

14 July 2014

Inflation

WPI well below the glide path

WPI inflation softened to 5.4% in Jun'14, with core WPI slowing below the 4% mark. Though food and fuel led to the deceleration, manufactured-product inflation inched up in Jun'14. With monsoon currently remaining 43% below normal, the rate-cut-cycle may not start before 2015, against our expectations of Oct'14.

Performance. WPI inflation softened to 5.4% in Jun'14 from 6.0% in the previous month. The softening has been in primary-product inflation (6.8 % in Jun'14 vs 8.6% in May'14) and fuel & power (9.0% vs 10.5%). Manufactured products inflation, on the other hand, continued to rise (3.6% in Jun'14 vs 3.5% in May'14). Among manufactured products, inflation has been high in textiles and basic metals. Core inflation has fallen marginally to 3.9%. Non-core inflation (food and fuel) has also slid to 7.2%. Inflation for Apr'14 has been revised upward to 5.6% from 5.2%.

Assessment. The slowdown in inflation has once again been driven by food and fuel. Inflation in potatoes (among vegetables) was 43% and 21% in fruits. Also, animal-protein products such as fish and milk remain high. There has been a broad-based softening in fuel and power, with electricity inflation unchanged at 12%. The nearly flat core WPI indicates pass-through of elevated non-core into core inflation. The continued divergence between WPI and CPI is likely because of changes in wholesale and retail margins.

Outlook. Our analysis suggests that from the high inflationary path during FY10-14, India is structurally moving towards a low inflationary situation. A serious monsoon deficiency, coupled with high global oil prices, could however slow down this transition. While poor monsoon could increase food prices because of lower supply, demand destruction/deferral would lower manufactured goods inflation. Electricity inflation, which is still elevated, could fall below 10% due to the announced cut in electricity prices by several states. The spillover of high non-core into core inflation is playing out. Given the base, WPI inflation could hover largely around 5-6% in the next 3-4 months.

Recommendations. From the perspective of monetary policy, CPI has replaced WPI as the key inflation indicator. Consequently, the CPI number is more crucial. We expect CPI to soften to 8.1% (Jun'14) later in the day today. With monsoon rainfall currently 43% below the long-period average (LPA) and 29 out of 36 meteorological divisions facing deficient or scanty rainfall, we expect the RBI to continue its wait-and-watch for the rest of 2014. A large impact of monsoon on prices may delay the rate-cut-cycle, which we expected to commence in Oct'14.

WPI Inflation (Jun'14): 5.4%

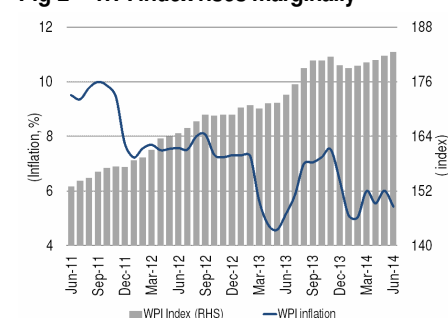
CPI RU Inflation (May'14): 8.3%

Fig 1 – WPI inflation slows in Jun'14

	Year-end		
	Mar-14	Jun-14	YTD
Wholesale Price Index	6.0	5.4	5.7
Primary Articles	9.8	6.8	7.5
Food	12.8	8.1	8.8
Fuel & Power	10.2	9.0	9.6
Mineral Oils	11.6	10.2	11.0
Manufactured Products	3.0	3.6	3.6
Food	3.2	2.3	2.5
	Year-end		
	Mar-14	May-14	YTD
Consumer price Rural-Urba	9.5	8.3	8.4
Food, etc.	11.1	9.3	9.5
Fuel and Light	7.4	5.1	5.5
Clothing, etc.	9.3	8.9	8.8
Housing	10.4	9.2	9.4
Medical Care	6.4	6.1	6.2
Transport etc.	7.0	7.0	6.6

