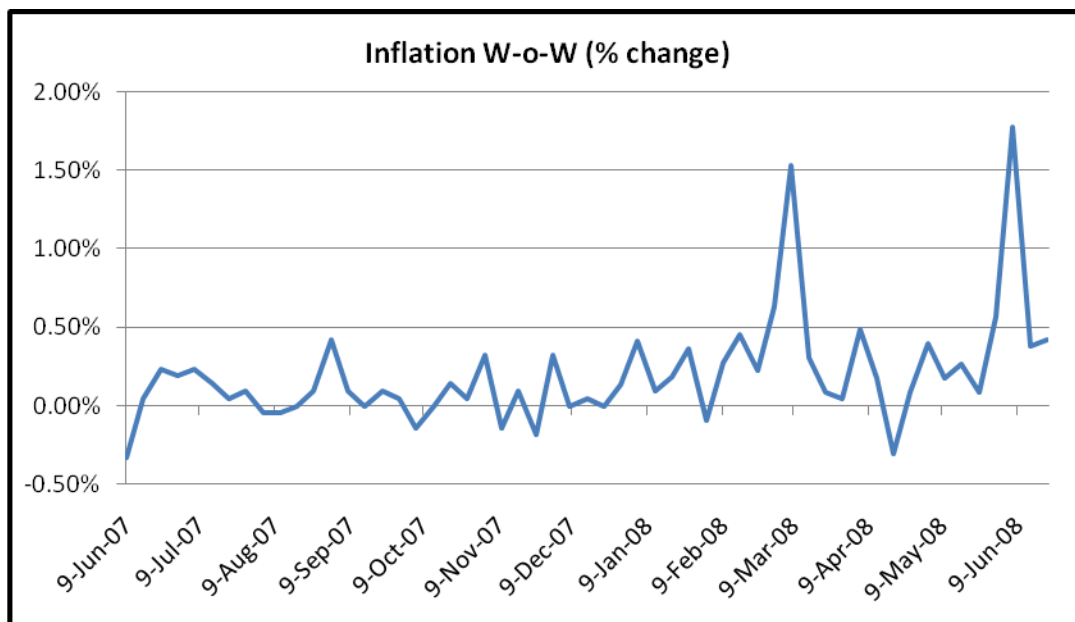


Double digit Inflation...till when???

Inflation, which is running close to 12%, has become one of the most important economic indicators that investors watch for... week after week. The price of the commodities are running upwards, and WPI is growing week after week on an average at 0.36% in 2008 (in comparison to much lower average W-o-W growth of 0.09% in last decade i.e. 1998-2007).

Controlling spiraling price rise is a major challenge to policy makers in the country. In coming weeks Inflation figure will also be impacted with low base effect.

Inflation for the week ending at 2nd, 9th and 16th August may be higher even if WPI doesn't grow week on week, as in the corresponding weeks last year had negative growth (lower index). In the corresponding weeks last year, W-o-W growth was (0.05%), (0.05%) and 0% respectively.



Source: www.debttonnet.com, SPA Research

We have analysed WPI numbers in our spreadsheet. On this basis we observe that Inflation has grown week – on – week on an average at 0.09% from 1998 – 2007. However, 2008 has been exceptional with W-o-W growth of 0.36%. We have tried and plotted forward Inflation Y-o-Y growth numbers for next 1 year based on 3 scenarios. Please note that, the forward Inflation numbers are purely based on the extrapolation in the spreadsheet based on the assumptions that we have taken in different cases.

Case – 1: WPI grows by 0.36% W-o-W growth rate (average of 2008 YTD)

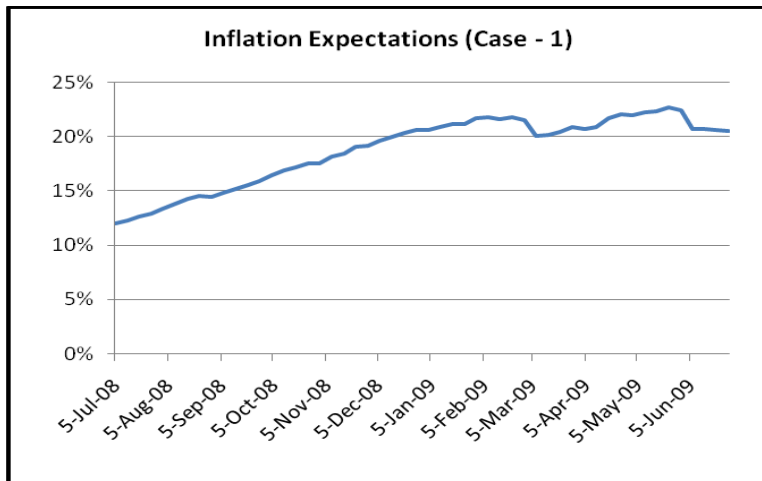
Case – 2: WPI grows by 0.09% W-o-W growth rate (average of last decade i.e. 1998-2008)

