

Inflation

CPI November.....3.41% YoY
WPI November3.39%YoY

Cash crunch brings food prices down....

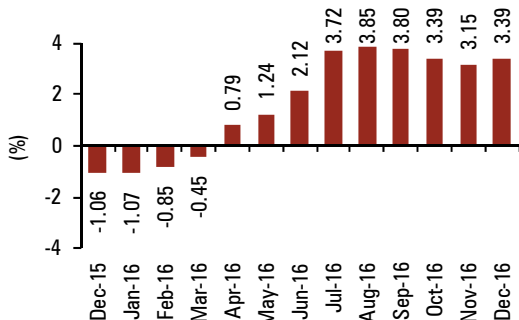
Key readings...

- The Consumer Price Index (CPI) inflation eased further to nearly two year low of 3.41% in December on the back of sharp fall in food and inflation
- The deceleration in inflation was primary led by a fall in food inflation, which accounts for over 45% in inflation index. Food Inflation fell sharply to 1.36% from 2.11% in November. A sharp fall in vegetable prices was one of the major contributors to lower food inflation, which continues to witness disinflationary pressure. Pulses, which were in double digits till September, were at negative 1.63 % in December, from 0.23% in the previous month. However, a steady rise in cereals and products with almost 10% weight in CPI may be a cause of concern, going forward
- Core inflation (excluding food & fuel inflation) continued to remain sticky at around 4.90% reflecting the limited impact of demonetisation
- The wholesale price index (WPI) based inflation broke the three-month declining trend and rose to 3.39% compared to 3.15% in November
- Overall, food inflation, with 15% weightage in WPI index was negative 0.7% in December against 1.54% in December

Sharp fall in CPI				
Items	Weights(%)	Oct-16	Nov-16	Dec-16
CPI	100.0	4.20	3.63	3.41
CFPI	39.1	3.28	2.11	1.36
Core CPI	47.3	4.98	4.94	4.90
Fuel	6.8	2.81	2.80	3.77

Components of CPI				
Items	Weights(%)	Oct-16	Nov-16	Dec-16
Food&bev.	45.9	3.71	2.56	1.98
Pan,tob& intox.	2.4	7.01	6.21	6.47
Cloth & Foot	6.5	5.24	4.98	4.88
Housing	10.1	5.15	5.04	4.98
Fuel & light	6.8	2.81	2.80	3.77
Misc.	28.3	4.58	4.83	4.73

Wholesale price moderate in November (WPI YoY %)



Components of WPI (YoY %)

Particulars	Weights	Sep-16	Oct-16	Nov-16	Dec-16
WPI	100.0	3.80	3.39	3.15	3.39
Primary Articles	20.1	5.36	3.31	1.25	0.27
Fuel & Power	14.9	5.64	6.18	7.07	8.65
Manuf.Goods	65.0	2.54	2.67	3.20	3.67

MoM inflation (%)

Particulars	Weights	Sep-16	Oct-16	Nov-16	Dec-16
CPI	100.0	-0.23	0.46	-0.15	-0.61
Food & Bev	45.9	-0.94	0.29	-0.66	-1.54
Fuel & light	6.8	0.40	0.08	0.64	1.28
Housing	10.1	0.47	0.63	0.31	-0.46
Clothing	6.5	0.45	0.52	0.37	0.22
Misc	28.3	0.57	0.41	0.41	0.08
WPI	100.0	-0.05	-0.16	0.11	-0.16
Primary Arti.	20.1	-1.56	-1.36	-0.92	-1.20
Fuel & Power	14.9	1.81	0.97	1.82	0.73
Manuf.Goods	65.0	0.26	0.13	0.32	0.06

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Sharp fall in vegetable prices pulls CPI inflation down

- A sharp fall in vegetable prices, which declined 14.7% in December was the major contributor to the fall in headline CPI inflation. The sudden sharp cash crunch due to demonetisation led to consumers, transporters and other people in the value chain shying away from the market. The perishables nature of the vegetables added to pressure as sellers were forced to dump food items at lower prices
- Also, businesses resorted to price discounting to boost flagging sales following the government's cash crackdown, fuelling hopes of an interest rate cut by the central bank
- Fuel inflation rose to 3.77% in December, from 2.80% in the previous month. However, going forward, fuel inflation faces an upside risk as global crude oil prices witnessed a sharp jump in prices since the start of December 2016
- Cereals, which has around 10% weightage in CPI basket, have been steadily rising and were up 5.42% in December vs. 2.12% in the same month last year
- Pulses prices fell to -1.63% vs. 0.23% in November. Government measures (like increased MSP, creation of buffer stock and increased imports) to address structural issues in pulses have led to a relief in price pressures in the segment. Normal monsoon and upbeat kharif sowing are expected to lead to additional price easing in pulses
- Prices of milk & milk-based products eased 4.4%. Other protein-based food items like meat and fish fell to 4.87% vs. 5.83% in November
- Housing inflation rose slightly to 4.45% in December compared to 4.21% in December
- Edible oils and fats prices increased 2.95% whereas those for sugar and confectionery edged up 21.1 % on a YoY basis

