

India Macro Flash

Reining in Food Inflation – It's Not a Distant Dream!

■ Inflation a priority: BJP manifesto; committee report chaired by Mr. Modi –

While the overwhelming election mandate has energized equity and currency markets ([Big Win...Big Possibilities](#)), fears of elevated inflation/higher borrowing have resulted in rates market remaining lackluster with 10y yields trading at 8.75%. However, this could change. As seen on pg.2, while CPI food inflation has averaged 11% in the last three years, the political intent as reflected in the BJP manifesto coupled with the credible game plan submitted by none other than Mr. Modi in 2011 bodes well for the inflation outlook. India's watchful central bank is another positive.

■ What can be done? — Short-term fixes to long-term solutions

– **Near term:** Sub-optimal food grain price and procurement policies have resulted in surplus of food grain stocks of 55mt (rice 17mt, wheat 34mt) against the buffer norm of 21mt (rice 14mt+wheat 7mt). An immediate solution could be to offload or run-down wheat inventory (10% lower wheat prices to lower CPI by 50bps). There is a possibility of re-visiting futures trading of “essential commodities.”

– **Medium term:** Measures include (1) Calibrating MSP rates with market prices; (2) Setting up a Price Stabilization Fund – viz. a price spectrum band possibly similar to the 2003 scheme for plantation crops; (3) Modification of APMC Act that would enable competitive markets; and (4) Unbundling FCI operations into procurement, storage and distribution which could improve efficiency.

– **Long term:** Optimizing agri market efficiency would entail creating (1) a robust supply chain infrastructure for agri produce (storage, transportation etc.); (2) a single National Agriculture Market, similar to the centre-state structure being contemplated regarding ‘unlocking’ investments (See [Post Election Investor Concerns](#)); and (3) River linking to improve irrigation capabilities.

■ **CPI outlook: To come off with a lag** — We maintain our view of CPI averaging 8% in FY15 and 6.5% in FY16 (see pg.3). The decline in CPI inflation would largely be in line with the “glide path” envisaged by the Patel committee report. In the immediate term, we acknowledge the upside risks on inflation from (1) El Nino and (2) suppressed inflation in the fuel / energy space.

■ **Monetary policy implication: Potential room for easing in 2015** — As regards monetary policy, we maintain our view of an extended pause on rates through 2014 as CPI inflation should roughly meet RBI's target of 8% by Jan'15 and 6% by Jan'16. In the event that the BJP government takes definite measures to improve food procurement policy, off load excess food grain stocks, calibrate MSP hikes etc., the space could open up for an easing of policy rates in 2015.

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With thanks to

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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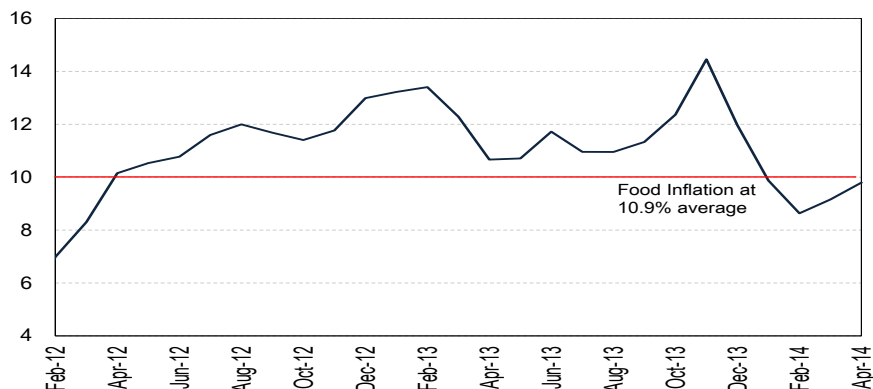
What can be done... Offloading Food Stocks

AVG FOOD INFLATION AT 11%

Since FY12, food inflation has averaged 11%... but this could change .

Considering 1/3rd weight of wheat in the Cereals index (wt=14.6% in CPI) , a 10% decline in wheat prices would lower CPI inflation by close to 50bps.

