SBI RESEARCH

ECOWRAP

KAHIN PE NIGAHEIN (READ HEADLINE INFLATION), KAHIN PE NISHANA (READ CORE INFLATION): HOW THE CPI DATA RELEASED TODAY SHOULD BE READ... BUT HEADLINE CPI IS TARGETED....

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Indian headline CPI for the month of November is providing impetus to end of rate hike cycles in India. While the domestic inflation may still come under control due to hawkish monetary policy being followed by RBI, as long as US inflation does not come under control, Fed may have to increase rate giving incentives for capital outflows from emerging markets resulting into exchange rate volatility and currency depreciation.

After the lower CPI inflation for Nov'22, we have revised down our estimates for the remaining months of this fiscal. We believe CPI inflation will remain at 6.5%-6.7% for Dec'22 and Jan'22. Thereafter inflation will decline materially coming down to 5% by Mar'23. For Q1 FY24 we expect average CPI of 4.4%. We now maintain a minimal probability of a February terminal 25 bps rate hike. However, that will also be accompanied with a change in stance to neutral, if it was to happen so. The next policy statement is due on Feb 6-8 and just comes after the budget announcement on Feb 1 and after the FOMC policy statement on Jan 31-Feb11, first in 2023. From that point, RBI will be in a vantage position of taking a considerate view in February policy. Yields are also now likely to move towards 7%, aided by low SDL borrowings.

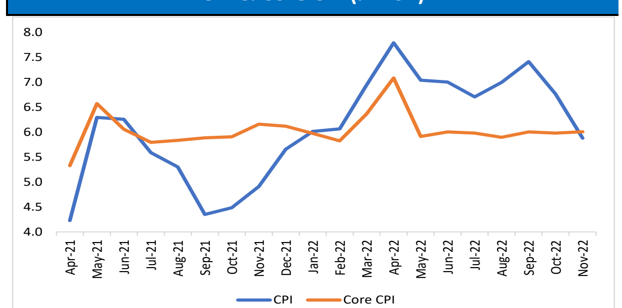
Remarkably, consumer non-durables suffered significant contraction during the month explaining nearly 57% of the total decline during the month. It declined on monthly basis as well. This is worrisome as it reflects slackening pace of rural demand.

US CPI data release tomorrow together with FOMC meeting scheduled consecutively this week are important not just in global context but also in Indian context. Fed, to account for lag in rental inflation reporting, relies on private surveys of rents and home prices and substitute them in CPI account, in order to validate their policy decisions. While the time of large increases in rates is certainly over, however, the strategy for now is to being watchful of the comforts provided by CPI numbers. While higher than expected drop of US October CPI showed headline inflation dropping to 7.7% instead of market expectation of 8% has provided some comforts however US NFP data showed US Non-Farm payrolls was 263K in November against the expectation of 200K, and 284K in October, giving impetus for Fed to pursue rate hike cycles of smaller magnitudes as reflected in increasing wages, stagnant unemployment rate, and increasing job openings.

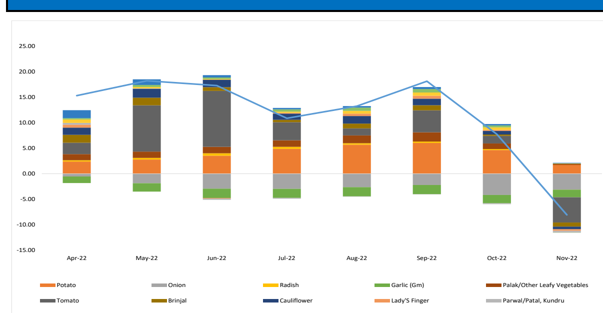
CPI FELL TO 11-MONTH LOW: VEGETABLES THE ELEMENT OF SURPRISE

- The broader trajectory of the CPI was in line with expectations of a decline but the sharp decline in prices of vegetables was a surprise to the market. CPI inflation fell to an 11-month low of 5.88% in November, primarily due to softening prices of food items (mainly vegetables).
- The vegetable CPI sub-index fell by 8.08% led by three new additions in the negative territory. These include the sharp drop in prices of tomatoes, brinjal and beans. However, the drop is not only account of these but also due to moderation in prices of potatoes which was spoiler in previous month.
- We have been maintaining that the fear of impact of unseasonal rains on CPI inflation (particularly on food CPI) should be unfounded as farmers have now become smarter and more tuned to ground realities (e.g. crop of larger duration are being planted to take care of unseasonal rains). Also, vegetable arrivals in mandis have jumped manifold compared to pre pandemic indicating that the supply chain has now been completely restored.

