

14 January 2016

WPI

Food spearheads the pull back

For the 14th month running, in Dec'15 the WPI continued in deflation (-0.7%). The pullback in WPI inflation stemmed primarily from food. The high inflation in pulses and onions, and hardening inflation in other foods, are driving food inflation. Fuel deflation fell to single digits (-9.1%), while manufactured products slowed slightly to -1.4%. While WPI inflation could be positive in the next few months, the lagged impact of crude might push WPI back into deflation. Any rate cut would be decided on by the trajectory of CPI inflation; if the CPI is in sync with the RBI's inflation target, another 50- to 75-bp rate-cut in 2016 is likely.

Performance. WPI inflation in Dec'15 was -0.7% (-2% in Nov'15). The jump in food inflation, at 6.2%, was considerable (3.8% last month). Deflation in fuel & power rose to -9.1% (vs. -11.1%). Manufactured-product deflation was also slightly lower (-1.4%). Non-core inflation (0.8%) turned positive after 13 months. Core deflation slowed to -2% (a 151bp correction). Ytd deflation was -3%, within which, the fuel and power component is in a -12.6% deflation. In the past five months WPI inflation rose 433bps.

Assessment. For the fifth month in a row, WPI deflation has been lower. After having risen for the past three months, the WPI fell in Dec'15. While the food index has gone up, both manufactured product and fuel indices have dropped. Pulses inflation, corrected marginally to 56%, inflation in onion and tomatoes also fell. Potatoes persisted in deflation. The upswing in other vegetables, fruit and spices is causing the hardening. There was broad-based deflation in basic metals, textiles, rubber & plastic products due to falling commodity prices.

Outlook. While prices of food items are likely to continue to firm up, the trend in sensitive items such as pulses, onion and tomatoes are downward. The impact of the fall in crude prices in Nov and Dec'15 has yet to be factored into the fuel deflation. So, while WPI might turn positive in the next couple of months, it is likely to slip into the negative, again. Surplus global capacity and the slowdown in global recovery would prolong the capex cycle; so, the turnaround in manufactured-product inflation would be protracted.

Recommendations. We expect the CPI to hold within the RBI's target of under 6% for Jan'16. The upside risks to this figure are contained—for two reasons. First, falling crude prices; second, low MSP rise for *rabi* and *kharif* crops announced for FY16. The MSP announced for the *rabi* crop ranges between 5% and 8%; for *kharif* crops it is around 2% to 4%. We expect CPI inflation to peak in Jan'16. If this downshift plays out, scope remains for another 50- to 75-bp rate cut in 2016. The rate-cut is likely to be introduced, post-Budget.

WPI Inflation (Dec'15): -0.7%

CPI Inflation (Dec'15): 5.6%

Fig 1 – WPI deflation turning around

	Year-end		
	Mar-15	Dec-15	YTD
Wholesale Price Index	2.0	-0.7	-3.0
Primary Articles	3.0	5.5	-0.5
Food	6.1	8.2	3.0
Fuel & Power	-0.9	-9.1	-12.6
Mineral Oils	-2.8	-15.5	-19.6
Manufactured Products	2.4	-1.4	-1.3
Food	2.4	2.0	-0.4

Source: Government of India

Fig 2 – Small volatility noted in index



Source: Government of India

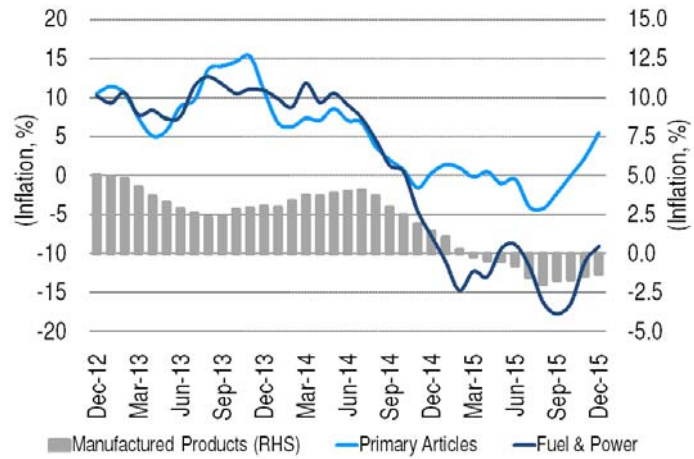
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Protracted deflation in fuel and power