Figure 1. India – New CPI Food Inflation (YoY)



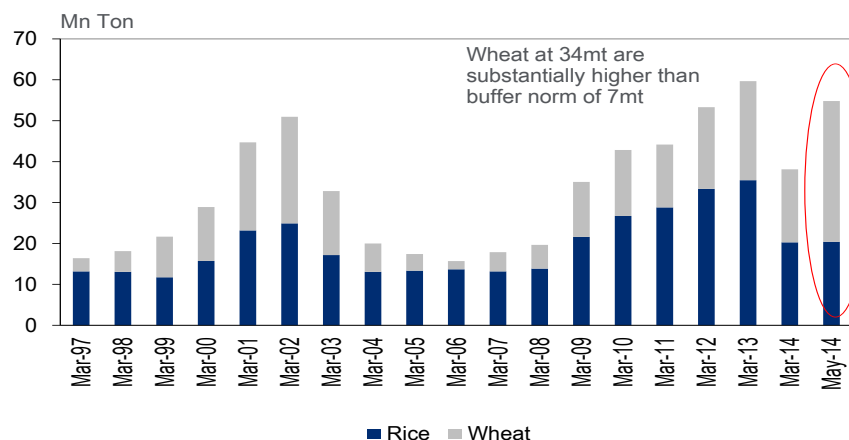
Source: Citi Research, CSO

OFFLOAD EXCESS FOOD STOCKS

Sub-optimal food grain price and procurement policies have resulted in surplus of food grain stocks of 55mt (rice 17mt, wheat 34mt) against the buffer norm of 21mt (rice 14mt+wheat 7mt).

An immediate solution could be to offload or run down wheat inventory (10% lower wheat prices to lower CPI by 50bps).

Figure 2. India – Food Grain Stocks with FCI (mn ton)



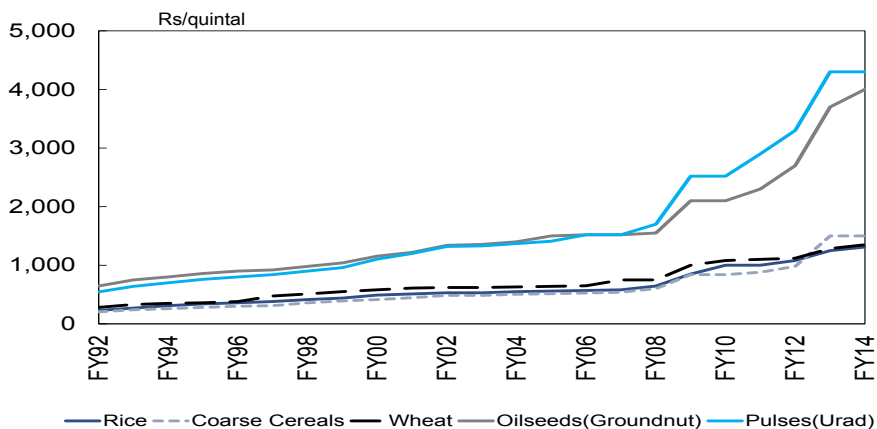
Source: Citi Research, FCI

CALLIBRATE MINIMUM SUPPORT PRICES WITH THE MARKET

Currently agri producers are armed with an MSP “put” option (increasing quantum of government food-grain procurement and at higher minimum support prices).

The MSPs of cereals and also oil seeds and pulses have risen sharply since FY09.

Figure 3. India – Trends in Minimum Supports Prices (Rs / Quintal)