Source: Government of India

Fig 2 – WPI index rises marginally



Source: Government of India (Gol)

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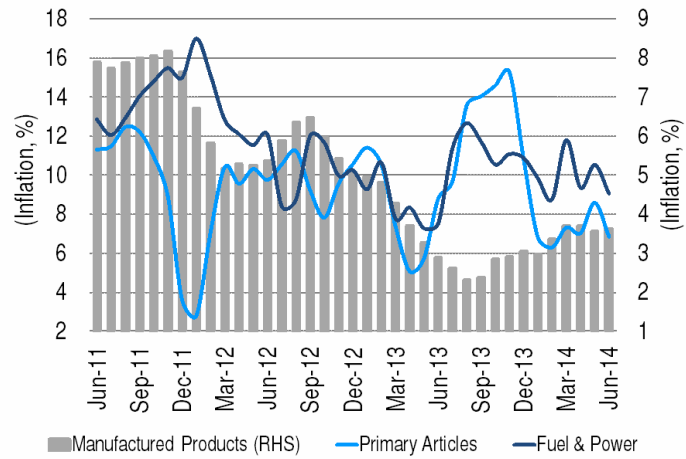
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Primary-product and fuel inflation reduced substantially in Jun'14; manufactured-product inflation has increased

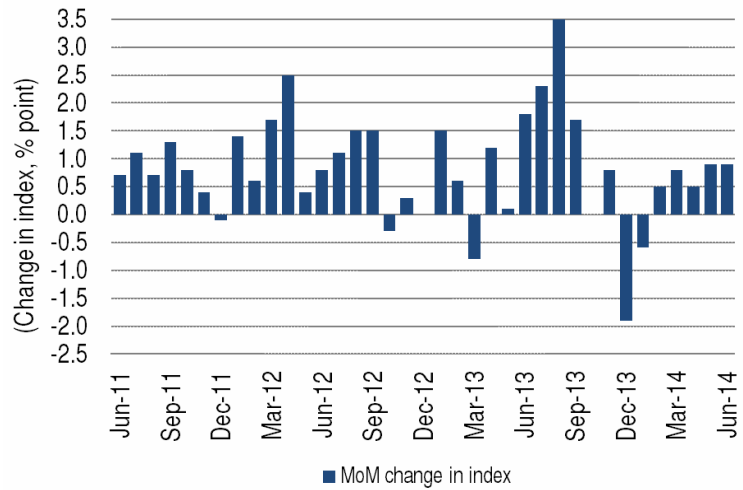
Fig 3 – Primary and fuel inflation slow down, manufactured goods rise



Source: Gol

Equal rise in MoM WPI inflation as last month

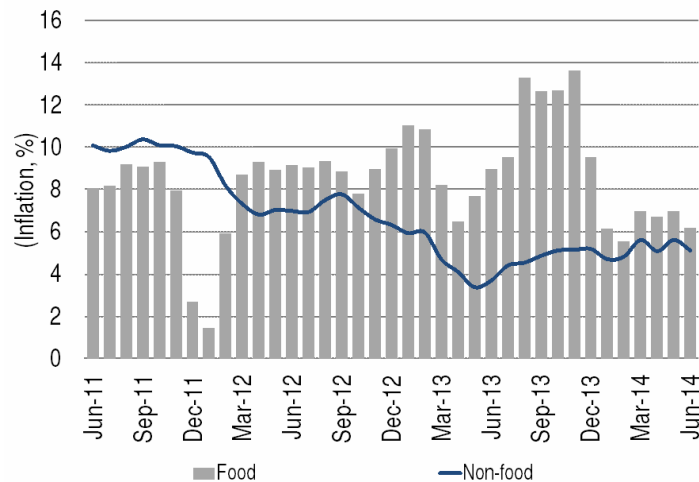
Fig 4 – Month-on-month rise in the WPI



Source: Gol

Between May'14 and Jun'14, food and non-food inflation dropped 80bps and 50bps respectively