RBI warns again on being too optimistic

- The RBI's Monetary Policy Committee in its December 7 policy meeting kept interest rates unchanged. In its policy statement, it pointed out that the effect of demonetisation on the economy and inflation could be transitory and the full assessment of its impact is awaited based on data
- RBI has also raised concerns about the continued persistence of core inflation, which constitutes around 45% of the CPI basket. Although housing and personal care inflation softened marginally, the steady rise in inflation in respect of education, medical and health services, and transport and communication has imparted stickiness to inflation in this category
- Core inflation remains sticky at 4.81% YoY in December. However, given the impact of demonetisation, core inflation is expected to moderate
- Going forward, base effects are expected to reverse and turn unfavourable in January and February. If the usual winter moderation in food prices does not materialise due to the disruptions, food inflation pressures could re-emerge
- Other major factors that could affect inflation in near term are firming up of crude oil prices with Opec's agreement to cut production, volatility in currency, reaction of financial markets following the US monetary policy decision to hike rate and effect of the Seventh Pay Commission

WPI inflation inches higher as uptrend in fuel prices offsets benign food prices

- Wholesale Price Index (WPI) inflation for December inched higher to 3.39% compared to 3.15% in November. WPI inflation accelerated on the back of the adverse base effect and increasing commodity prices
- Easing vegetable and food prices after a good monsoon, brought inflation down, apart from the demonetisation of high-denomination notes, which kept the public from spending too much amid a tight liquidity situation
- WPI food inflation came down to 1.54%, from 4.34% last month. Vegetables, which fuelled inflation as recently as July, saw a decline in prices by almost 10%
- Vegetables prices extended its deflationary pressures and were recorded at (-)33.11% in December. Inflation in this category had scaled a high of 28.45% in July
- Manufactured products, comprising almost 65% in the index, inched higher to 3.67% in December compared to (-)1.49% in same month last year.
- Fuel inflation, which contributes 14.91% in weightage to the index continued its uptrend (up 8.65%), led by higher price of furnace oil (5%), kerosene, petrol and LPG (2% each) and high speed diesel (1%)
- Going ahead, headline WPI inflation is likely to head higher than CPI inflation owing to higher commodity prices and adverse base effect. We remain cautious on the upward momentum of prices of oil and other base metals

With the banking system flush with large influx of deposits, interest rates both in the wholesale market and banking system are likely headed lower

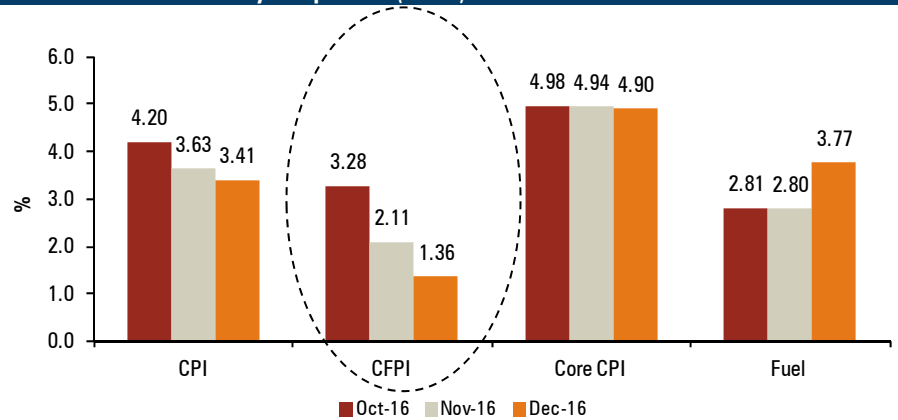
The government has already announced APMC reforms. Farmers can now directly sell their produce in the market. Other measures like cracking down on hoarders and efficient vigilance will improve supply side disruptions

Recent demonetisation reform likely to be disinflationary but may be transitory

The government's move to suck out 86% value of money in circulation by demonetising ₹ 500 and ₹ 1,000 currency notes will adversely impact India's economic growth, at least in the short run. Demonetisation will have an impact on a large number of cash transactions that will have a multiplier effect on the economy. The same will have a disinflationary impact over the next few quarters.