Source: CACP

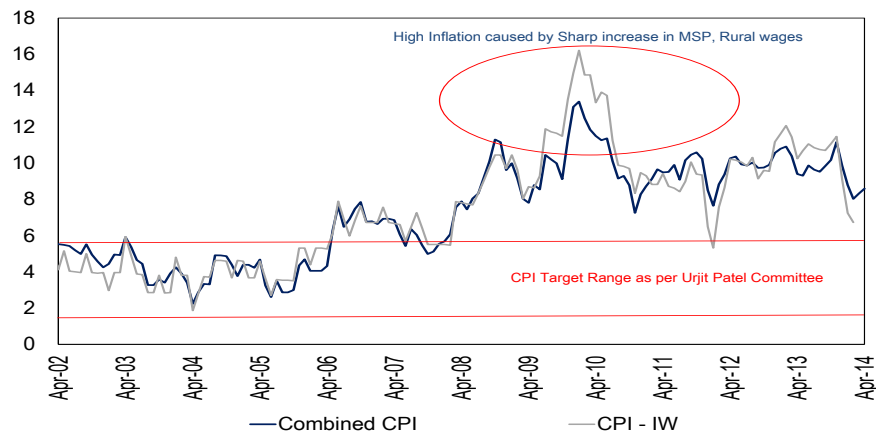
Inflation and Rates Outlook

CPI INFLATION OUTLOOK

We expect CPI to average 8% in FY15E vs. 9.5% in FY14. The easing trend could intensify in FY16 as impact of government and RBI action becomes more visible. As a result we expect CPI to decline to 6.5% in FY16E.

Key risks for inflation estimates remain (1) interplay between commodity and INR, (2) El Nino, and (3) evolving fiscal trends.

Figure 4. India – Historical Trend in CPI Inflation (%YoY)



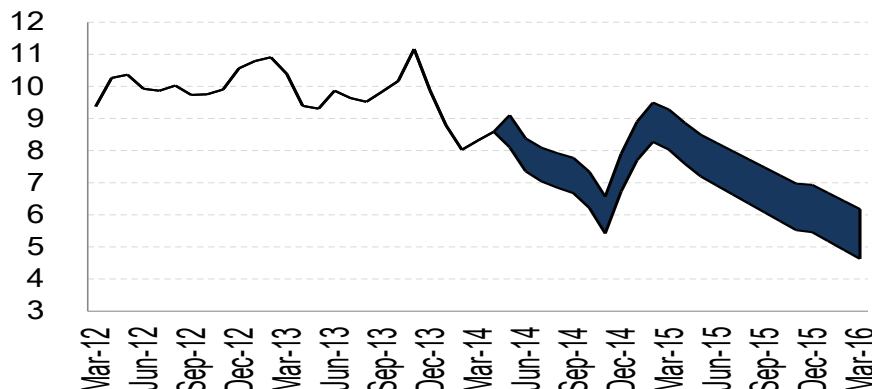
Source: Citi Research, RBI, Urjit Patel Committee Report

CPI TO FOLLOW “GLIDE PATH”

The decline in CPI inflation would largely be in line with the “glide path” envisaged by the Patel committee report i.e. 8% in Jan’15 and 6% in Jan’16.

In the near term, the inflation reading could benefit from favorable base effect from June-onwards and could trend towards sub 7% reading by November.

Figure 5. India – Projected Glide Path of CPI till FY16



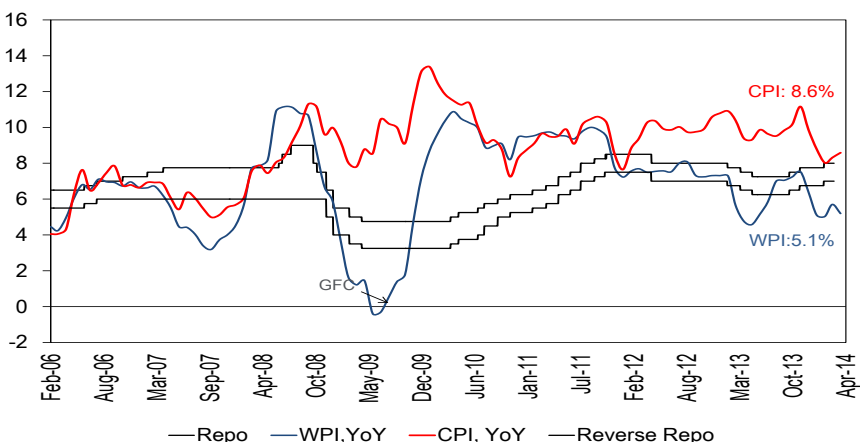
Source: Citi Research, CSO

PAUSE IN 2014: EASING SPACE TO OPEN UP IN 2015

We maintain our view of an extended pause on rates through 2014, as CPI inflation roughly meets RBI’s interim targets of 8% by Jan’15E and 6% by Jan’16E.