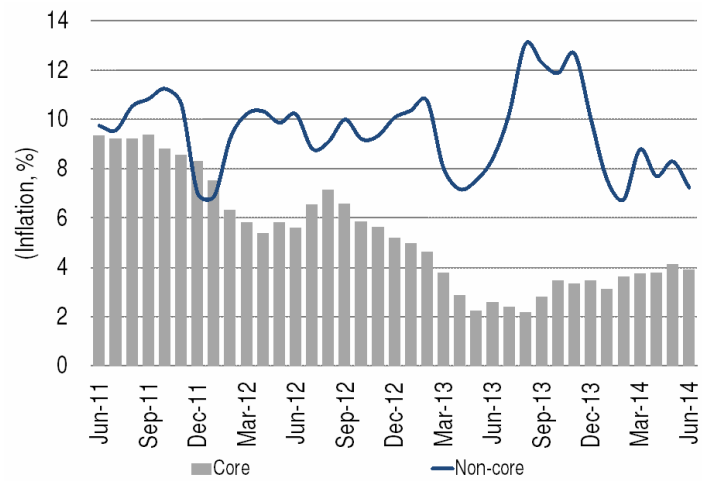
Fig 5 – Both food and non-food inflation softened in Jun'14



Source: Gol

In Jun'14, core WPI reverted to below 4%

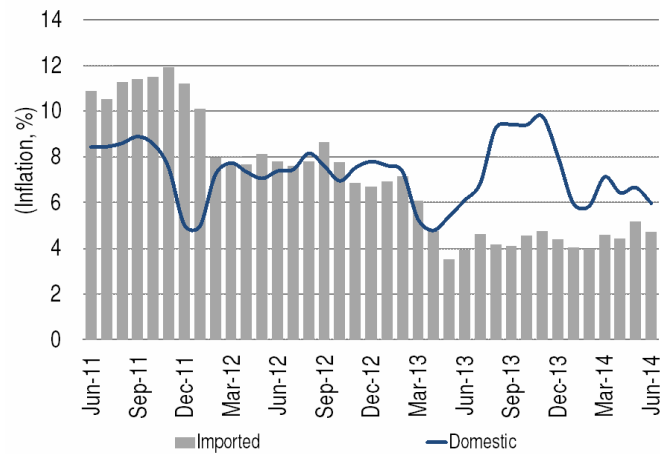
Fig 6 – Both non-core and core inflation fall



Source: GoI

Imported inflation fell below 5%, while domestic inflation slowed to a 4-month low

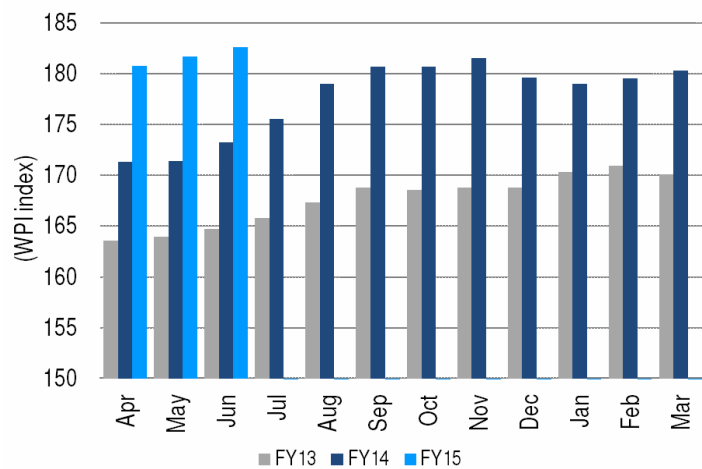
Fig 7 – Inflation slowdown in domestic and imported components



