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भारतीय स्टेट बैंक
STATE BANK OF INDIA

'Be the Bank of Choice for a Transforming India'

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REALIZED MSP IMPACT ON HEADLINE CPI TILL JULY IS AT 7 BPS

The retail inflation has come as a breather and has declined substantially to 4.17% from 4.92% (downwardly revised) in June. The core inflation, which was moving in upward trajectory has also shown signs of cooling and has moderated to 6.29% from the month before level of 6.39% (downwardly revised).

For the first time in several months, seasonally adjusted Core CPI and CPI adjusted for Transport revealed a deceleration on a m-o-m basis. We expect Core CPI to decline further in incoming months, with a sub 6% reading for August looking imminent. Headline CPI is also expected to track sub 4% in August or close to it.

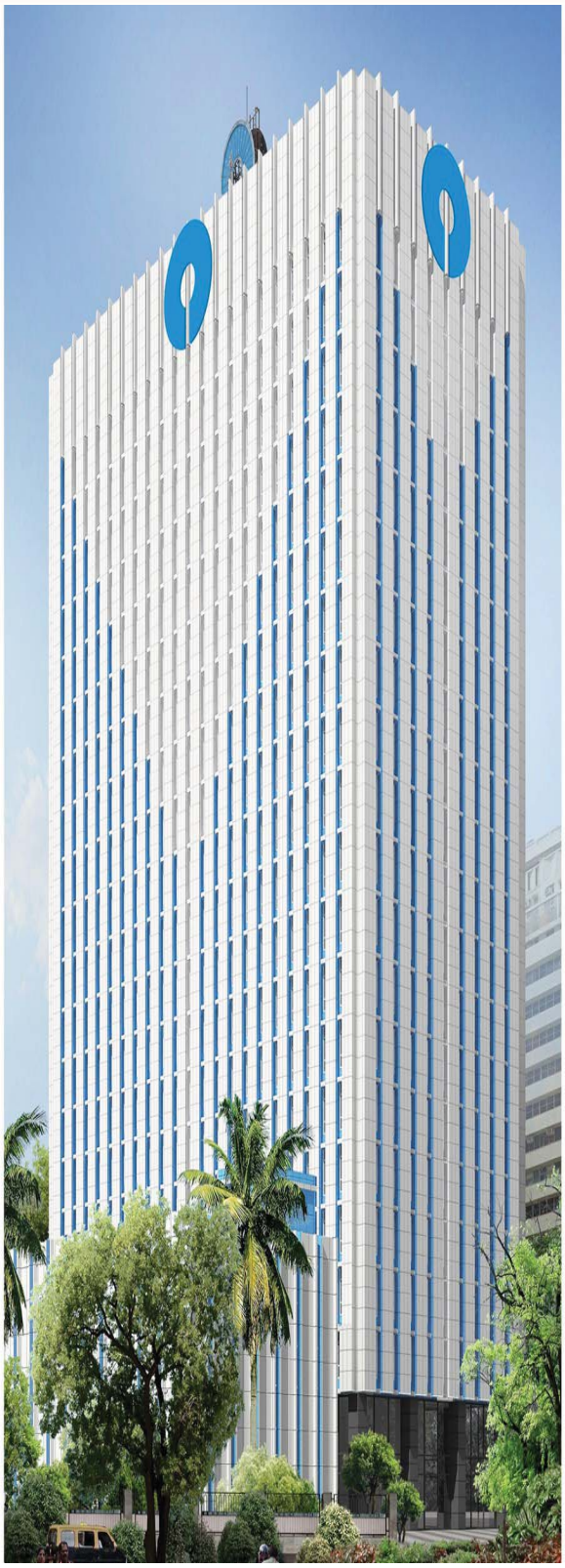
Our MSP Inflation Pathfinder that quantifies the direct impact of food items linked with MSP shows the realised value of MSP increase on Headline CPI till Jul'18 was 7 bps.

The MPC will have 2 inflation readings before the October policy. With the August inflation number tracking below July and Core expected to continue its downward journey, we expect RBI to be on hold in October policy. Our base call is still a pause in current fiscal, though the RBI's overt fixation of a 4% inflation goal and projections of a 5% inflation in Q1FY20 would mean a proactive rate action may not be just almost ruled out. Again, it should be a case of timing either in Q4FY19 / busy season or Q1FY20 / lean season. Our research shows that the rate actions by RBI in the past has been nearly symmetric across busy or lean seasons. Interestingly, excluding the base impact, core CPI is currently trending at close to 5.5%.

We also believe the recent exchange rate disturbances will have more of an impact on WPI than CPI. This is precisely the reason why WPI and CPI have diverged more in recent times, though logic of declining food prices would have persuaded us to believe that a convergence was the most plausible outcome.