CPI & Core CPI (% YoY)



Weighted contribution of vegetable items in vegetable sub-index



Source: SBI Research

- Core CPI, on the other hand, increased marginally to 6.01% due to increase in transport and communication CPI.

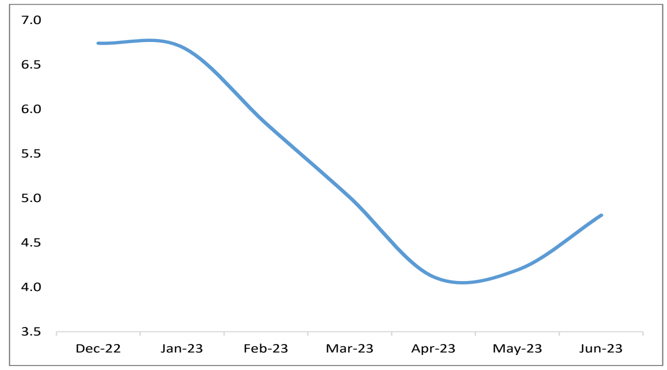
INFLATION TRAJECTORY

- After the lower CPI inflation for Nov’22, we have revised down our estimates for the remaining months of this fiscal. We believe CPI inflation will remain above 6.5% for Dec’22 and Jan’22. Thereafter inflation will decline materially coming down to 5% by Mar’23. For Q1 FY24 we expect average CPI of 4.4%.
- We now maintain that future rate change in February policy as widely anticipated in market now has turned from low to minimal. We maintain a minimal probability of a February terminal 25 bps rate hike. However, that will also be accompanied with a change in stance to neutral, if it was to happen so. The next policy statement is due on Feb 6-8 and just comes after the budget announcement on Feb 1 and after the FOMC policy statement on Jan 31-1, first in 2023. From that point, RBI will be in a vantage position of taking a considerate view in February policy.

IIP CONTRACTED BY 4%, LED BY MANUFACTURING

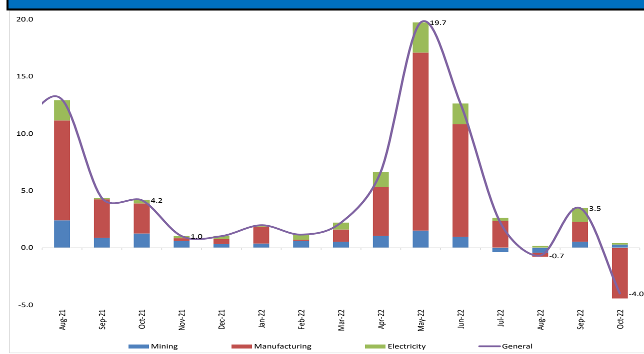
- Index of industrial production contracted by 4% yoy in Oct’22 compared to a positive growth of 4.2% in Oct’21 and 3.1% in Sep’22. Decline in manufacturing growth (-5.6% yoy) has been responsible for the overall dip in IIP.
- Manufacturing of pharmaceuticals, medicinal chemical and botanical products contributed maximum to the decline in manufacturing followed by electrical equipment, textile and apparel.
- Meanwhile, mining and electricity grew 2.5% and 1.2% respectively during the month. As per the use-based classification, all the categories witnessed contraction except for primary good and infrastructure/ construction goods both of which grew modestly (2% yoy and 1% yoy respectively). Consumer non-durables suffered significant contraction during the month explaining nearly 57% of the total decline during the month. It declined on monthly basis as well. This is worrisome as it reflects sluggish rural demand.

CPI Inflation Trajectory



Source: SBI Research

Weighted contribution in IIP (%)



Source: SBI Research

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