

HIGHLIGHTS

- *The year-on-year (YoY) CPI inflation surprised on the downside, declining to a 17-month low print of 2.3% in November 2018 from 3.4% in October 2018, undershooting our and consensus expectation.*
- *The sequential moderation in the CPI inflation in November 2018 was led by a combination of favourable factors such as the correction in retail fuel prices, discomfiting factors like the deeper disinflation in food prices, and base effects related to the waning impact of the revision in house rent allowance (HRA) for central government employees.*
- *The food and beverages sub-index recorded a series-low disinflation of 1.7% on a YoY basis in November 2018, partly reflecting the base effect, as well as the trends for vegetables, egg, sugar etc.*
- *The core-CPI inflation (excluding food and beverages, fuel and light, as well as petrol and diesel for vehicles) dipped to 5.7% in November 2018 from 6.0% in October 2018, led primarily by miscellaneous items, housing, and clothing and footwear.*

OVERVIEW

- The CPI inflation corrected to a 17-month low of 2.3% in November 2018 (+4.9% in November 2017) from 3.4% in October 2018 (+3.6% in October 2017; refer Exhibit 1 and 2), and undershot our forecast (+3.0%) and consensus expectations (+2.7%). This sequential moderation was led by a combination of factors such as the correction in retail fuel prices, deeper disinflation in food prices, and base effects related to the waning impact of the HRA revision for central government employees. Moreover, the CPI inflation remained below the Monetary Policy Committee's (MPC's) medium term target of 4.0%, for the fourth month in a row.
- The disinflation in the food and beverages sub-index worsened to a series-low 1.7% in November 2018 (+4.4% in November 2017) from 0.1% in October 2018 (+2.3% in October 2017; refer Exhibit 3), partly on account of the base effect. Moreover, the YoY CPI inflation print eased in November 2018 relative to October 2018, for most sub-indices, such as vegetables (to -15.6% from -8.1%), egg (to -3.9% from +2.2%), sugar and confectionary (to -9.0% from -7.6%), cereals and products (to +1.3% from +2.6%), oils and fats (to +1.6% from +2.2%), fruits (to +0.2% from +0.5%), and milk and products (to +0.8% from +0.9%). However, the YoY inflation rose in November 2018 relative to October 2018 for meat and fish (to +5.0% from +3.2%), pulses and products (to -9.2% from -10.4%), non-alcoholic beverages (to +3.4% from +2.3%), and spices (to +3.1% from +2.7%). In month-on-month (MoM) terms, the food and beverages sub-index declined by 0.1% in November 2018, in contrast to the considerable rise of 1.4% that had been recorded in November 2017 (refer Exhibit 4), driven by the trend in vegetables (-1.8%, +6.9%).
- The inflation related to fuel and light corrected to 7.4% in November 2018 (+8.2% in November 2017) from 8.5% in October 2018 (+6.4% in October 2017). While this sub-index rose by a substantial 1.3% in MoM terms in November 2018, this was lower than the increase of 2.3% recorded in November 2017.
- The core-CPI inflation softened to 5.7% in November 2018 from the three-month high 6.0% in October 2018 (refer Exhibit 5), led by miscellaneous items, housing, and clothing and footwear. On an MoM basis, this sub-index rose by 0.3% in November 2018, lower than

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the uptick of 0.7% recorded in November 2017. Nevertheless, the core-CPI inflation remained at elevated levels in November 2018 and the wedge between headline and core-CPI inflation widened to 335 bps in November 2018 from 267 bps in October 2018.