Source: GoI

WPI will get the benefit of a favourable base till Nov'14

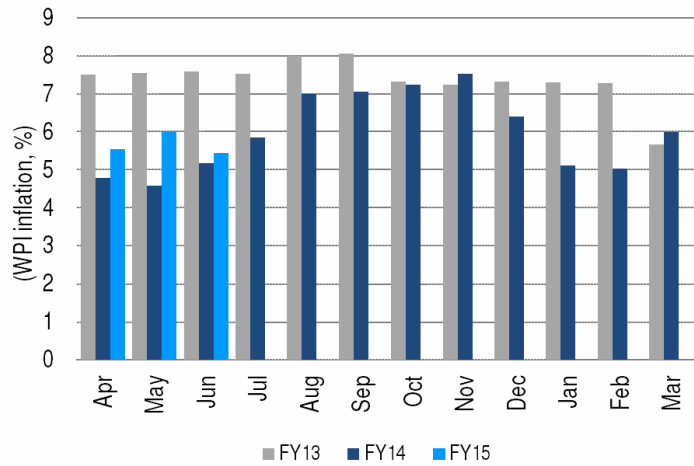
Fig 8 – Base effect likely to soften inflation for the next few months



Source: GoI

Rise in WPI inflation started from Jun'13, with higher base WPI inflation likely to soften in phases in the next six months

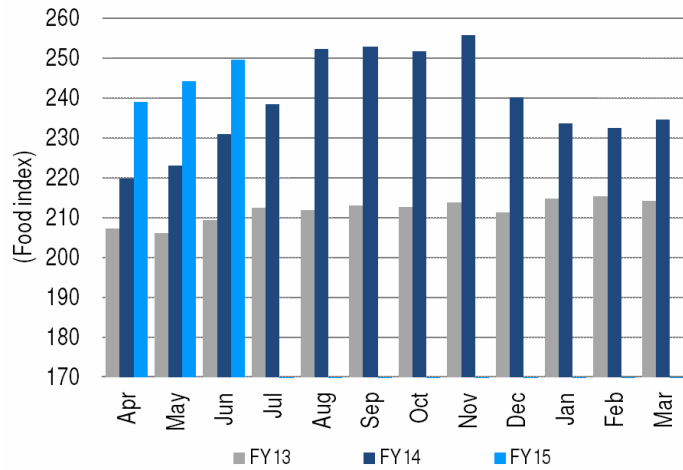
Fig 9– Jun'14 inflation near to Jun'13 inflation



Source: GoI

Despite some hardening since Mar'13, food index in Jun is still below the Aug-Nov'13 levels

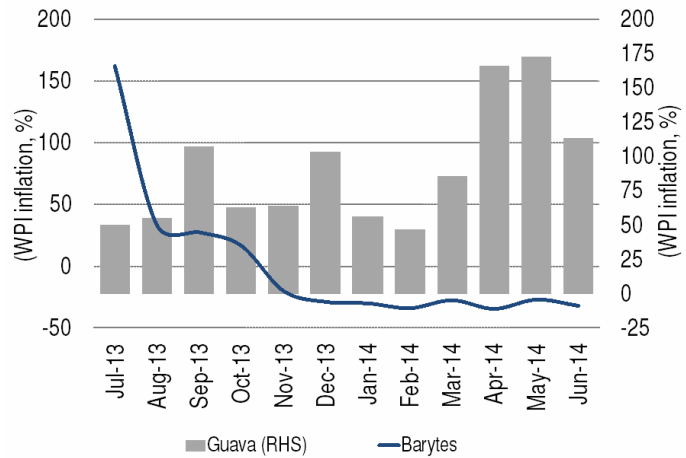
Fig 10– Food index rises consistently



Source: GoI

After onions and potatoes, now guavas show the highest inflation – 113% in Jun'14. By contrast, barytes prices went down 32% during the month