Case – 3: WPI remains as it is (i.e. 0% W-o-W growth)

Case – 1:

Our assumption over here is "WPI grows by 0.36% W-o-W growth rate (average of 2008 YTD)"

This assumption is based on average of the current year Inflation growth W-o-W and was taken with a view to see how Inflation numbers look like if this exceptional W-o-W growth continues for 1 more year.



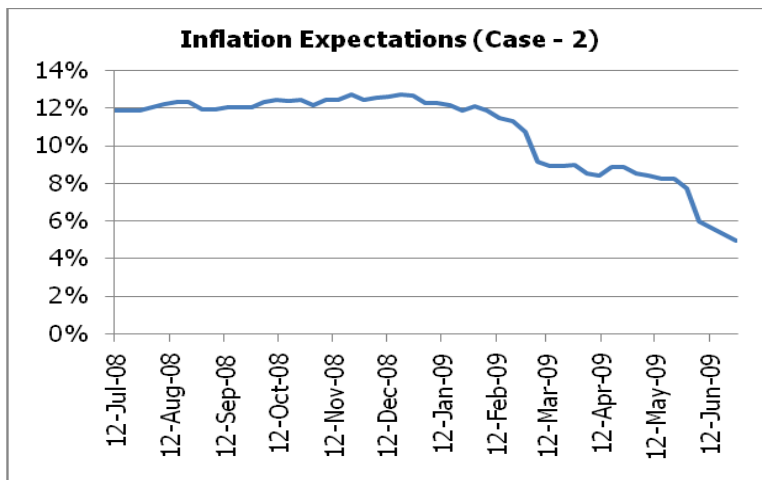
Source: SPA Research

This is worst case scenario where in Inflation would surpass 20% mark in Dec'08 and will peak in May'09 at 22% mark. If this scenario happens to be reality, we are headed for very tough times ahead, though probability of the same remains very low.

Case – 2:

Our assumption over here is "WPI grows by 0.09% W-o-W growth rate (average of 2001-2007)"

This assumption is based on historical averages and was taken with a view that Inflation may revert to its long term W-o-W average growth rate of 0.09%



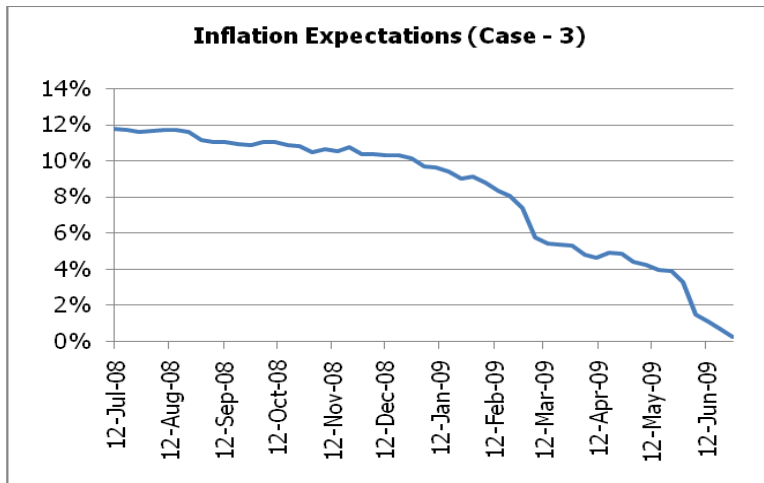
Source: SPA Research

This is more likely scenario which is based on the assumption that every statistical number tends to revert to its long term mean. Even in this scenario, Inflation will continue to remain around 12% mark till Feb'09. Further, we observe that Inflation will moderate to RBI's comfort zone of 5% only after Jun'09.