- The inflation for miscellaneous items (with a weight of 28.3% in the CPI) dipped to 6.2% in November 2018 from 6.7% in October 2018. The YoY CPI inflation eased in November 2018 relative to the previous month for transport and communication (to +6.1% from +7.7%, reflecting the recent fall in prices of fuels such as petrol and diesel), healthcare (to +7.2% from +7.8%), personal care and effects (to +4.1% from +5.2%), and household goods and services (to +5.8% from +6.1%). In contrast, the CPI inflation rose for education (to +6.6% from +6.2%), and recreation and amusement activities (to +5.9% from +5.0%) in November 2018 relative to October 2018. On an MoM basis, the sub-index for miscellaneous items was unchanged in November 2018, in contrast to the 0.5% rise in November 2017.
- Reflecting the favourable base effect, housing inflation (with a weight of 10.1% in the CPI Index) softened further to a 15-month low 6.0% in November 2018 from 6.6% in October 2018. In MoM terms, the sub-index rose by 0.4% in November 2018, considerably lower than 0.9% increase recorded in November 2017, which had reflected the staggered impact of the revision in house rent allowance for Central Government employees.
- Moreover, the inflation for clothing and footwear (with a weight of 6.5% in the CPI) eased to a series-low 3.5% in November 2018 from 3.6% in October 2018. In MoM terms, the sub-index for clothing and footwear rose by 0.7% in November 2018, similar to the uptick recorded in November 2017.
- The inflation for pan, tobacco and intoxicants (with a weight of 2.4% in the CPI) remained largely steady at 6.1% in November 2018. Moreover, this sub-index increased by a substantial 1.1% in MoM terms in November 2018, similar to the rise recorded in November 2017.
- The urban CPI inflation moderated to a 16-month low 3.1% in November 2018 from 4.0% in October 2018, led by food and beverages (to -1.7% from -0.2%), housing (to +6.0% from +6.6%), pan, tobacco and intoxicants (to +5.2% from +6.1%), clothing and footwear (to +5.2% from +5.4%) and miscellaneous items (to +5.8% from +6.4%).
- Similarly, the rural CPI inflation softened to a mild 1.7% in November 2018 from 2.8% in October 2018, led by food and beverages (to -1.6% from -0.1%), fuel and light (to +6.7% from +8.4%), miscellaneous items (to +6.4% from +7.0%), clothing and footwear (to +2.4% from +2.5%), even as the price for pan, tobacco and intoxicants rose during these two months (to +6.4% from +6.0%). The urban CPI inflation exceeded the rural CPI inflation for the fifth month in a row in November 2018 (refer Exhibit 6).
- The buildup in the CPI inflation up to November 2018 stood at 3.2%, sharply lower than the buildup of 5.1% recorded up to November 2017.
- The final headline CPI inflation for October 2018 was revised to 3.4% from the initial 3.3%, partly reflecting the upward revision in meat and fish (to +3.2% from +3.0%) and fruits (to +0.5% from +0.4%).

OUTLOOK

The high frequency data reveals a mixed trend in food prices in early December 2018, with an uptick in some pulses, oils and milk offset by a seasonal correction in vegetables, as well as a dip in sugar. Factors such as weak post-monsoon rainfall and lagging rabi sowing cast some doubt on how long food prices would remain in the disinflation zone.

The recent stabilisation in crude oil prices and the INR have eased concerns related to the trajectory for the CPI and the WPI inflation. In our view, the CPI inflation may remain sub-3% in December 2018, before rising in Q4 FY2019 led by an unfavourable base effect. Overall, the average CPI inflation is expected to record a mild rise to 3.9% in FY2019 from 3.6% in FY2018.

While it is too early to assess whether a rate cut would be forthcoming in the February 2019 review of the Monetary Policy Committee, there is a significant likelihood of a change in the monetary policy stance back to neutral from calibrated tightening. This is likely to serve as a precursor to a repo rate cut in Q1 FY2020, if inflationary risks arising from domestic and global factors, remain in check.

