SBI

ECOWRAP

भारतीय स्टेट बैंक
STATE BANK OF INDIA

MARCH 12, 2018
ISSUE NO: 75, FY18

CPI & IIP DELIGHT: BEST IS YET TO COME

As expected, CPI inflation eased to 4.44% in Feb'18 compared to 5.07% in the previous month, with all the components witnessing decline in prices except for health, clothing and footwear, transport and communication. Signs of a thaw in rural demand was visible with rural CPI crashing by 84 basis points from the earlier month. With Mar'18 CPI expected to be in the same range of around 4.4%-4.5%, the Q4 actual CPI numbers could actually undershoot RBI Q4 projections (5.1%) by around 40-50 bps.

If the conditions remain the same, RBI inflation projection for FY19 at 5.1-5.6% for first half and 4.5-4.6% for second half will be undershot by 40-50 bps for the next fiscal as well, despite MSP implementation, as RBI studies show that MSP implementation does not lead to significant increase in food prices.

With crashing vegetable prices and recent financial market developments, a Pandora's Box has been opened for RBI and it remains to be seen what will be the RBI response. One shortcoming of Inflation Targeting (whether strict or flexible) is that it *may neglect important information about the build-up of financial imbalances given that these developments do not materialize rapidly into consumer price pressures*. The surge on yield on the 10-Year Government Security (G-sec) during Q3 FY18 has impacted the mark-to-market (MTM) losses for banks on their investment portfolios during Q3 FY18. This will pose further risk to financial stability.

The Index of Industrial Production (IIP) numbers have delighted by growing by whopping 7.5% in Jan'18, compared to 7.1% in Dec'17 and 3.5% in Jan'17. Steep growth in manufacturing and electricity propelled IIP forward. The numbers are expected to be at an all-time high in the month of February (partly because of base effect). It can even be expected that they might touch double digits (first time in new series).

CPI INFLATION MODERATED IN FEB'18

- As expected, CPI inflation eased to 4.44% in Feb'18 compared to 5.07% in the previous month, with all the components witnessing decline in prices except for health, clothing and footwear, transport and communication. Decline in prices of food and beverages to 3.28% compared to 4.58% in Jan'18 has been the major contributor to the easing inflation. CPI ex-food also moderated to 5.37% in Feb'18 from 5.49% in Jan'18.
- Rural inflation declined significantly to 4.37% from 5.21% in Jan'18, while CPI urban came in at 4.52% compared to 4.93% in Jan'18. Meanwhile, the Core CPI has increased moderately to 5.17% compared to 5.14% in Jan'18. The overall CPI inflation has come below core inflation in 2018.
- The 1st week Mandi prices indicate that vegetable prices have declined in Mar'18. So, CPI inflation for Mar'18 is likely to be lower than the Feb'18 number (if the first week trend follows through).
- We believe inflation for Q4 FY18 should average to 4.6% which is on the lower side when compared to RBI's projection of 5.1% for Q4 FY18.

RBI Projections will be undershot

Period	RBI Projection	Our Estimates
Jan-Mar'18	5.1%	4.7%
Apr-Sep'18	5.1-5.6%	RBI projection will be undershot by at least 30 bps
Oct'18-Mar'19	4.5-4.6%	

Source: RBI; SBI Research

FINANCIAL STABILITY

- The surge on yield on the 10-Year Government Security (G-sec) during Q3 FY18 on the back of higher-than-budgeted fiscal deficit concerns of the Government of India (GoI) for FY18, has impacted the result in mark-to-market (MTM) losses for banks on their investment portfolios during Q3 FY18.
- In the wake of the recent financial market developments, the onus will also now lie on RBI to balance financial stability with inflation targeting. According to a working paper of Central Bank of Brazil "*One shortcoming of Inflation Targeting (whether strict or flexible) is that it may neglect important information about the build-up of financial imbalances given that these developments do not materialize rapidly into consumer price pressures. By ignoring asset bubbles and other financial developments, Inflation Targeting could pose serious risks to financial stability*." Such build-up of financial imbalances has also been exacerbated by huge treasury losses of banks, posing further risks to financial stability.
- According to Minsky's "financial instability hypothesis", economic growth encourages the adoption of a riskier behaviour of the financial institutions and speculative economic activities. When firms revise their positions due to the excessive level of external financing with regard to realized profits, they may be forced to sell capital assets to obtain cash and to meet their debt commitments. At the macroeconomic level, this may generate a negative chain reaction with a general decrease in prices, investment spending, profits, and a persistent unemployment due to numerous bankruptcies.

IIP MAY TOUCH DOUBLE DIGIT NEXT MONTH

- The Index of Industrial Production (IIP) grew by whopping 7.5% in Jan'18, compared to 7.1% in Dec'17 and 3.5% in Jan'17. Steep growth in Manufacturing (8.6%) and Electricity (7.6%), compared to the meagre growth in Mining (0.1%) was the main reason behind IIP growth. Cumulatively, IIP growth for Apr'17-Jan'18 was 4.1% compared to 5.0% in corresponding period last year.
- As per use based classification, capital goods increased by whopping 14.6%. Primary goods increased by 5.8%, intermediate goods by 4.9% and Infrastructure/ Construction goods by 6.8%. The Consumer durables and Consumer non-durables have recorded growth of 8.0% and 10.5%, respectively. Out of 23 industry groups in the manufacturing sector, 16 have shown positive growth during Jan'18 as compared to the corresponding month of the previous year.
- We expect that Feb'18 month IIP growth might be in double digits (first time in new series). Last time IIP growth touched double digit was in Oct'10 (in the old series).

*****

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!

DISCLAIMER

CONTACT DETAILS

Dr. Soumya Kanti Ghosh
Group Chief Economic Adviser
State Bank of India
Corporate Centre
Madam Cama Road
Nariman Point

Email: soumya.ghosh@sbi.co.in
gcea.erd@sbi.co.in
Phone: 022-22742440

: @kantisoumya