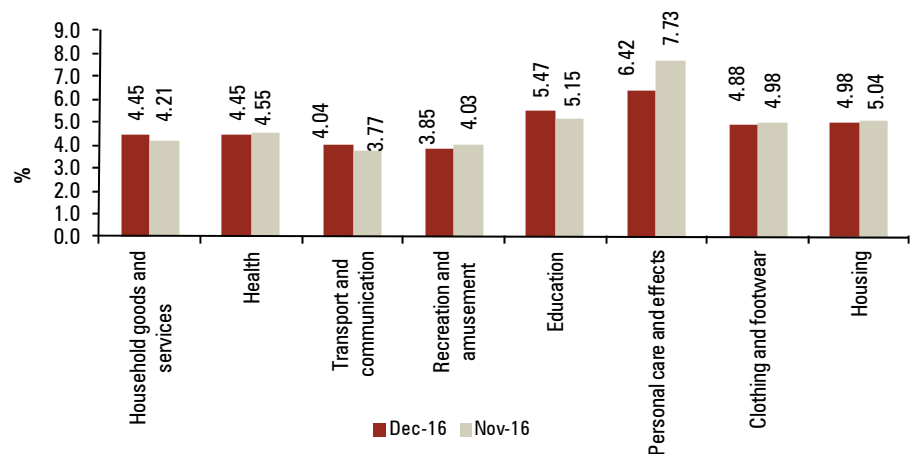
The Reserve Bank of India will monitor macroeconomic and financial developments for any further scope for policy action. It expects inflation to reduce to 5% by March 2017. Although the central bank has enough leeway time wise, firming international commodity prices, especially crude oil and implementation of Seventh Pay Commission are going to put upward pressure on inflation in coming months.

Exhibit 1: CPI – Breakdown by components (YoY%)



Source: CSO, ICICIdirect.com Research

Exhibit 2: Core CPI – Breakdown by components (YoY%)



Source: CSO, ICICIdirect.com Research

Fall in prices of personal care goods was triggered mainly by a slowdown in purchases caused by the currency crunch

RBI's inflation projections...

"CPI inflation is expected to average at 6% in 2016-17 and moderate to around 5% in Q4 of 2016-17".

Exhibit 3: CPI - Breakdown by components (YoY%)

	Weights	Month				
		Aug-16	Sep-16	Oct-16	Nov-16	Dec-16
Food and beverages	45.9	5.83	4.12	3.71	2.56	1.98
Cereals and products	9.67	4.11	4.17	4.40	4.86	5.42
Meat and fish	3.61	5.85	5.83	6.00	5.83	4.87
Milk and products	6.61	4.36	4.27	4.42	4.57	4.40
Oils and fats	3.56	5.03	4.65	3.89	2.70	2.95
Fruits	2.89	4.31	6.07	4.50	4.52	4.82
Vegetables	6.04	1.02	-7.21	-5.85	-10.35	-14.76
Pulses and products	2.38	21.94	14.33	4.24	0.23	-1.63
Sugar and confectionery	1.36	24.89	25.77	23.62	22.40	21.19
Spices	2.5	8.83	8.10	7.40	6.48	6.14
Non-alcoholic beverages	1.26	4.32	4.23	4.13	3.70	3.77
Prepared meals	5.55	5.60	5.81	6.17	5.82	5.64
Pan, tobacco and intoxicants	2.4	6.94	6.82	7.01	6.21	6.47
Clothing and footwear	7.9	5.30	5.19	5.24	4.98	4.88
Housing	10.1	5.29	5.18	5.15	5.04	4.98
Fuel and light	6.8	2.57	3.07	2.81	2.80	3.77
Miscellaneous	28.3	4.18	4.51	4.58	4.83	4.73
Household goods and services	3.8	4.60	4.32	4.39	4.21	4.45
Health	5.9	4.52	4.67	4.73	4.55	4.45
Transport & comm	8.6	1.25	2.70	3.41	3.77	4.04
Recreation and amusement	1.7	4.25	3.97	4.04	4.03	3.85
Education	4.5	5.19	4.93	5.16	5.15	5.47
Personal care and effects	3.9	8.19	7.67	7.11	7.73	6.42

Source: CSO, ICICIdirect.com Research

Exhibit 4: WPI - Breakdown by components (YoY%)

	Weights	Month			Average FY16	Average FY15
		Dec-15	Nov-16	Dec-16		
WPI	100.0	-1.06	3.15	3.39	-2.49	2.00
Primary Articles	20.12	4.58	1.25	0.27	0.31	2.98
Fuel & Power	14.91	-9.15	7.07	8.65	-11.67	-0.95
Manufactured Goods	64.97	-1.49	3.20	3.67	-1.10	2.42