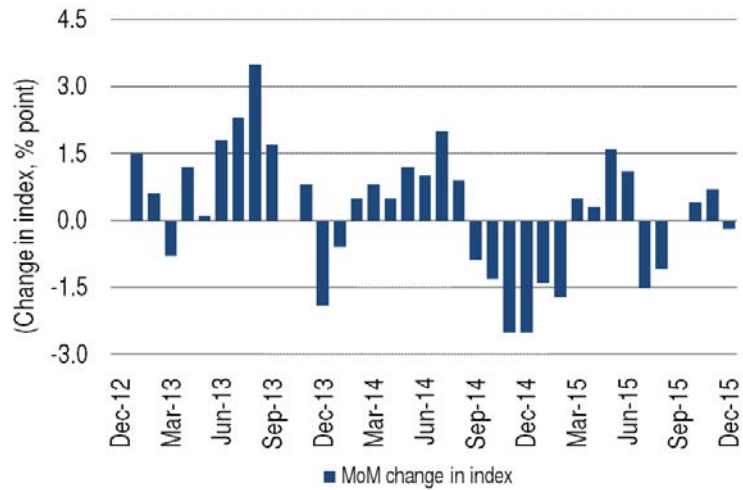
Fig 3 – Broad-based increase in WPI inflation



Source: Gol

Volatility of the WPI index has gone down in the past year

Fig 4 – Rising food index working 'ainst the fall in fuel and manufacturing indices



Source: Gol

Non-food inflation still deep in the negative

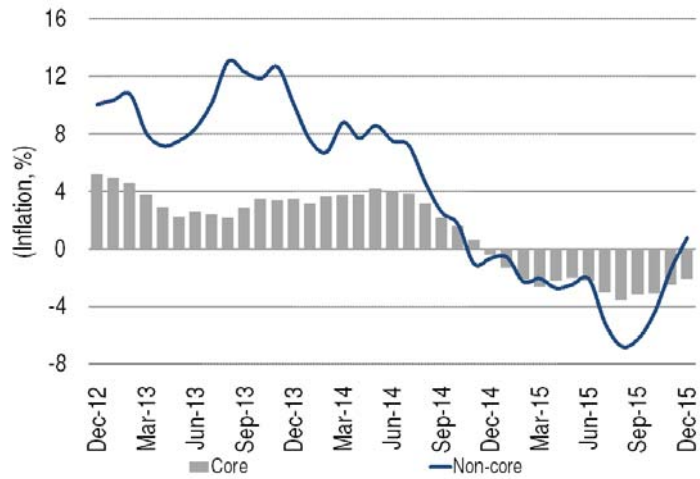
Fig 5 – Deflation in non-food counter balancing rising food inflation



Source: Gol

Fuel deflation has kept non-core in the negative

Fig 6 – Non-core inflation overtakes core inflation



Source: GoI

We have been importing deflation for more than a year

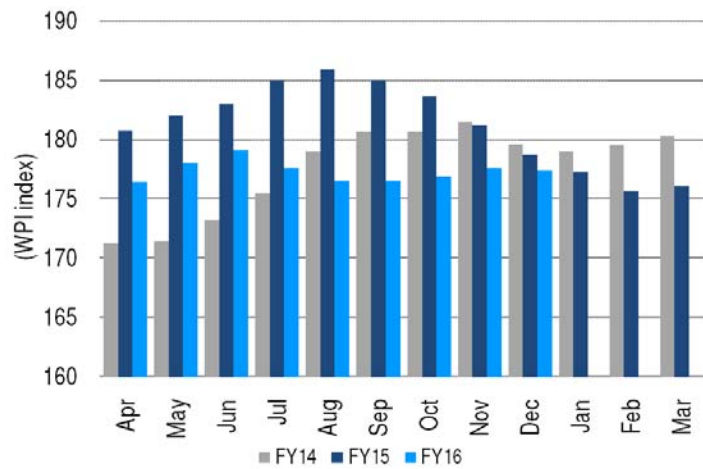
Fig 7 – Domestic and imported deflation bottomed out in Aug'15