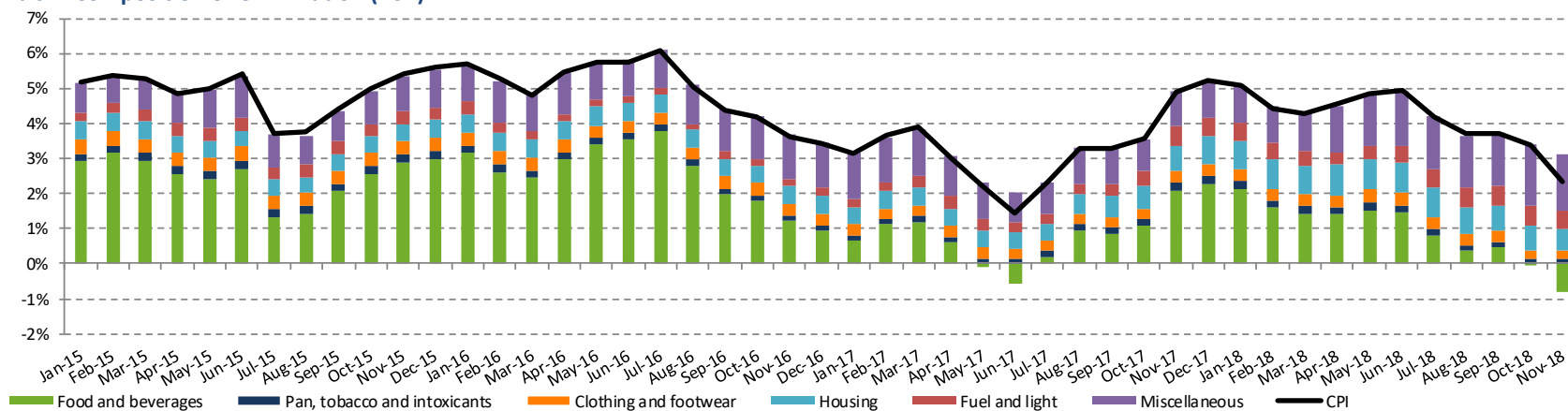
Exhibit 1: Trend in CPI Inflation (YoY)

	Weight	YoY Inflation				MoM	Buildup*
		Sep-18	Oct-18	Oct-18	Nov-18	Nov-18	Nov-18
		Final	Provisional	Final	Provisional	Provisional	Provisional
CPI (combined)	100.00	3.7%	3.3%	3.4%	2.3%	0.1%	3.2%
Food and beverages	45.86	1.0%	-0.1%	-0.1%	-1.7%	-0.1%	1.8%
Cereals and products	9.67	2.9%	2.6%	2.6%	1.3%	-1.0%	0.9%
Meat and fish	3.61	2.4%	3.0%	3.2%	5.0%	1.9%	4.1%
Egg	0.43	3.8%	2.2%	2.3%	-3.9%	2.3%	-0.7%
Milk and products	6.61	2.4%	0.9%	0.9%	0.8%	0.1%	0.5%
Oils and fats	3.56	3.1%	2.2%	2.1%	1.6%	-0.3%	0.3%
Fruits	2.89	1.7%	0.4%	0.5%	0.2%	0.2%	-2.5%
Vegetables	6.04	-4.2%	-8.1%	-8.1%	-15.6%	-1.8%	9.0%
Pulses and products	2.38	-8.7%	-10.3%	-10.4%	-9.2%	0.4%	-4.4%
Sugar and confectionary	1.36	-6.4%	-7.6%	-7.6%	-9.0%	-0.5%	-3.6%
Spices	2.50	2.9%	2.8%	2.7%	3.1%	0.7%	2.3%
Pan, tobacco and intoxicants	2.38	5.6%	6.1%	6.1%	6.1%	1.1%	4.0%
Clothing and footwear	6.53	4.6%	3.6%	3.6%	3.5%	0.7%	2.6%
Housing	10.07	7.1%	6.6%	6.6%	6.0%	0.4%	3.5%
Fuel and light	6.84	8.6%	8.5%	8.5%	7.4%	1.3%	6.4%
Miscellaneous	28.32	5.6%	6.7%	6.7%	6.2%	0.0%	4.6%
Household goods and services	3.80	4.8%	6.1%	6.0%	5.8%	0.4%	4.9%
Health	5.89	6.0%	7.9%	7.8%	7.2%	0.4%	5.8%
Transport and communication	8.59	6.5%	7.7%	7.7%	6.1%	-1.1%	3.7%
Recreation and amusement	1.68	5.2%	4.9%	5.0%	5.9%	1.3%	4.7%
Education	4.46	6.4%	6.2%	6.2%	6.6%	0.9%	5.7%
Personal care and effects	3.89	4.1%	5.2%	5.2%	4.1%	-0.5%	3.0%
CPI-Food	36.55	0.5%	-0.9%	-0.9%	-2.6%	-0.3%	1.7%
CPI-Core	44.97	5.7%	6.1%	6.0%	5.7%	0.3%	4.0%
CPI Rural		3.3%	2.8%	2.8%	1.7%	0.1%	2.7%
CPI Urban		4.3%	4.0%	4.0%	3.1%	0.1%	3.7%