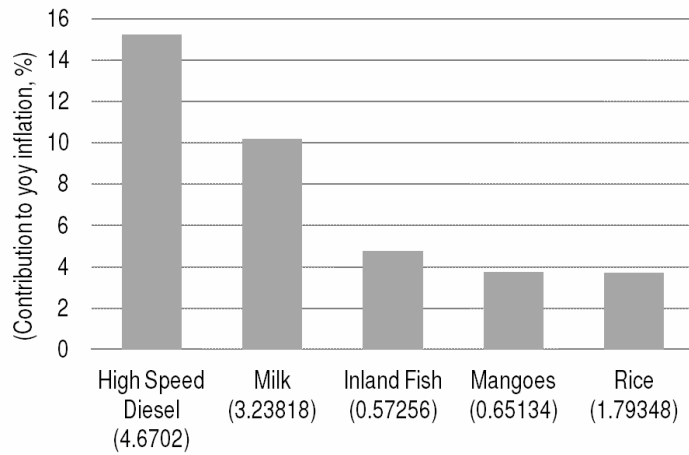
Fig 11 – Guava inflation at record high



Source: GoI

The highest contributor to yoy inflation was diesel, followed by milk and inland fish

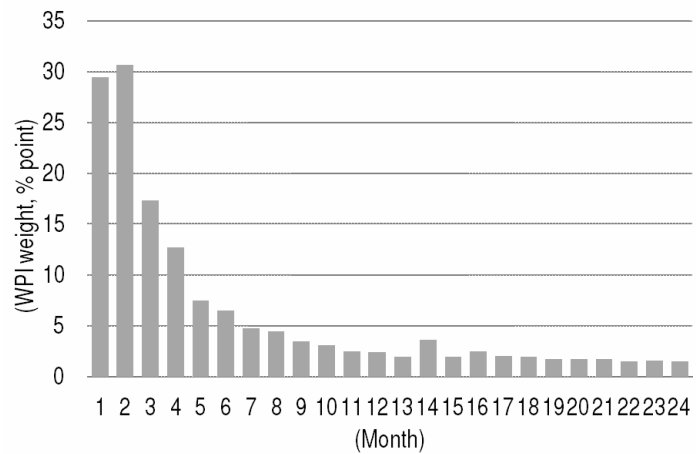
Fig 12 – 34% of yoy inflation was generated by products with 9% weight



Source: GoI

The standard of WPI data in terms of update frequency is not satisfactory, indicating a substitution risk of sharp data revision

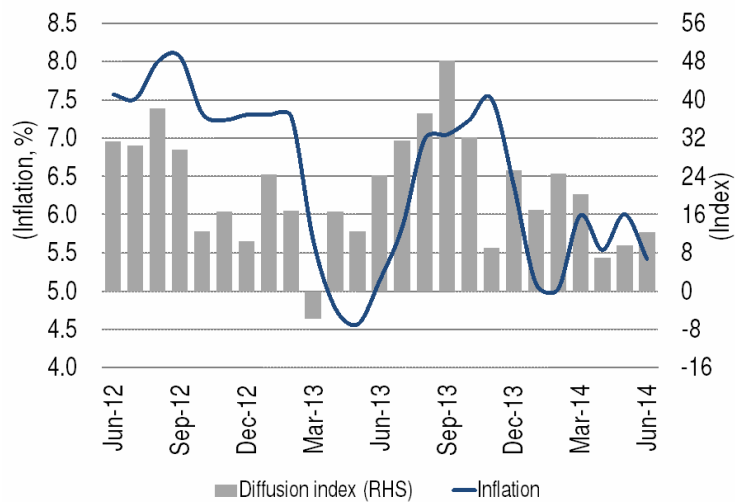
Fig 13 – Update on WPI figures not-so-satisfactory



Source: GoI

Disaggregated data suggest that prices of more products are going up than down, MoM

