



ECOWRAP

WPI Inflation Plunges to 5-year low

The decline in WPI to 1.77% (SBI:1.65%) for Oct'14 will raise the clamour for a rate cut. We however maintain that RBI may go for the jugular in a decisive manner (50 basis point or so), but only after it is convinced that CPI downward trajectory is sustained and inflationary expectations are anchored decisively lower. This may happen materially only in Q1FY16. However, in an inflation targeting framework, with the Government having the goal independence (and RBI: instrument independence) is likely to set a CPI target more than 4% and this may then hasten the RBI action. We expect the Government may set the CPI target around 5% or so, with deviation of around 2% on either side. The logic of such actually follows from Patel Committee recommendations. The report points out that the level of CPI-combined inflation above which it is inimically harmful to growth is 6.2%. If we take this as the threshold rate of inflation and juxtapose this with a 4% CPI target, it implies that the recommendations may have a built-in bias of being deflationary. By this logic, the band could be built around a mean of 5% with the deviations centred around such a mean.

Meanwhile, after hovering in the negative territory for nearly 21-months, the real interest rate is now floating in the positive zone. If RBI leaves the rates unchanged in the coming policy review, the real rates would reach as high as 3.5% during Nov'14 by taking CPI as proxy and 7.2% if WPI is taken as proxy (for 1Y-3Y bucket). Interestingly it will led to a situation, where real interest rates will be higher than nominal interest rates for most banks in the deposit category of less than 1 year (upto 90days). This is way above the 0.5% (CPI) and 1.5% (WPI) real rate prevailing on a cross cyclical basis in India.

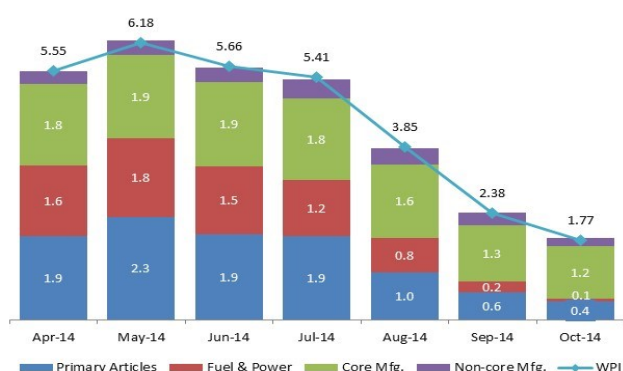
WPI Inflation Plunges to 5-year low of 1.77% in October 2014

- ◆ WPI inflation moderated to 61-month low of 1.77% (SBI Projection: 1.65%), in Oct'14 as against 2.38% growth in Sep'14 and 7.24% in Oct'13. The sharp moderation in inflation is due to favorable base effect, moderation in food prices, softening crude oil prices and weak growth. All segments of WPI declined in the month of Oct'14.
- ◆ Core WPI also declined to 2.55% in Oct'14 against 2.81% in Sep'14 and 2.86% in Oct'13. However, the Aug'14 inflation reading was revised up by 11 bps to 3.85%.
- ◆ Primary article prices, that mainly driving inflation for last couple of years have declined to nine year low of 1.43%. However, vegetable prices registered a negative annual growth of 19.6% in Oct'14.

Item	Oct-14
WPI	100
1. Primary Article	42
Food	32
2. Fuel & Power	48
3. Manufactured Products	10