*Buildup with reference to March 2018

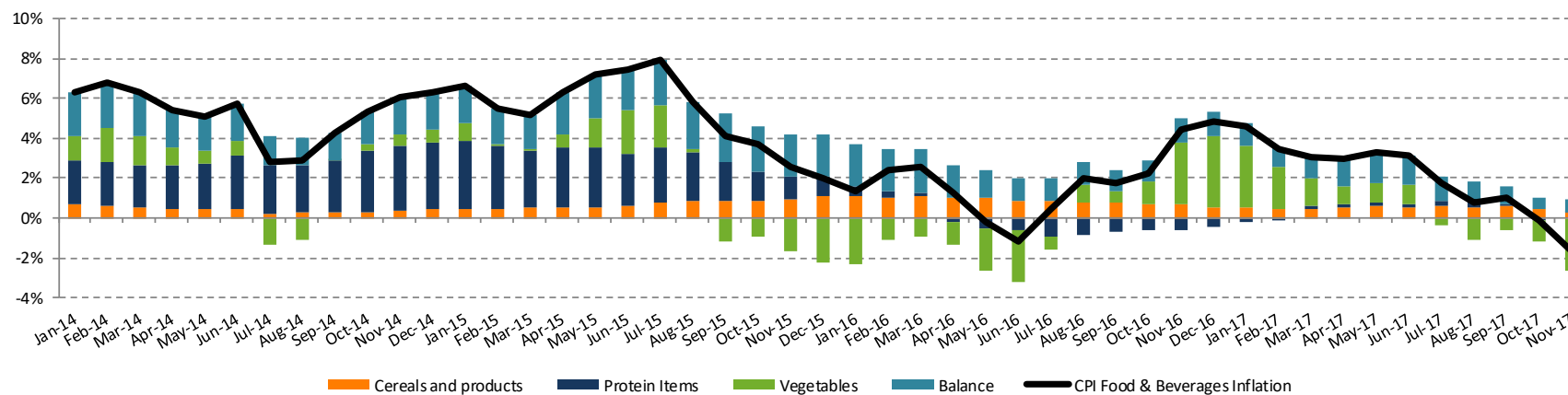
Source: Central Statistics Office (CSO); ICRA research

Exhibit 2: Composition of CPI Inflation (YoY)



