

ECOWRAP

We told you so!

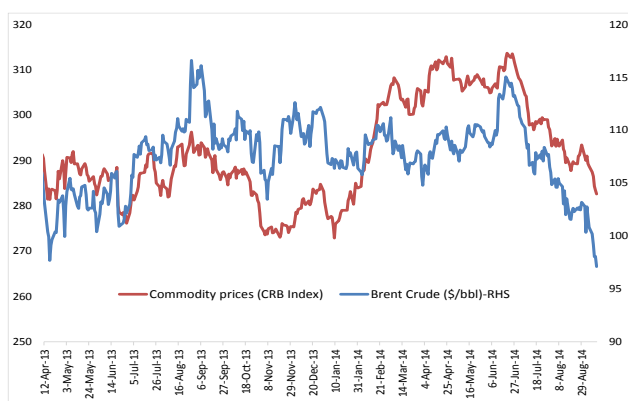


Inflation trajectory, particularly retail, is following the classical refrain "We told you so!". CPI inflation that came in at 7.8% in Aug'14 (SBI:7.83%), was entirely dictated by elevated food prices. The decline in WPI inflation at 3.74% (SBI:3.98%) was more than market expectations. Interestingly, significant softening of global commodity and fuel prices is expected to influence the WPI trajectory and we believe WPI could be at 4.5% by Mar'15 (our estimates show that around 70% of WPI basket is influenced by global price trends). CPI trajectory, though will be benign, but could be at 7.7% by Mar'15. The difference with WPI and CPI food is that while the former rises as well as corrects rapidly (in current year, the build-up in wholesale vegetable prices at retail level has been at a negative 2.4%), CPI food rises as well as corrects slowly (in current year, the build-up in retail vegetable prices at retail level has been at 14.7%). Interestingly, WPI core seems to be most stable indicator of all price measures. As far as IIP is concerned, we believe Jul'14 IIP could be an aberration, that may soon be corrected. As of now, we are bang on 8% Jan'15 CPI target, though there is a lurking possibility of food prices playing the spoilsport. The million dollar elusive question of when the RBI will cut the rate. If we leave aside, the issue of inflation, purely on the basis of an uncertain risk appetite and the US monetary policy will warrant no change in policy rates. After all, going by historical trends, if Fed raises policy rates without a concomitant raise in repo rate, there are indeed clear evidences of capital outflows! Add to this, a new round of geo-political risks, with Scotland going for referendum on 18 Sep'14 will continue to set a hawkish tone on the part of RBI going forward.

WPI plunges to 5-Year Low

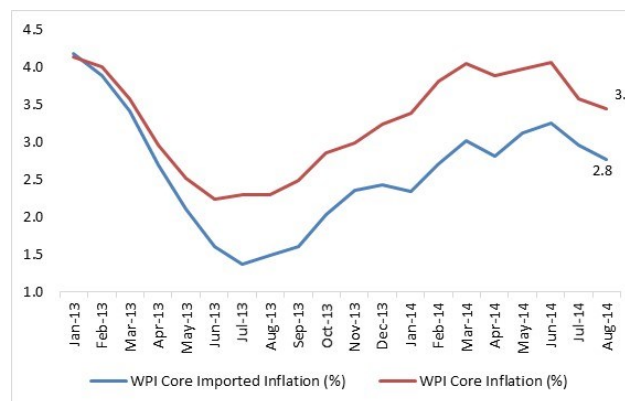
- ◆ Close to our projections (3.98%), WPI inflation moderated to 58-month low of 3.74% in Aug'14 as against 5.19% growth in Jul'14 and 6.99% in Aug'13 (however, Jun'14 reading was revised up by 23 bps). All segments of WPI declined in the month of Aug'14.
- ◆ Interestingly, significant softening of global commodity and fuel prices is expected to influence the WPI trajectory and we believe WPI could be at 4.5% by Mar'15 (our estimates show that around 70% of WPI basket is influenced by global price trends). In Aug'14, core WPI declined to 3.45% from 3.58% in Jul'14.
- ◆ The wedge between WPI core and WPI core imported has widened for the last 12 months, indicating that the global commodity prices is having a significant impact on WPI trajectory, apart from the fuel sub-component.