Source: CSO, ICICIdirect.com Research

The government's decision to scrap 10% import duty on wheat amid rising domestic prices and concerns of a dip in buffer stocks following two consecutive drought years should support wheat prices, going forward

WPI inflation broke the three-month declining trend and rose to 3.39% in December, mainly due to a rise in prices of manufactured items, even as food prices dropped

Exhibit 5: Primary articles - Breakdown by components (YoY%)

	Weights	Month			Average FY16	Average FY15
		Dec-15	Nov-16	Dec-16		
Primary Articles	20.1	4.58	1.25	0.27	0.31	2.98
Food Articles	14.3	7.89	1.54	-0.70	3.42	6.08
Food Grains & Cereals	4.1	11.66	11.02	10.21	7.66	3.99
Rice	1.8	-1.25	4.80	4.38	-1.66	6.70
Wheat	1.1	3.91	10.71	12.82	3.67	-0.29
Pulses	0.7	55.76	21.73	18.12	39.47	5.88
Fruits & Vegetables	3.8	9.06	-11.75	-17.39	-1.31	5.35
Milk	3.2	1.78	4.19	4.11	3.28	9.97
Eggs, Meat & Fish	2.4	5.03	5.82	2.73	2.01	2.37
Spices	0.6	21.76	-3.88	-5.69	14.64	21.68
Non-Food Articles	4.3	7.84	-0.14	0.62	3.51	-0.55
Fibres	0.9	2.71	14.05	11.88	-3.78	-10.20
Oil Seed	1.8	8.23	-5.05	-3.30	2.88	3.10
Other Non Food Articles	1.4	7.86	3.46	5.62	8.44	0.98
Minerals	1.5	-31.02	1.12	12.86	-29.92	-10.96

Source: CSO, ICICIdirect.com Research

Food inflation basket witnessed contraction, with inflation at (-)0.70% in December against 1.54% in November

Exhibit 6: Fuel group - Breakdown by components (YoY%)

	Weights	Month			Average FY16	Average FY15
		Dec-15	Nov-16	Dec-16		
Fuel Group	14.9	-9.15	7.07	8.65	-11.67	-0.95
Coal	2.1	0.05	0.68	0.68	0.05	-0.51
Mineral Oils	9.4	-15.47	12.35	14.84	-18.30	-2.79
Controlled Fuel :						
LPG	0.9	-2.51	1.80	2.09	-4.11	0.65
Kerosene	0.7	-4.03	9.64	12.12	-6.27	-6.80
High Speed Diesel	4.7	-13.80	19.26	20.25	-16.28	2.49
Market determined fuel :						
Petrol	1.1	-7.90	5.54	8.52	-10.25	-5.44
Aviation Turbine fuel	0.3	-32.74	14.09	10.67	-34.22	-12.05
Light Diesel Oil	0.1	-20.34	-1.78	3.31	-34.36	-13.38
Bitumen	0.2	-29.07	-7.59	-6.33	-28.82	-4.95
Furnace Oil	0.5	-40.69	13.90	32.65	-41.05	-14.81
Lubricants	0.2	-0.11	0.00	0.00	2.11	4.73
Electricity	3.5	5.73	-2.77	-2.77	3.74	5.88

Source: CSO, ICICIdirect.com Research

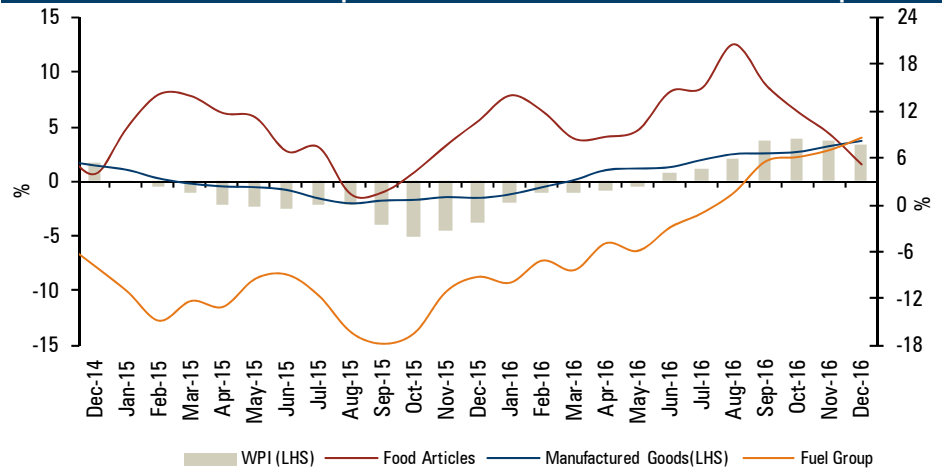
Fuel and manufactured goods inflation rose in December due to rise in metals & crude oil prices