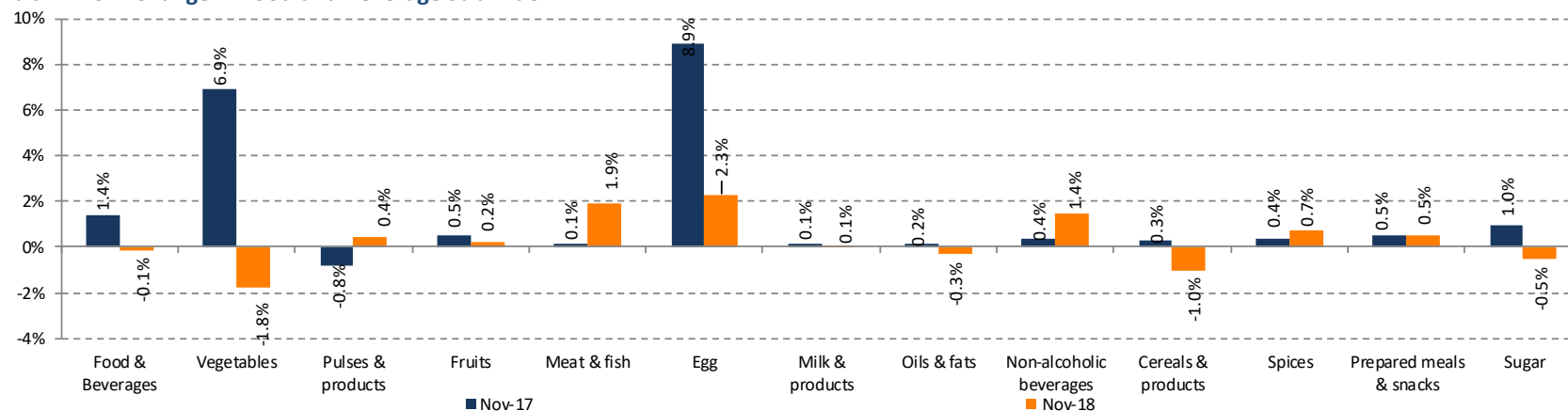
Source: CSO; ICRA research

Exhibit 3: Composition of Food and Beverages Inflation (YoY)