In the event that the new government takes definite measures to improve food procurement policy, offload excess food grain stocks, calibrate MSP hikes etc... the space could open up for an easing of policy rates in 2015.

Figure 6. India – Historical Trends in Repo Rate and Inflation (%YoY)



Source: Citi Research, RBI

Statistical Snapshot

Figure 7. India Macroeconomic Summary FY03 – 16E

| Fiscal Year to 31 March | FY03 | FY04 | FY05 | FY06 | FY07 | FY08 | FY09 | FY10 | FY11 | FY12 | FY13 | FY14 | FY15E | FY16E |
|--------------------------------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|
| National Income Indicators | | | | | | | | | | | | | | |
| Nominal GDP(Rs bn) | 25,500 | 28,617 | 32,422 | 36,934 | 42,947 | 49,871 | 56,301 | 64,778 | 77,841 | 90,097 | 101,133 | 113,205 | 127,921 | 145,830 |
| Nominal GDP (US\$ bn) | 527 | 623 | 720 | 834 | 950 | 1,241 | 1,224 | 1,367 | 1,708 | 1,873 | 1,873 | 1,874 | 2,063 | 2,352 |
| Per Capita GDP (US\$) | 499 | 582 | 662 | 754 | 847 | 1,090 | 1,061 | 1,168 | 1,440 | 1,558 | 1,539 | 1,495 | 1,646 | 1,848 |
| Real GDP growth (%) | 4.0 | 8.1 | 7.0 | 9.5 | 9.6 | 9.3 | 6.7 | 8.6 | 8.9 | 6.7 | 4.5 | 4.9 | 5.6 | 6.5 |
| Agriculture growth (%) | -6.6 | 9.0 | 0.2 | 5.1 | 4.2 | 5.8 | 0.1 | 0.8 | 8.6 | 5.0 | 1.4 | 4.6 | 0.5 | 3.0 |
| Industry growth (%) | 7.2 | 7.3 | 9.8 | 9.7 | 12.2 | 9.7 | 4.4 | 9.2 | 7.6 | 7.8 | 1.0 | 0.7 | 3.9 | 5.9 |
| Services growth (%) | 7.0 | 8.1 | 8.1 | 10.9 | 10.1 | 10.3 | 10.0 | 10.5 | 9.7 | 6.6 | 7.0 | 6.9 | 7.3 | 7.5 |
| By Demand (%YoY) | | | | | | | | | | | | | | |
| Consumption | 2.3 | 5.4 | 1.9 | 8.7 | 7.7 | 9.4 | 7.7 | 8.4 | 8.2 | 8.9 | 5.2 | 4.4 | 5.6 | 6.8 |
| Pvt Consumption | 2.9 | 5.9 | 1.7 | 8.6 | 8.5 | 9.4 | 7.2 | 7.4 | 8.7 | 9.3 | 5.0 | 4.1 | 5.5 | 7.0 |
| Public Consumption | -0.4 | 2.6 | 3.4 | 8.9 | 3.8 | 9.6 | 10.4 | 13.9 | 5.8 | 6.9 | 6.2 | 5.5 | 6.0 | 6.0 |
| Gross Fixed Capital Formation | 6.8 | 13.6 | 20.7 | 16.2 | 13.8 | 16.2 | 3.5 | 7.7 | 11.0 | 12.3 | 0.8 | 0.2 | 2.5 | 6.5 |
| Cons; Invst, Savings * (%GDP) | | | | | | | | | | | | | | |
| Consumption | 77.2 | 75.0 | 70.1 | 69.2 | 68.0 | 67.2 | 68.6 | 69.1 | 67.5 | 68.5 | 68.8 | 69.8 | 70.1 | 69.8 |
