

April 2013

# CRISIL EconomyFirstCut

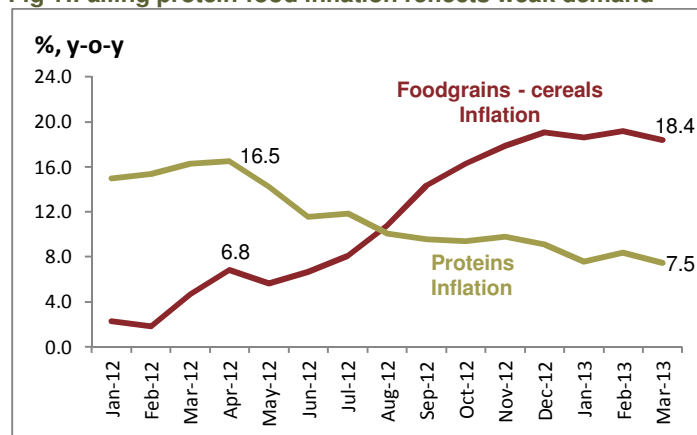
## Chill in demand cools inflation

WPI-based inflation fell to 5.96 per cent in March 2013 from 6.84 per cent in the previous month. This is the first time that WPI inflation has fallen below the 6.0 per cent mark in past 40 months. Average WPI inflation for 2012-13 stood at 7.3 per cent, significantly lower than 8.9 per cent inflation recorded in 2011-12. Core or non-food manufacturing inflation continued its downward momentum and fell to 3.5 per cent in March, reflecting reduced pricing power of corporates due to slowing demand in the economy (Figure 2). Household consumption growth slipped to a decadal year low of 4.1 % in 2012-13.

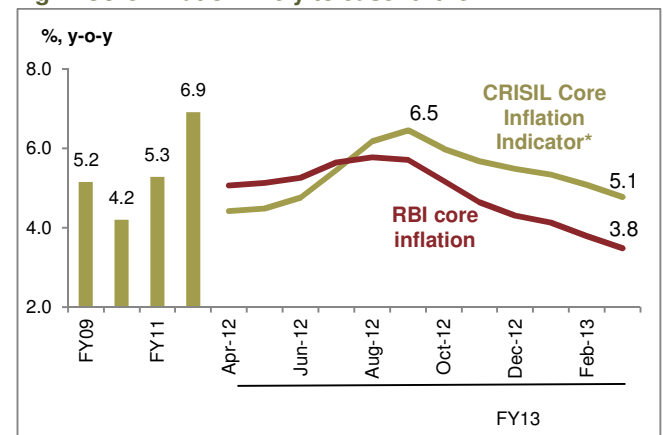
Weakening rural demand in 2012-13 has also reduced protein-food (milk, egg, fish & meat) inflation, which had risen significantly over the last few years driven by high growth in rural incomes (Figure1). Average protein-food inflation declined to 10.4 per cent in 2012-13 from 11.3 per cent in 2011-12 and 23.2 per cent in 2010-11.

**Our View:** In 2013-14, CRISIL Research forecasts average WPI inflation to decline to 6.3 per cent, led by expectations of higher agricultural output (assuming normal monsoons), lower international crude oil prices and further weakening of demand-side pressures. While core inflation may pick up momentum in the second half of the fiscal year as demand recovers slowly, average core inflation for 2013-14 is expected to be lower than in 2012-13. The probability of inflation surprising on the downside is high, in our opinion.

**Fig 1: Falling protein-food inflation reflects weak demand**



**Fig 2: Core inflation likely to ease further**



Note: CRISIL Core Inflation Indicator excludes base metals from manufacturing inflation

Source: Ministry of Commerce and Industry, CRISIL Research

- High food inflation in recent years has been largely attributed to rising rural demand for milk, egg, fish & meat leading to high protein-food inflation. In 2012-13, even though protein inflation declined sharply, overall food inflation continued to remain high at 9.8 per cent as inflation in cereals rose from 6.8 per cent to 18.4 per cent during the year (Figure 1). This was largely because of a 15 per cent increase in minimum support prices for foodgrain procurement by the government even as its stock of rice and wheat was almost 2.5 times higher than what is required by buffer norms.
- Core inflation as measured by CRISIL Core Inflation Indicator; fell to 4.2 per cent during the last crisis as growth slowed down sharply to 6.7 per cent in 2008-09 from 9.3 per cent in the preceding year. The current slowdown in growth - from 9.3 per cent in 2010-11 to 5.0 per cent in 2012-13 - has been far more pronounced and longer-lasting indicating that core inflation is likely to continue its downward momentum atleast for the H1, 2013-14.

Inflation in major inflation groups								Apr-Mar	
(2004-05 base)	Weight	Oct-12	Nov-12	Dec-12	Jan-13	Feb-13	Mar-13	FY12	FY13
<b>General</b>	100.0	7.3	7.2	7.3	6.6	6.8	6.0	8.9	7.3
<b>Primary</b>	20.1	7.8	9.6	10.6	10.3	9.7	7.6	9.8	9.7
- Food articles	14.3	6.7	8.8	10.6	11.9	11.4	8.7	7.3	9.8
- Non-Food articles	4.3	11.4	14.0	13.6	10.5	10.1	9.0	9.6	10.2
- Minerals	1.5	8.6	6.9	5.6	2.1	0.6	-0.4	26.6	8.0
<b>Fuel</b>	14.9	11.6	10.0	10.2	7.1	10.5	10.2	14.0	10.3
<i>of which</i>									
- Petrol	1.1	3.8	1.5	3.4	3.8	6.2	5.1	21.9	6.8
- Diesel	4.7	14.6	14.6	14.6	15.0	19.2	21.2	8.5	11.2
<b>Manufacturing</b>	64.9	5.9	5.4	5.0	4.8	4.5	4.1	7.3	5.4
- Food	9.9	9.8	9.2	8.7	8.2	8.2	7.0	7.1	8.0
- Non Food	55.0	5.2	4.6	4.3	4.1	3.8	3.5	7.3	4.8
- CCII	55.9	6.0	5.7	5.5	5.3	5.1	4.8	6.9	5.3

Source: Ministry of Commerce and Industry, CRISIL Research

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