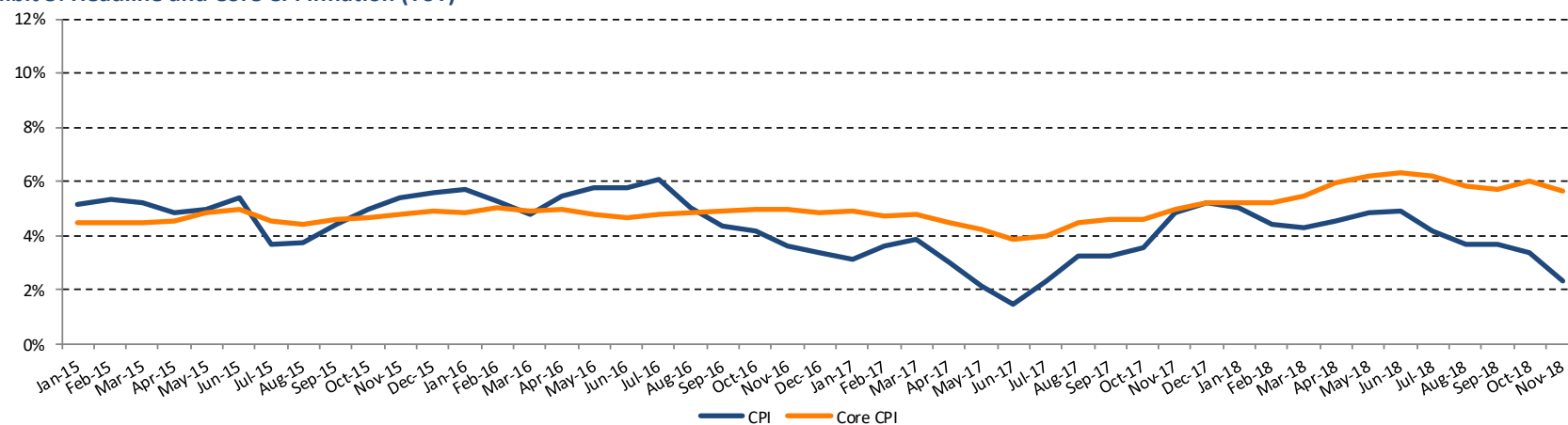
Source: CSO; ICRA research

Exhibit 4: MoM Change in Food and Beverage Sub-Index



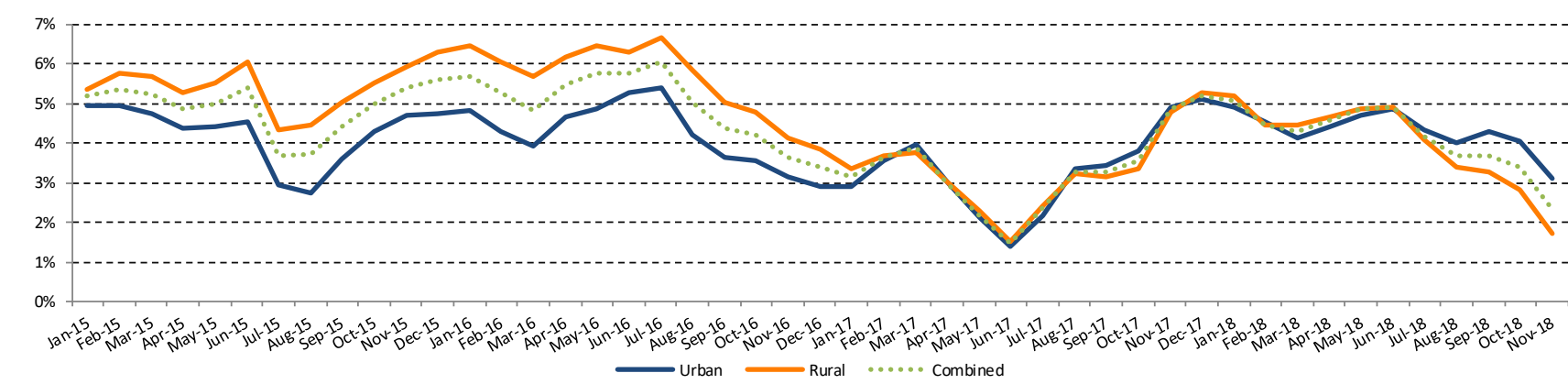
Source: CSO; ICRA research

Exhibit 5: Headline and Core CPI Inflation (YoY)



Source: CSO; ICRA research

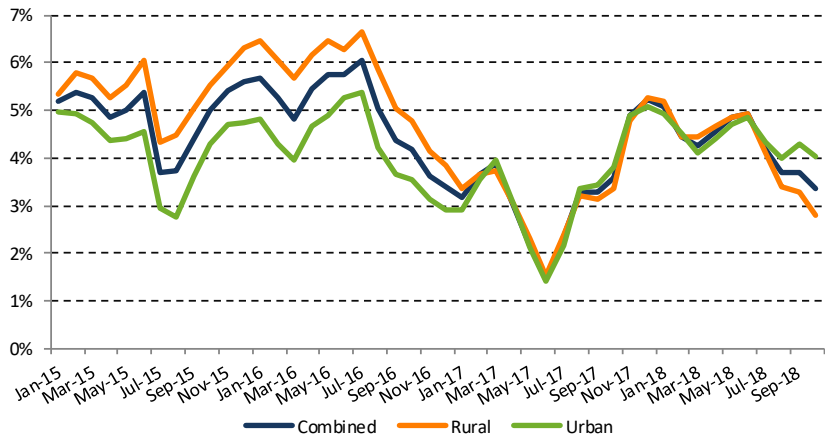
Exhibit 6: Rural and Urban CPI Inflation (YoY)



Source: CSO; ICRA research

ANNEXURE

Exhibit 7: CPI Inflation (YoY)



Source: CSO; ICRA research

Exhibit 8: Food and Beverages Inflation (YoY)