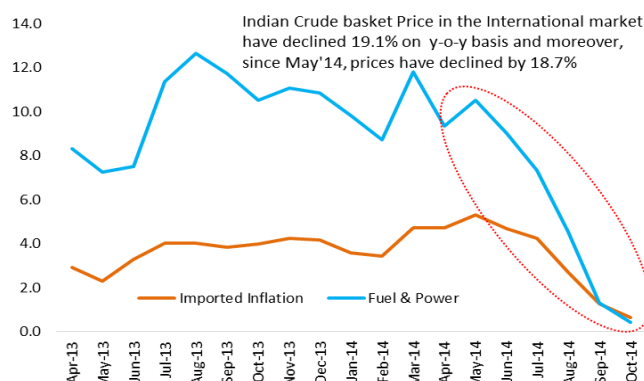
Source: SBI Research

Chart 1: WPI Inflation: Weighted Contribution



Source: RBI, EA Industry, SBI Research

Chart 2: Fuel Prices and Fuel Inflation



Source: RBI, EA Industry, SBI Research

- ◆ India imports nearly 80% of its crude requirement from abroad. Anemic demand in the international market have eased price pressure in the domestic economy. Indian crude basket prices in the international market have slipped drastically. On a y-o-y basis, price of Indian crude basket is down by 19.1% in Oct'13 and moreover, recent trend shows that the fall has got momentum in last couple of months as the prices since May'14 have declined by 18.7%.
- ◆ Fuel inflation, that was in double digit in May'14 (10.5%) have nosedived to reach five year low of 0.43% in Oct'14. Similar trend is also being seen in the imported inflation segment as it has fallen drastically from 5.33% in May'14 to 0.67% in Oct'14, lowest in last five years.

Higher Positive Real Interest Rate vs. Lower Nominal Deposit Rate

- ◆ Cooling domestic prices (both WPI and CPI) and higher nominal interest rate structure accompanied with credible monetary policy measures by the central bank in anchoring inflation expectations has led to positive real deposit rates in the economy.
- ◆ After hovering in the negative territory for nearly 21-months, the real interest rate is now floating in the positive zone. If RBI leaves the rates unchanged in the coming policy review, the real rates would reach as high as 3.5% during Nov'14 by taking CPI as proxy and 7.2% if WPI is taken as proxy (for 1Y-3Y bucket).
- ◆ Interestingly it will led to a situation, where real interest rates will be higher than nominal interest rates for most banks in the deposit category of less than 1 year (upto 90days). This is way above the 0.5% (CPI) and 1.5% (WPI) real rate prevailing on a cross cyclical basis in India.

Table 2: Retail Term Deposit Rates (%) Offered by Indian Banks Under Different Buckets

Bank	upto 45D	46D-90D	91D-179D	180D-1Y	1Y-3Y	3Y-5Y	5Y & above
Axis Bank	6.00	8.25	8.25	8.75	9.00	9.00	8.75
Bank of Baroda	4.50	6.50	7.30	8.25	9.05	9.05	9.05
Bank of India	4.50	6.50	7.30	8.25	9.05	9.05	9.05
Canara Bank	6.25	7.00	7.25	8.50	9.05	9.00	9.00
Central Bank	6.00	7.50	8.20	8.50	9.05	8.75	8.75
Corporation Bank	6.00	8.00	8.00	9.00	9.00	9.11	9.00
HDFC	6.00	8.25	8.25	8.75	9.00	8.75	8.25
ICICI	5.50	7.75	7.75	7.75	9.00	8.75	8.50
IDBI	6.00	8.00	8.00	9.00	9.05	9.00	9.10
Indian Overseas Bank	7.25	7.25	7.50	8.50	9.00	9.00	9.00
Oriental Bank of Commerce	6.00	8.00	8.50	8.50	9.00	8.75	8.75
Punjab National Bank	4.50	6.50	7.00	8.25	9.00	9.00	9.00
Union Bank of India	6.00	6.50	7.50	8.60	9.05	9.00	9.00
State Bank of India	5.00	7.00	7.00	7.50	8.75	8.75	8.50
Average nominal deposit rate	5.68	7.36	7.70	8.44	9.00	8.93	8.84
<i>October 2014 CPI: 5.52%, October 2014 WPI: 1.77%</i>							
Projected real deposit rate with WPI as proxy (figures in parentheses with CPI as proxy) in Nov'14	3.91 (0.16)	5.59 (1.84)	5.93 (2.18)	6.67 (2.92)	7.23 (3.48)	7.16 (3.41)	7.07 (3.32)
Source: SBI Research							

Going Forward

- ◆ The decline in WPI to 1.77% for Oct'14 will raise the clamor for a rate cut. We however maintain that RBI may go for the jugular in a decisive manner (50 basis point or so), but only after it is convinced that CPI downward trajectory is sustained and inflationary expectations are anchored decisively lower. This may happen materially only in Q1FY16.

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