| Gross Capital Formation | 24.6 | 26.9 | 32.8 | 34.7 | 35.7 | 38.1 | 34.3 | 36.3 | 36.5 | 36.4 | 34.7 | 35.3 | 35.7 | 35.7 |
| Gross Domestic Savings | 25.4 | 28.7 | 32.4 | 33.4 | 34.6 | 36.8 | 32.0 | 33.7 | 33.7 | 31.3 | 30.1 | 30.5 | 30.8 | 31.0 |
| Real Indicators (%YoY) | | | | | | | | | | | | | | |
| Commercial vehicle sales | 40.4 | 36.2 | 22.4 | 10.1 | 33.3 | 4.2 | -21.4 | 39.2 | 27.0 | 19.5 | -1.9 | -20.2 | -4.5 | 11.6 |
| Car sales | 5.3 | 27.2 | 17.8 | 7.7 | 20.7 | 12.1 | 0.3 | 25.7 | 29.2 | 3.9 | 2.4 | -6.7 | 1.7 | 10.6 |
| Two-wheelers | 15.8 | 11.3 | 15.7 | 13.6 | 11.5 | -7.8 | 2.7 | 25.9 | 25.8 | 13.9 | 2.9 | 7.3 | 10.0 | 10.0 |
| Diesel consumption | 0.3 | 1.2 | 6.9 | 1.4 | 6.7 | 11.1 | 8.5 | 8.9 | 6.5 | 8.0 | 6.7 | -1.0 | 4.0 | 4.0 |
| Mobile Tele density | 1.3 | 3.1 | 4.8 | 8.2 | 14.1 | 22.0 | 33.0 | 48.5 | 66.8 | 75.1 | 79.0 | 87.9 | 78 | 80 |
| Monetary Indicators (% YoY) | | | | | | | | | | | | | | |
| Money supply | 16.1 | 13.0 | 14.0 | 15.9 | 20.0 | 22.1 | 20.5 | 19.2 | 16.2 | 15.8 | 13.4 | 17.0 | 18.0 | 18.0 |
| Inflation – WPI (Avg) | 3.4 | 5.5 | 6.5 | 3.7 | 6.5 | 4.8 | 8.0 | 3.6 | 9.6 | 8.8 | 7.5 | 5.9 | 5.5 | 5 |
| CPI (Avg) | 4.1 | 3.8 | 3.9 | 4.2 | 6.8 | 6.2 | 9.1 | 12.3 | 10.5 | 8.4 | 10.2 | 9.5 | 8.0 | 6.5 |
| Bank credit growth | 23.7 | 15.3 | 30.9 | 37.0 | 28.1 | 22.3 | 17.5 | 16.9 | 21.5 | 17.0 | 14.1 | 15.0 | 15.0 | 15.0 |
| Deposit growth | 16.1 | 17.5 | 13.0 | 24.0 | 23.8 | 22.4 | 19.9 | 17.2 | 15.9 | 13.5 | 14.2 | 13.5 | 14.0 | 14.0 |
| Fiscal Indicators (% GDP) | | | | | | | | | | | | | | |
| Centre's fiscal deficit | -5.7 | -4.3 | -3.9 | -4.0 | -3.3 | -2.5 | -6.0 | -6.5 | -4.8 | -5.7 | -4.9 | -4.6 | -4.1 | -4.0 |
| State fiscal deficit | -3.5 | -3.9 | -3.4 | -2.5 | -2.1 | -1.4 | -2.3 | -2.9 | -2.1 | -2.4 | -2.3 | -2.2 | -2.6 | -2.5 |
| Combined deficit (Centre+State) | -9.2 | -8.2 | -7.2 | -6.5 | -5.4 | -4.0 | -8.3 | -9.3 | -6.9 | -8.1 | -7.2 | -6.9 | -6.7 | -6.5 |
| Off Balance Sheet Items | | | | -0.5 | -0.9 | -0.6 | -1.7 | -0.2 | | | | | | |
| Combined liabilities (dom+ext) | 90.7 | 90.0 | 88.8 | 84.6 | 79.9 | 76.1 | 76.8 | 75.5 | 70.2 | 69.6 | 69.8 | 69.6 | 68.5 | 66.2 |
| External Sector (% YoY) | | | | | | | | | | | | | | |