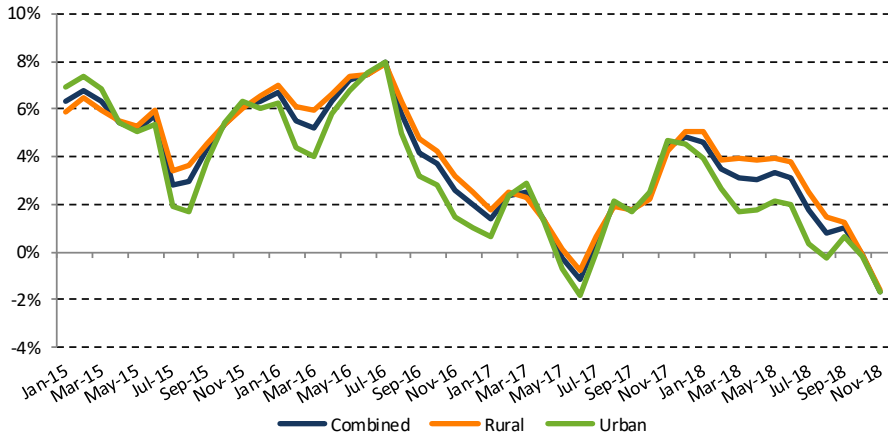
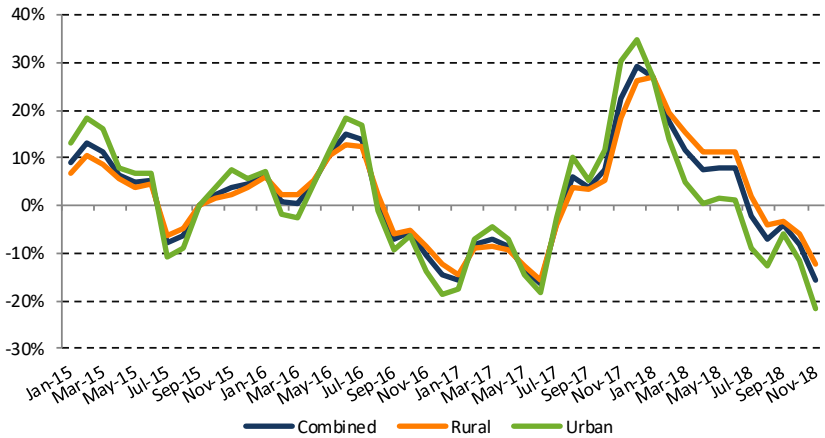


Exhibit 9: Vegetables Inflation (YoY)



Source: CSO; ICRA research

Exhibit 10: Fuel and Light Inflation (YoY)

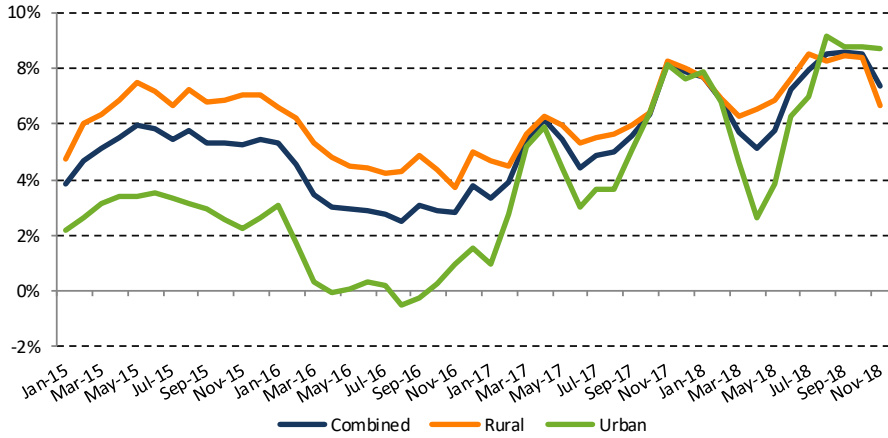


Exhibit 11: Housing Inflation (YoY)

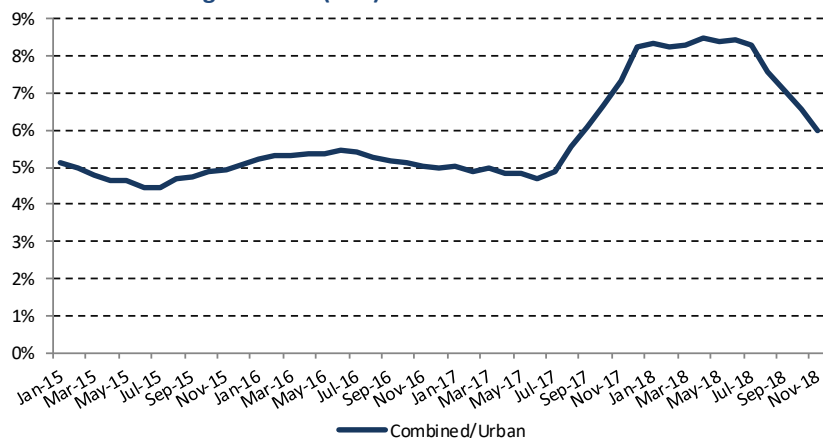
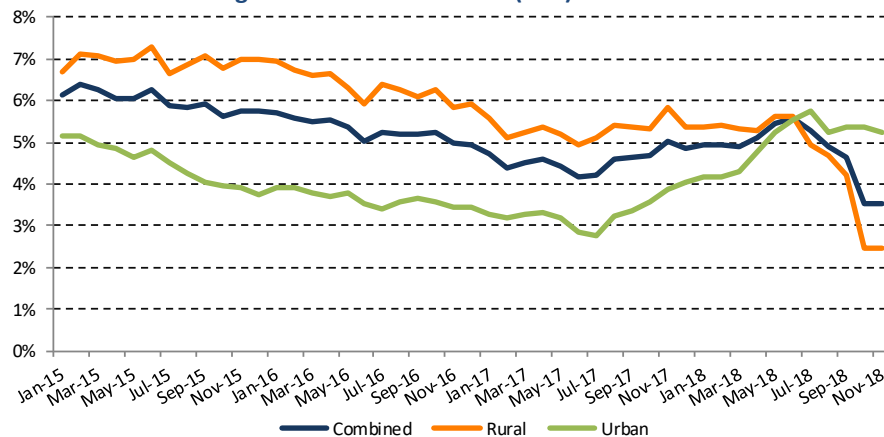