Source: GoI

In FY16, the index has been lower than in FY15

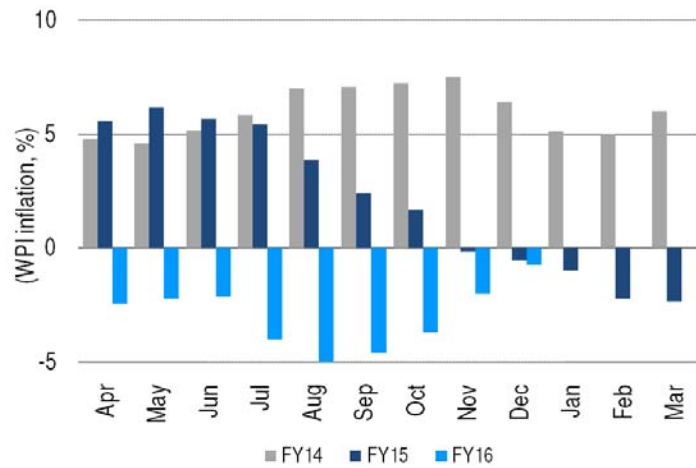
Fig 8 – Base would turn favourable in Q4 FY16



Source: GoI

Longest stretch of deflation

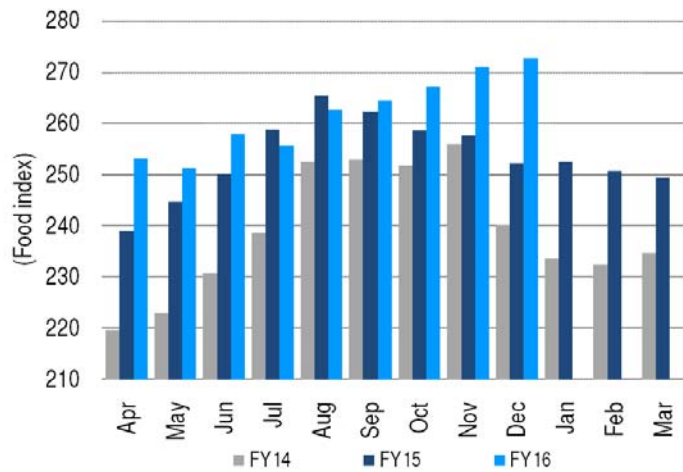
Fig 9 – WPI in deflation for 14th month; fast approaching zero



Source: GoI

The food index has been climbing for the past five months

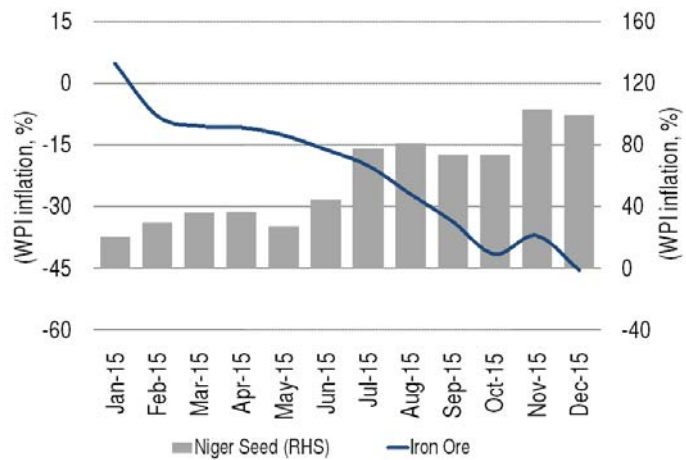
Fig 10 – Food index hits all-time high



Source: GoI

Of the WPI components, iron-ore and niger seed saw the highest inflation and steepest deflation, respectively, in Dec'15