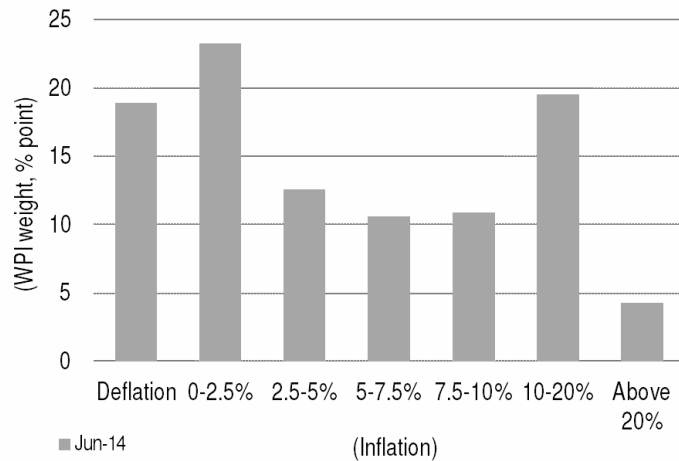
Fig 14 – Diffusion index suggests inflation is not-so-symmetric



Source: GoI

Within WPI, 23% items are facing inflation above 10%, pulling up the overall average; nearly 19% of other items are facing yoy price fall

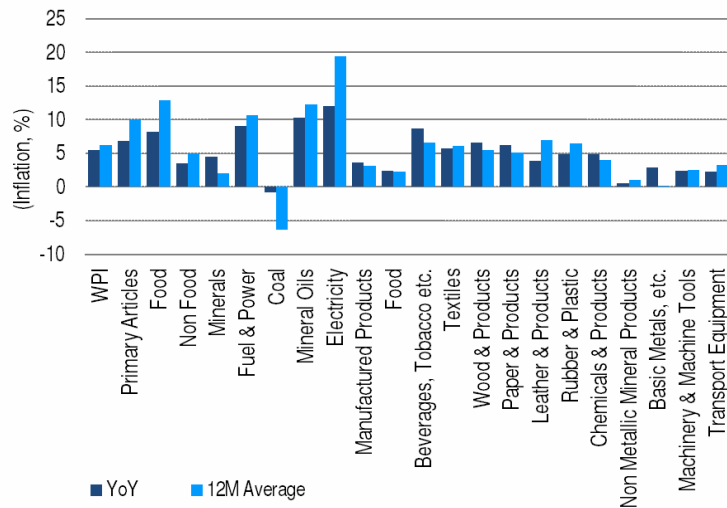
Fig 15 – Still, 23% of the products in WPI face above 10% inflation



Source: Gol

Mineral oil and electricity inflation still elevated

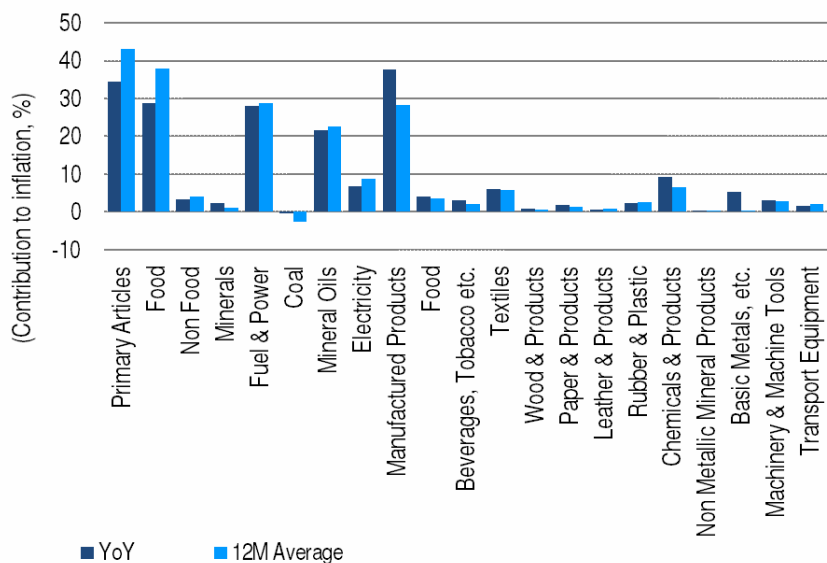
Fig 16 – Electricity, fuel and mineral oil inflation above 10%