Exhibit 12: Clothing and Footwear Inflation (YoY)



Source: CSO; ICRA research

Exhibit 13: Miscellaneous Inflation (YoY)

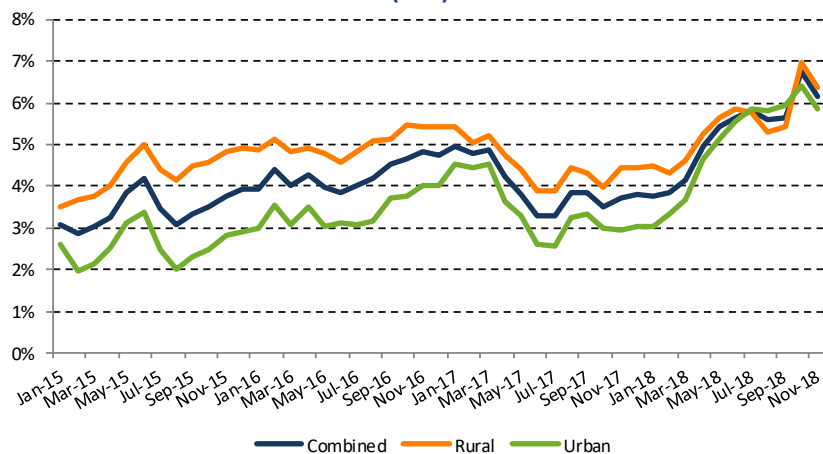
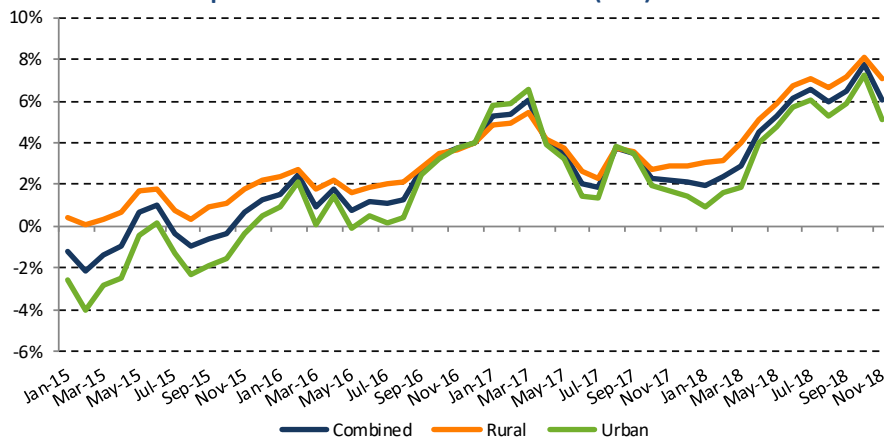


Exhibit 14: Transport and Communication Inflation (YoY)



Source: CSO; ICRA research



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