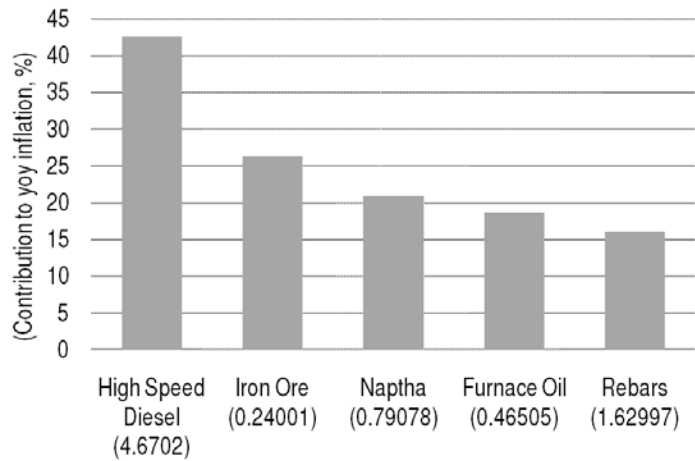
Fig 11 – Falling commodity prices have led to high deflation in iron ore



Source: GoI

Broad-based deflation in fuel components

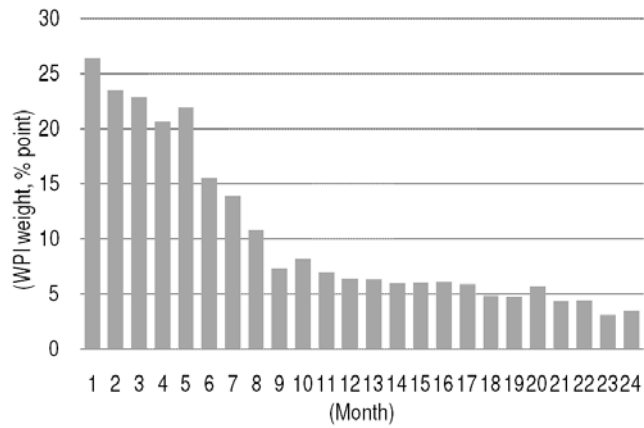
Fig 12 – High-speed diesel, the largest contributor to the fall



Source: Gol

Considerable revisions in the first five months

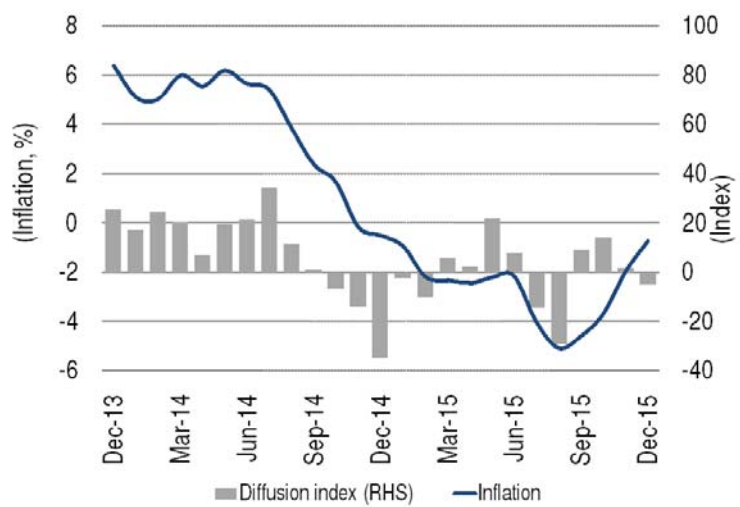
Fig 13 – Significant WPI revisions for the second month



Source: Gol

The diffusion index has been volatile over the past year

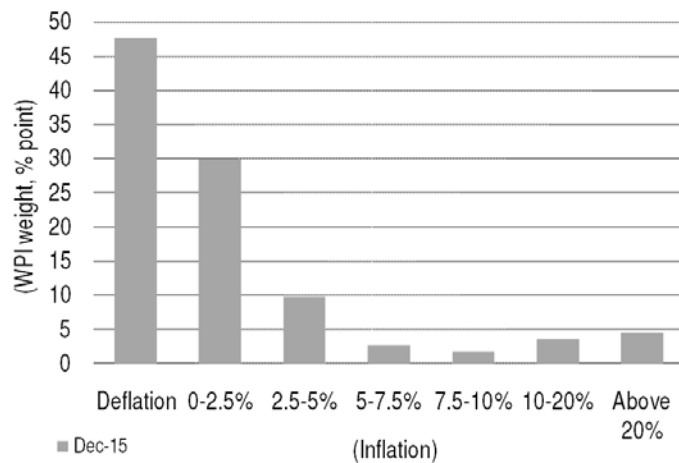
Fig 14 – Diffusion index showing inflation is tilted towards a few commodities