Meanwhile, the continued increase in service inflation indicates that the relation between inflation and output gap does not seem sacrosanct in Indian context and hence the RBI argument of *output gap almost closed* needs to be carefully validated.

On the corporate front, Sans, Bank, Finance, Insurance and Refineries, with 1731 companies, the bottom line exhibited improved Y-o-Y growth of 35% with top and middle line growth at 17% and 25% respectively. This may be attributed mainly due to low base effect.



CPI INFLATION EASED

- CPI inflation eased to 4.17% in Jul'18 from 4.92% (revised) in Jun'18, driven by cheaper food prices. The moderation in 'Pan, tobacco and intoxicants' also contributed the downward move. Meanwhile, the Core CPI inflation declined to 6.29% compared to 6.39% in Jun'18. Our projections for CPI FY19 is at 4.6% and for FY20 is 4.5%.
- For the first time in several months, seasonally adjusted Core CPI and CPI adjusted for Transport revealed a deceleration on a m-o-m basis. We expect Core CPI to decline further in incoming months, with a sub 6% reading for August looking imminent. Headline CPI is also expected to track sub 4% in August.
- The MPC will have 2 inflation readings before the October policy. With the August inflation number tracking below July and Core expected to continue its downward journey, we expect RBI to be on hold in October policy. Our base call is still a pause in current fiscal, though the RBI's overt fixation of a 4% inflation goal and projections of a 5% inflation in Q1FY20 would mean a proactive rate action may not be just almost ruled out. Again, it should be a case of timing either in Q4FY19 / busy season or Q1FY20 / lean season. Our research shows that the rate actions by RBI in the past has been nearly symmetric across busy or lean seasons. Interestingly, excluding the base impact, core CPI is currently trending at close to 5.5%.

INTRODUCING MSP INFLATION PATHFINDER

- For a better understanding of the impact of MSP on CPI Headline inflation, we have now constructed a **MSP Inflation Pathfinder** to estimate the realised impact of MSP increase on CPI inflation Trajectory on a real time basis. The MSP Inflation Pathfinder will quantify both Direct and Indirect Impact on a realised basis based on CPI data to be released from August onwards.
  - ⇒**MSP Direct Pathfinder:** This will quantify the direct impact of food items linked with MSP. The weight of this index is 15.61% in overall CPI. *The realised value of MSP Direct Pathfinder during Jul'18 was 7 bps*.
  - ⇒**MSP Indirect Pathfinder:** We have listed all the items where MSP announced products are used as inputs. For example, some food grains are used as inputs in cooked meals, prepared sweets, cake, pastry, cooked snacks, etc. We have also included items prepared using cotton, jute, etc. as inputs. The weight of this index is 11.1% in overall CPI. Since, MSP has been implemented in Jul'18, *the realization of MSP Indirect Pathfinder will however take time*.

Impact of Incremental MSP on CPI inflation

Kharif Crops	MSP 2018-19	Weight (%)	Modeled Inflation during Jul to Dec (in bps)	Realised Inflation in Jul (in bps)
Cereals	1750	4.38	-	2.0
Jowar-Hybrid	2430	0.23	4.1	0.0
Bajra	1950	0.11	3.7	-0.1
Ragi	2895	0.05	1.5	0.0
Maize	1700	0.06	1.6	0.0
Arhar	5675	0.80	18.3	2.1
Moong	6975	0.36	19.5	2.0
Urad	5600	0.27	5.5	1.2
Groundnut	4890	0.33	6.5	0.0
Sunflower Seed	5388	0.30	11.7	0.4
Soyabean (Yellow)	3399	0.30	-	-
Sesamum	6249	0.01	-	-
Nigerseed	5877	0.01	0.2	-
Cotton Medium	5150	0.05	0.5	-
Total			73	7

Source: AGMARKNET, CACP, SBI Research

- The impact of MSP increase is currently marginal at 7 bps due to moderate increase in cereals (though the weightage is very high). In our earlier report we have estimated that post announcement of MSP with 150% hike in cost of production, the CPI inflation could increase by 73 bps and this could only be realized in one or two quarters subject to procurement by the Government/ State Government.

UNADJUSTED CPI VIS-À-VIS SEASONALLY ADJUSTED CPI

- The recent hike of repo rate by 25 bps has been mostly driven by increase in Core CPI rather than headline CPI. We have examined the seasonally adjusted series of both headline CPI and Core CPI.
- We compared the trend of seasonally adjusted series with unadjusted of both headline and core CPI during last six months and the result gives a mixed trend. The seasonally adjusted headline inflation is declining as well as Core CPI and Core of Core CPI.