Chart 1: Commodity Prices and Brent Crude



Source: SBI Research

Chart 2: Wedge between Core and Core Imported

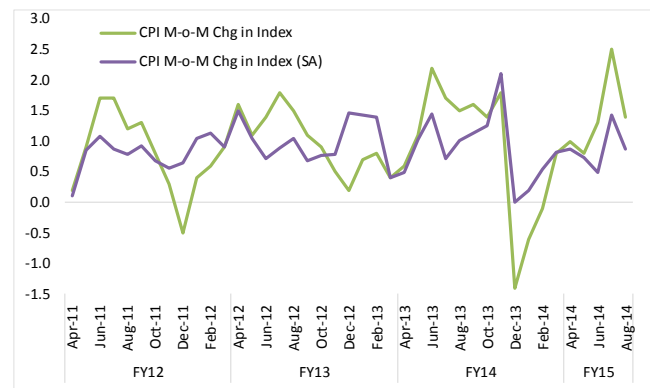


Source: SBI Research

Most Segments of CPI Inflation Touched All-Time Low in Aug'14

- ◆ Retail inflation (CPI-Combined) also moderated in the Aug'14 however at the slower pace and stood at 7.80% as compared to 7.96% in Jul'14 and 9.52% in Aug'13.
- ◆ CPI core inflation eased to 6.9% in Aug'14 from 7.4% in Jul'14. All segments of CPI was the lowest reading for the CPI data since inception.
- ◆ Our forecast show, that though we are bang on 8% CPI target on Jan'15 (our seasonally adjusted series shows a zero growth in the Index in Dec'14), there is still a lurking fear of food prices playing the spoilsport.

Chart 3: CPI Inflation (M-o-M Change in Index)



Source: SBI Research; SA: Seasonal Adjusted

Rural Demand

- ◆ Inflation in Rural Household Requisites is the proxy for rural demand since this segments represents the items of daily living. Since Apr'14, inflation in rural household requisites has declined by 300 basis points to 4.6% in Aug'14. This indicates that rural demand has been significantly subdued in the current fiscal and the process of disinflationary impetus is continuing at a rapid pace.

Table 1: CPI Inflation in Household Requisites

	Apr-14	May-14	Jun-14	Jul-14	Aug-14	Difference (Aug to Apr)
Rural	7.6	7.3	5.8	6.4	4.6	-3.0
Urban	6.6	7.0	6.4	6.7	5.5	-1.2
Combined	7.2	7.1	6.0	6.5	4.9	-2.3

Source: MOSPI, SBI Research

Table 2: Stability of WPI and CPI Inflation

Item	Weights	FY12		FY13		FY14		FY15*	
		Mean	SD	Mean	SD	Mean	SD	Mean	SD
Overall WPI	100.00	9.0	1.06	7.4	0.60	6.0	1.05	5.3	0.92
Core WPI	54.99	7.3	0.99	4.9	0.73	2.9	0.60	3.8	0.27
Overall CPI	100.00	-	-	10.2	0.40	9.5	0.84	8.0	0.43
Core CPI	40.81	-	-	8.7	0.77	8.0	0.22	7.4	0.34

Source: SBI Research; SD: Standard Deviation; *Apr-Aug

Industrial Output Growth decelerated at 0.5% in Jul'14

- ◆ Industrial output for Jul'14 registered an annual growth of 0.5%, much below the market expectations. The cumulative growth for the period Apr-Jul FY15 over the corresponding period of the previous year stands at 3.3%.
- ◆ Among the major sub indices, Industrial production for the Mining, Manufacturing and Electricity sectors registered growth of 2.1%, -1.0% and 11.7%, respectively as compared to Jul'13.
- ◆ In terms of industries, twelve (12) out of the twenty two (22) industry groups in the manufacturing sector have shown positive growth during the month of Jul'14 as compared to the corresponding month of the previous year.
- ◆ As per Use-based classification, Basic goods sector expanded at 7.6%, Capital goods at -3.8% and Intermediate goods at 2.6%.