| Exports (US\$bn) | 53.8 | 66.3 | 85.2 | 105.2 | 128.9 | 166.2 | 189.0 | 182.4 | 250.5 | 309.8 | 306.6 | 323.4 | 349.3 | 384.3 |
| % YoY | 20.3 | 23.3 | 28.5 | 23.4 | 22.6 | 28.9 | 13.7 | -3.5 | 37.3 | 23.7 | -1.0 | 5.5 | 8.0 | 10.0 |
| Imports (US\$bn) | 64.5 | 80.0 | 118.9 | 157.1 | 190.7 | 257.6 | 308.5 | 300.6 | 381.1 | 499.5 | 502.2 | 472.1 | 514.6 | 566.1 |
| %YoY | 14.5 | 24.1 | 48.6 | 32.1 | 21.4 | 35.1 | 19.8 | -2.6 | 26.7 | 31.1 | 0.5 | -6.0 | 9.0 | 10.0 |
| Trade deficit (US\$bn) | -10.7 | -13.7 | -33.7 | -51.9 | -61.8 | -91.5 | -119.5 | -118.2 | -130.6 | -189.8 | -195.7 | -148.7 | -165.3 | -181.8 |
| Invisibles (US\$bn) | 17.0 | 27.8 | 31.2 | 42.0 | 52.2 | 75.7 | 91.6 | 80.0 | 84.6 | 111.6 | 107.5 | 111.9 | 118.6 | 123.7 |
| Current Account Deficit (US\$bn) | 6.3 | 14.1 | -2.5 | -9.9 | -9.6 | -15.7 | -27.9 | -38.2 | -45.9 | -78.2 | -88.2 | -36.8 | -46.7 | -58.1 |
| % to GDP | 1.2 | 2.3 | -0.3 | -1.2 | -1.0 | -1.3 | -2.3 | -2.8 | -2.7 | -4.2 | -4.7 | -2.0 | -2.3 | -2.5 |
| Capital Account (US\$bn) | 10.8 | 16.7 | 28.0 | 25.5 | 45.2 | 106.6 | 7.4 | 51.6 | 62.0 | 67.8 | 89.3 | 50.1 | 63.6 | 77.6 |
| % GDP | 2.1 | 2.7 | 3.9 | 3.1 | 4.8 | 8.6 | 0.6 | 3.8 | 3.6 | 3.6 | 4.8 | 2.7 | 3.1 | 3.3 |
| Forex Assets (incl gold) (US\$bn) | 100.6 | 131.2 | 137.2 | 177.3 | 275.6 | 254.6 | 283.5 | 297.3 | 296.7 | 296.6 | 295.7 | 303.6 | 325.0 | 345.0 |
| Months of imports | 18.7 | 19.7 | 13.8 | 13.5 | 17.3 | 11.9 | 11.0 | 11.9 | 9.3 | 7.1 | 7.1 | 7.7 | 7.6 | 7.3 |
| External Debt (US\$bn) | 104.9 | 112.7 | 134.0 | 139.1 | 172.4 | 224.4 | 224.5 | 260.9 | 317.9 | 360.8 | 404.9 | 426.0 | 441.0 | 456.0 |
| Short Term Debt (US\$bn) | 4.7 | 4.4 | 17.7 | 19.5 | 28.1 | 45.7 | 43.3 | 52.3 | 65.0 | 78.2 | 96.7 | 92.7 | | |
| Exchange Rate | | | | | | | | | | | | | | |
| US\$/INR - annual avg | 48.4 | 45.9 | 45.0 | 44.3 | 45.2 | 40.2 | 46.0 | 47.4 | 45.6 | 48.1 | 54.0 | 60.4 | 62.0 | 62.0 |
| % depreciation | 1.5 | -5.2 | -2.0 | -1.6 | 2.0 | -11.1 | 14.4 | 3.0 | -3.8 | 5.5 | 12.3 | 11.9 | 2.6 | 0.0 |

* At current prices.

Source: CSO, RBI, Ministry of Finance, Citi Research estimates

Appendix A-1

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