M-o-M change in CPI inflation and Seasonally Adjusted (SA) CPI inflation during last Seven Month

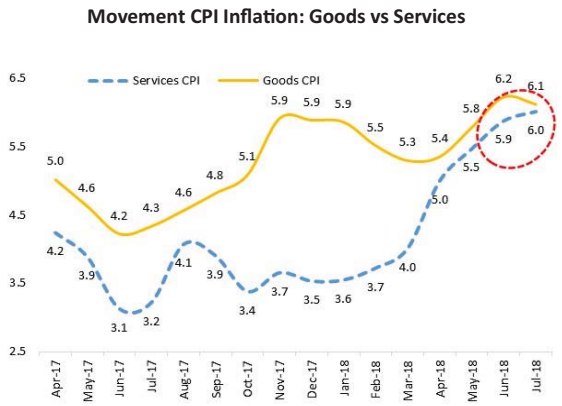
Month	CPI	CPI_SA	Core CPI	Core CPI_SA	Core of Core CPI	Core of Core CPI_SA
Jan-18	-0.15	-0.12	0.01	0.04	0.06	0.05
Feb-18	-0.62	-0.44	0.01	0.02	-0.07	-0.06
Mar-18	-0.16	-0.04	0.21	0.19	0.15	0.12
Apr-18	0.30	0.39	0.55	0.49	0.32	0.28
May-18	0.29	0.33	0.31	0.29	0.22	0.20
Jun-18	0.05	0.04	0.16	0.26	0.03	0.11
Jul-18	-0.75	-0.91	-0.10	-0.10	-0.18	-0.10
Average	-0.15	-0.11	0.17	0.17	0.08	0.09

Source: MOSPI, SBI Research

- Even as RBI decided to hike, RBI Governor later indicated in the press interaction that the Central Bank target is headline CPI and Core is only a component of it. It will be interesting to see how RBI will react to headline inflation which is expected to decline in coming months.

SERVICES INFLATION GOING TO BE HIGHER THAN GOODS INFLATION

- When analyzing economic activities, it is common to distinguish between services and goods. Globally, the services inflation is higher than the goods inflation and in India as well the gap is converging.
- The services CPI (including Housing: weightage 30.69) is continuously rising from Jun'17 and till Jun'18 and remained stagnant in Jul'18, it has increased by 314 bps. However, if we look at only services CPI, it has been increasing since Dec'17 to 6.0% in Jul'18.
- While, the Goods CPI (weightage 23.44) was declining till Mar'18 it increased there after and has now started showing a declining trend. In the current FY19, goods CPI inflation has increased by 83 bps.



Source: SBI Research

- We believe, in the coming months the services CPI inflation may cross the Goods CPI inflation. There are a number of reasons why services prices tend to rise more rapidly than goods prices. Increases in the demand for services relative to the demand for goods may at times explain some short-run increases in services prices relative to those for goods.
- The increase in service inflation dynamics indicates that the relation between inflation and output gap does not seem sacrosanct in Indian context and hence the arguments of output gap almost closed needs to be validated.

CORPORATE RESULT

- As per the standalone results declared for the first quarter of FY19, we saw top line growth of 18% and bottom line growth of 15% from the published results of around 2100 companies.
- Sans, Bank, Finance, Insurance and Refineries, with 1731 companies, the bottom line exhibited improved Y-o-Y growth of 35% with top and middle line growth at 17% and 25% respectively. This may be attributed mainly due to low base effect. While top-line (Net Sales) increased by 12% in Q1FY18, destocking, possibly, at low prices saw decline in growth in margins at mid- level (PBIDT) and bottom level (PAT).
- Sectors such as Gas Distribution, Automobiles, Steel, Chemicals, FMCG etc. reported all round growth in Q1FY19 as compared to the same period in previous year.
- Capital Goods - Non Electrical Equipment and IT – Software sector too reported excellent all round growth.

Growth in Key Parameters Q1FY19 and Q1FY18 (Y-o Y %)							
Sector	No of Companies	Net Sales		PBIDT		PAT	
		Q1FY19	Q1FY18	Q1FY19	Q1FY18	Q1FY19	Q1FY18
Gas Distribution	6	46	12	18	2	20	-8
Capital Goods-Non Elect. Equipment	74	44	4	269	-25	518	-45
Automobile	17	33	5	48	-3	70	-13
Fertilizers	17	26	10	73	7	264	159
Cables	11	26	32	58	37	103	165
Chemicals	104	25	3	41	-11	49	-13
Non Ferrous Metals	19	17	36	26	30	34	55
IT - Software	83	15	3	12	7	6	9
FMCG	43	13	7	23	2	27	2
Consumer Durables	32	12	22	15	30	13	34
Source: CLIne; Standalone results of 1731 companies							

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

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