Source: Gol

Less than 5% inflation in nearly 90% of goods

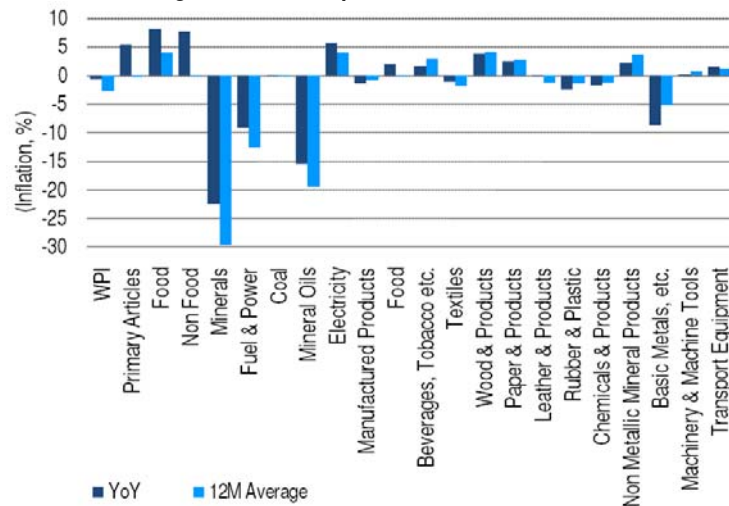
Fig 15 – Nearly half the goods in deflation; very few goods facing high inflation



Source: Gol

Low commodity prices having a huge impact

Fig 16 – Inflation starting to rise in a few pockets



Source: Gol

FY16 WPI inflation likely to be negative

Fig 17 – WPI continues in deep deflation

	Year ending					YTD
	Weights	Mar-14	Mar-15	Nov-15	Dec-15	
Wholesale Price Index	100.0	6.0	2.0	-2.0	-0.7	-3.0
Primary Articles	20.1	9.8	3.0	2.3	5.5	-0.5
Food	14.3	12.8	6.1	5.2	8.2	3.0
Non Food	4.3	5.6	-0.5	6.3	7.7	2.0
Minerals	1.5	-0.1	-11.0	-28.9	-22.5	-29.7
Fuel & Power	14.9	10.2	-0.9	-11.1	-9.1	-12.6
Coal	2.1	-8.5	-0.5	0.1	0.1	0.1
Mineral Oils	9.4	11.6	-2.8	-18.1	-15.5	-19.6
Electricity	3.5	22.2	5.9	5.7	5.7	4.4
Manufactured Products	65.0	3.0	2.4	-1.4	-1.4	-1.3
Food	10.0	3.2	2.4	0.9	2.0	-0.4
Beverages, Tobacco etc.	1.8	6.1	7.9	2.0	1.6	2.7
Textiles	7.3	5.8	2.6	-1.5	-1.1	-2.1
Wood & Products	0.6	4.7	4.9	5.5	3.9	4.5
Paper & Products	2.0	4.6	5.4	2.3	2.5	2.6
Leather & Products	0.8	6.7	1.3	-1.6	0.1	-1.0
Rubber & Plastic	3.0	6.2	2.6	-2.6	-2.4	-1.7
Chemicals & Products	12.0	3.6	2.6	-1.7	-1.7	-1.6
Non Metallic Mineral Products	2.6	1.8	4.0	1.0	2.2	3.0
Basic Metals, etc.	10.7	-0.9	0.6	-7.8	-8.7	-6.3
Machinery & Machine Tools	8.9	2.6	2.3	0.1	0.2	0.4
Transport Equipment	5.2	3.6	1.3	1.5	1.5	1.3

Source: Gol

Appendix

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