Exhibit 7: Manufactured goods - Breakdown by components (YoY%)

	Weights	Month			Average FY16	Average FY15
		Dec-15	Nov-16	Dec-16		
Manufactured Goods	65.0	-1.49	3.20	3.67	-1.10	2.42
Food Products	10.0	1.69	10.73	10.75	0.77	2.41
Manufacturing Ex Food	55.0	-0.57	-0.53	-0.22	-1.49	2.44
Beverages & Tobacco	1.8	2.03	7.36	7.67	2.86	7.93
Textiles	7.3	-1.13	1.58	1.43	-1.72	2.62
Wood & Wood Products	0.6	3.28	0.56	-0.82	4.21	4.86
Paper & Paper Products	2.0	2.58	1.10	1.29	2.57	5.40
Leather & Leather Products	0.8	0.21	1.87	1.04	-0.13	1.33
Chemicals & Chemical Products	12.0	-1.71	0.47	0.60	-1.47	2.64
Non-Metallic Mineral Products	2.6	2.71	0.39	0.56	2.60	3.98
Basic Metals	10.7	-9.23	2.90	5.42	-6.63	0.62
Machinery & Machine Tools	8.9	0.22	0.37	0.44	0.25	2.28
Transport, Equipment & Parts	5.2	1.47	1.30	1.45	1.33	1.28

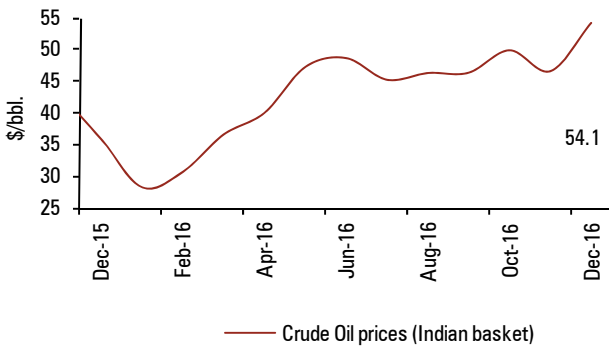
Source: CSO, ICICIdirect.com Research

Exhibit 8: WPI continues to trend upwards on lower base & rise in crude oil and metal prices



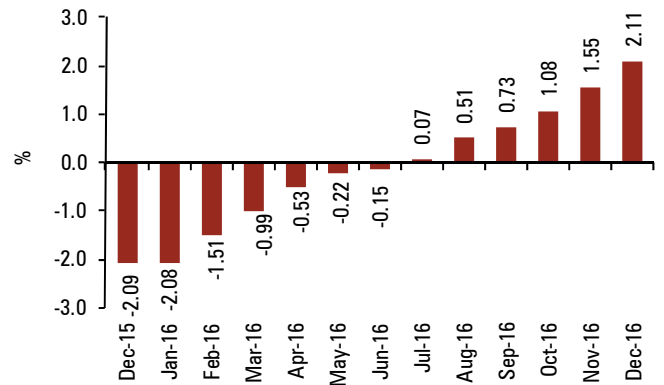
Source: CSO, ICICIdirect.com Research

Exhibit 9: Crude oil prices remain range bound but shoot up in December



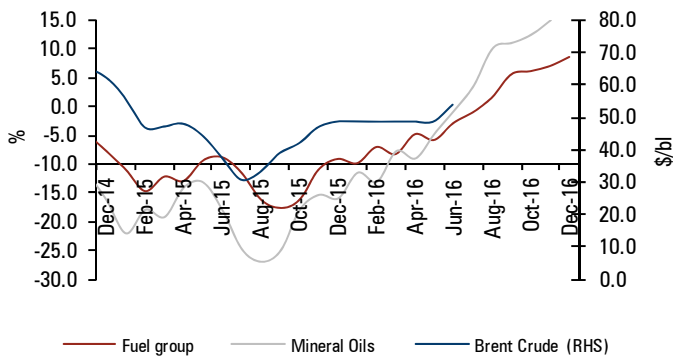
Source: ppac.org.in, ICICIdirect.com Research

Exhibit 10: Core WPI rising steadily in last six months



Source: CSO, ICICIdirect.com Research

Exhibit 11: Fuel group and mineral inflation rise sharply



Source: Bloomberg, CSO, ICICIdirect.com Research



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