release, we were erstwhile following the best practices which were abandoned in 2013.
- ◆ Till June 2013, the key macro indicators data like CPI, IIP, WPI and GDP were released by 12 noon, the practice followed by various developed and developing economies. However, in July 2013 the then Government took the decision to release the key macro data (except WPI) at 5:30 pm, which was apparently done to prevent any knee-jerk reaction to unfavourable data prints at that time.
- ◆ During Jan-Jun 2013, Rupee was too volatile and it was depreciating rapidly from as low as Rs 53 per dollar to as high as Rs 61 per dollar. During the same period, CPI was hovering in the range of 8-10%. Now the situation has changed and market is much more stable. The most important thing is that the RBI's targeted CPI inflation is now below 3%. Further, the markets always predict the data much before by various polls and adjust accordingly. So, the negative data doesn't affect the markets significantly.
- ◆ Looking at the global practices, the timing of CPI release of some major countries we find that almost all countries (except Russia) release the CPI data before noon, which is the most important factor in deciding the key policy rate by central bank.
- ◆ **Even the RBI has now decided to announce the MPC's policy rate decision at 11:45 am instead of 2:30 pm previously. We believe this is the right time that Government should withdraw the 5-year old decision and release all the key macro-economic indicators data before noon (say 11.00 am), as per the international practices. This will also increase Government's transparency in public disclosure.**

Growth in Current A/c Deposits of Selected Banks	
Name of Banks	Dec'18 over Dec'17 (YoY)
Allahabad Bank	-3.13%
Bank of Baroda	2.56%
Canara Bank	6.27%
HDFC Bank	10.48%
IDBI Bank	-8.08%
Indian Overseas Bank	-1.20%
IndusInd Bank Ltd	30.22%
Jammu and Kashmir Bank	32.22%
Kotak Mahindra Bank Ltd	22.44%
Oriental Bank of Commerce	-7.72%
South Indian Bank Ltd	11.38%
State Bank of India	-1.35%
Syndicate Bank	-9.14%
Union Bank of India	-11.54%
Axis Bank	19.41%
Total (15 Banks)	5.32%

Source: CLine; SBI Research

CPI Release Time	
Country	Local Time
Germany	8:00 AM
US	8:30 AM
Japan	8:30 AM
Canada	8:30 AM
France	8:45 AM
Spain	9:00 AM
UK	9:30 AM
China	9:30 AM
South Africa	10:00 AM
Brazil	10:00 AM
Australia	11:00 AM
Italy	11:00 AM
Russia	4:00 PM
India	5:30 PM

Source: SBI Research

IIP GREW 2.4% IN DEC'18

- ◆ IIP grew by 2.45% in Dec'18, compared to 0.3% in Nov'18 and 7.3% growth in Dec'17. Electricity and Manufacturing grew by 4.4% and 2.7%, respectively. Mining showed degrowth of 0.1%. During Apr-Dec'18, IIP grew by 4.6% compared to last year growth of 3.7%. As per Use-Based classification, Primary goods, Capital goods, intermediate goods declined by -1.2%, 5.9% and -1.5%, while Infrastructure/ Construction Goods increased by 10.1%.
- ◆ In terms of industries, 13 out of the 23 industry groups in the manufacturing sector have shown positive growth during the month of Dec'18. The industry group Manufacture of tobacco products has shown the highest positive growth of 27.9% followed by 17.9% in Manufacture of other transport equipment and 16.5% in Manufacture of wearing apparel. On the other hand, the industry group Manufacture of furniture has shown the highest negative growth of -18.7% followed by -16.4% in Other manufacturing and -5.4% in Manufacture of coke and refined petroleum products.
- ◆ RBI has recently released the results of the Dec'18 round of the Consumer Confidence Survey (CCS) which indicates that pessimism on the general economic situation in the last few rounds seems to have been arrested in the current round and the outlook for the year ahead is optimistic than before.

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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CONTACT DETAILS

Dr. Soumya Kanti Ghosh

Group Chief Economic Adviser
State Bank of India
Corporate Centre
Madam Cama Road
Nariman Point
Mumbai - 400021

Email: soumya.ghosh@sbi.co.in
gcea.erd@sbi.co.in

Phone: 022-22742440

 : [@kantisoumya](https://twitter.com/kantisoumya)