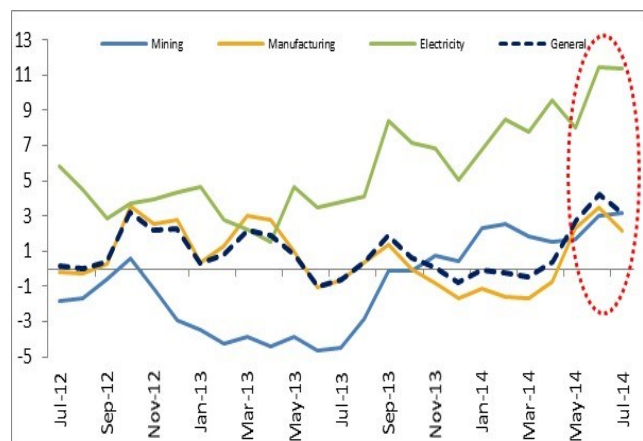
Table 3: IIP and Components Growth (%)

	Jul-14	Jul-13	Apr-Jul'14	Apr-Jul'13
Manufacturing	-1.0	3.0	2.3	-0.1
Electricity	11.7	5.2	11.4	3.9
Mining	2.1	-3.0	2.8	-4.3
Overall IIP	0.5	2.6	3.3	-0.1
Use Based				
Basic Goods	7.6	1.0	8.1	0.1
Intermediate	2.6	3.2	2.8	2.1
Capital Goods	-3.8	15.9	8.5	1.4
Consumer Goods	-7.4	-0.7	-4.5	-1.8
Durables	-20.9	-9.6	-12.5	-11.9
Non-Durables	2.9	7.4	1.3	7.2

Source: MOSPI, SBI Research

- ◆ Both the consumer durables and non-durable segment have shown dismal performance as the consumer durables sector has contracted by 20.9% and consumer non-durables have recorded growth of merely 2.9% respectively, with the overall growth in Consumer goods being (-)7.4%.
- ◆ Our prognosis is that, most of the consumer durables companies have witnessed a good volume growth in first quarter and to that extent, Jul'14 IIP number is likely to be revised upwards. Additionally, there was massive inventory de-accumulation in the June quarter, that may have led to a decline in production numbers. Overall, with consumer sentiments positive and discretionary spending on the rise, we are certain of a manufacturing recovery in FY15.

Chart 4: IIP Growth - 3m Moving Average



Source: SBI Research

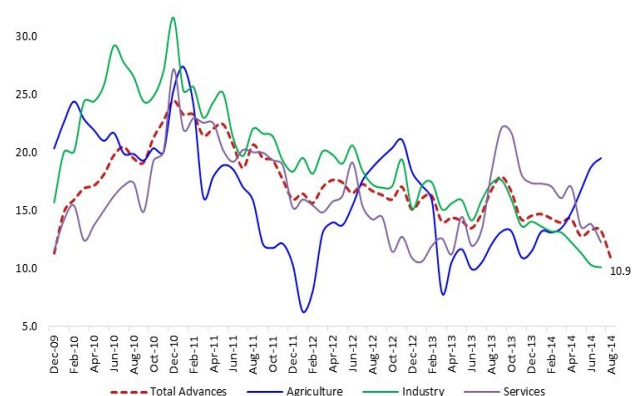
Bank Credit growth at 57-month low

- ◆ ASCB Credit growth has moderated to a 57-month low of 10.9% on 22 Aug'14, compared to last year growth of 16.3% on 23 Aug'13. The overall credit-deposit (CD) ratio declined to 76% on 22 Aug'14 from 77.5% in 23 Aug'13. In sector-wise, ASCBs credit deployment for Jul'14, indicates that except 'agriculture', all other segments has registered a decline in credit offtake.

Going Forward

- ◆ Going forward, future trend in domestic inflation will depend upon the trajectory of future trends in international commodity prices viz the oil prices and food prices, other than domestic disinflationary impetus.
- ◆ The oil prices have declined to below \$100 per barrel, this despite the conflict in Middle East. With US economy stepping up its domestic energy production, oil prices are expected to remain subdued for some time. The fall in consumer demand due to lackluster GDP growth, and Fed tapering will only contribute to lower demand and hence cheap oil prices will benefit economies like India. However, there may be uncertainty in long-term price trend for crude oil as demand from two largest buyers China and India may pick up later. At this juncture, factors causing up tick and down tick look evenly balanced.
- ◆ The difference with WPI and CPI food is that while the former rises as well as corrects rapidly (in current year, the build-up in wholesale vegetable prices has been at a negative 2.4%), CPI food rises as well as corrects slowly (in current year, the build-up in retail vegetable prices at retail level has been at 14.7%). Interestingly, WPI core seems to be most stable indicator of all price measures. As of now, we are bang on 8% Jan'15 CPI target, though there is a lurking possibility of food prices playing the spoilsport.
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Chart 5: Credit Growth (%) has slumped



Source: SBI Research

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