Source: Gol

Food (primary) and fuel contributed nearly 60% to yoy and 70% of 12-month average inflation

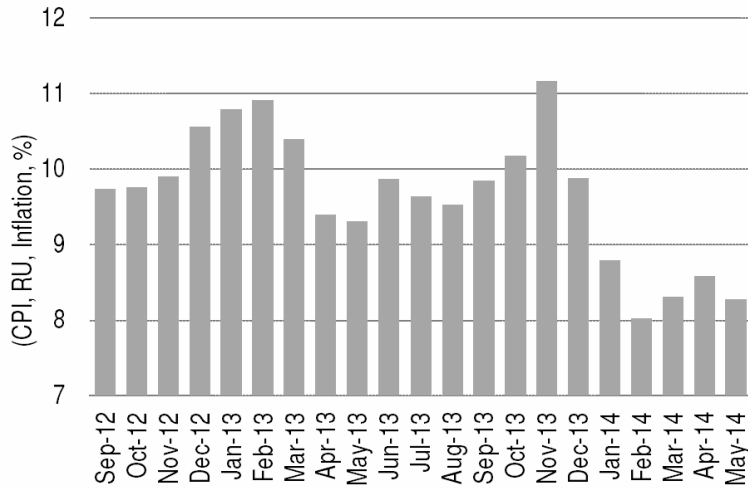
Fig 17 – 60% of yoy inflation still coming from food and fuel



Source: Gol

CPI inflation reversed the rising trend and softened in May'14, which contrasts with WPI inflation

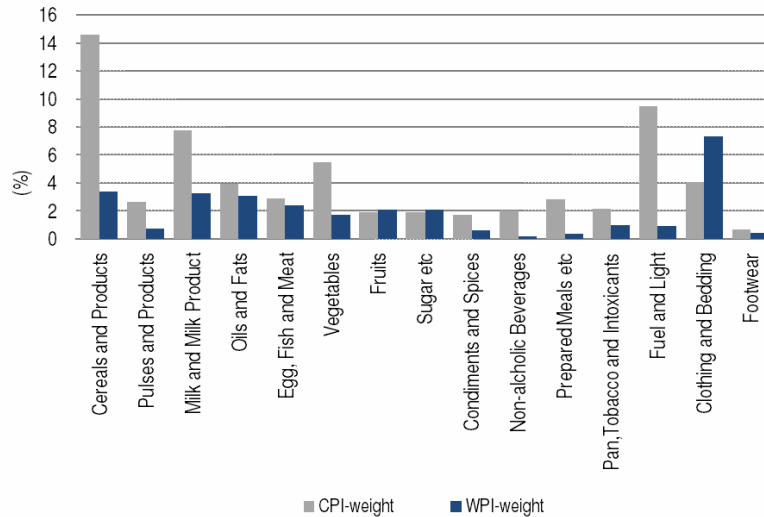
Fig 18 – CPI inflation decelerated in May'14



Source: GoI

Food and fuel account for 59% of CPI by weight, and just 22% of WPI. This, to a large extent, explains the large divergence between WPI and CPI in a situation of high food and fuel inflation and low manufactured-product inflation

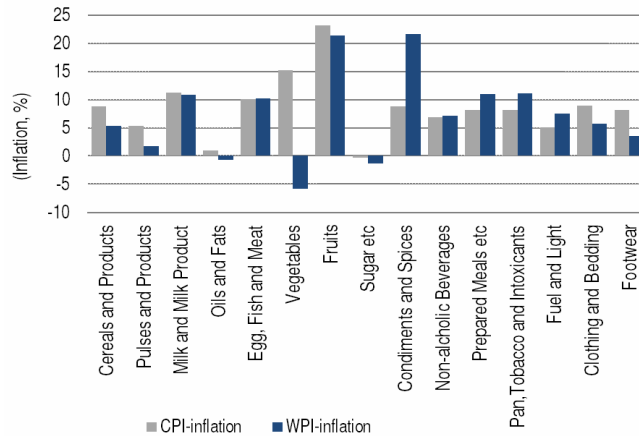
Fig 19 – Key reason for WPI-CPI divergence is weightings of food products



Source: GoI

WPI inflation higher than CPI-inflation for non-vegetarian items and spices

Fig 20 – CPI-WPI largely compatible at category-wise level



Source: GoI

FY14 is the third straight year of India being faced with high food and fuel inflation but falling manufactured-products inflation

Fig 21 – YTD WPI inflation at 5.7%

	Weights	Year ending				YTD
		Mar-13	Mar-14	May-14	Jun-14	
Wholesale Price Index	100.0	7.4	6.0	6.0	5.4	5.7
Primary Articles	20.1	9.8	9.8	8.6	6.8	7.5
Food	14.3	9.9	12.8	9.5	8.1	8.8
Non Food	4.3	10.5	5.6	4.9	3.5	4.0
Minerals	1.5	8.2	-0.1	8.8	4.4	5.3
Fuel & Power	14.9	10.3	10.2	10.5	9.0	9.6
Coal	2.1	9.2	-8.5	0.1	-0.9	-0.3
Mineral Oils	9.4	10.0	11.6	12.3	10.2	11.0
Electricity	3.5	12.9	22.2	12.0	12.0	12.0
Manufactured Products	65.0	5.4	3.0	3.5	3.6	3.6
Food	10.0	8.1	3.2	2.2	2.3	2.5
Beverages, Tobacco etc.	1.8	7.4	6.1	8.5	8.6	8.6
Textiles	7.3	2.2	5.8	5.2	5.7	5.8
Wood & Products	0.6	6.2	4.7	7.5	6.6	7.6
Paper & Products	2.0	3.5	4.6	6.5	6.2	6.4
Leather & Products	0.8	3.2	6.7	4.8	3.9	5.1
Rubber & Plastic	3.0	2.9	6.2	5.6	4.8	5.7
Chemicals & Products	12.0	6.6	3.6	4.8	4.9	4.8
Non Metallic Mineral Products	2.6	6.8	1.8	1.0	0.5	0.6
Basic Metals, etc.	10.7	6.3	-0.9	2.4	2.8	2.2
Machinery & Machine Tools	8.9	2.6	2.6	2.1	2.4	2.4
Transport Equipment	5.2	4.2	3.6	2.7	2.3	2.6

Source: GoI

Fig 22 – YTD CPI inflation below 10%

	Weights	Year ending				YTD
		Mar-14	Mar-14	Apr-14	May-14	
Consumer price Rural-Urban	100.00	9.5	8.3	8.6	8.3	8.4
Food, Beverages and Tobacco	49.71	11.1	9.2	9.6	9.3	9.5
Fuel and Light	9.49	7.4	6.3	5.9	5.1	5.5
Clothing, Bedding and Footwea	4.73	9.3	9.0	8.7	8.9	8.8
Housing	9.77	10.4	9.9	9.7	9.2	9.4
Education	3.35	8.2	8.6	8.1	7.6	7.9
Medical Care	5.69	6.4	6.6	6.3	6.1	6.2
Recreation and Amusement	1.43	6.1	6.3	6.0	5.6	5.8
Transport and Communication	7.57	7.0	5.9	6.2	7.0	6.6
Personal Care and Effects	2.92	6.5	6.7	6.5	6.4	6.4
Household Requisites	4.30	5.4	6.4	7.2	7.2	7.2
Others	1.06	11.3	10.9	10.9	10.2	10.5

Source: GoI

Services inflation in CPI elevated

Appendix

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