Case – 3:

Our assumption over here is "WPI remains as its current level (i.e. 0% W-o-W growth)"

This assumption was taken to see how long Inflation will remain in double digit territory, even if WPI numbers remain constant i.e. Zero growth for the index for next 1 year.

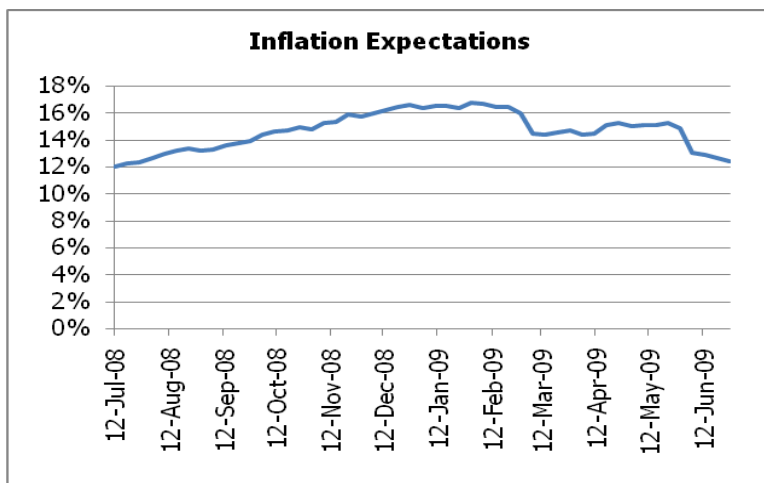


Source: SPA Research

This is very extreme scenario which is not practical. But even in such scenario, double digit inflation will continue to haunt us till Dec'08. Further, it may moderate to 6% by end of FY'09.

Conclusion:

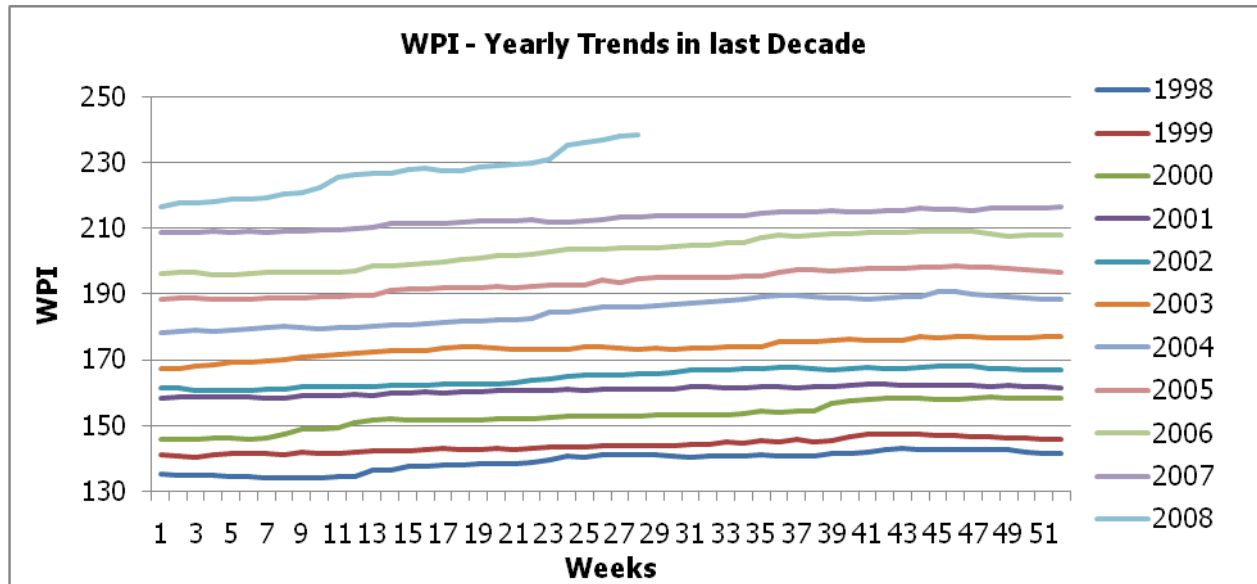
Based on above mentioned scenarios, we believe that Inflation may grow at a higher rate than 0.09% W-o-W, which is witnessed in past decade and at the same time, we also believe that the furious growth of 0.36% W-o-W in 2008 YTD may not continue.



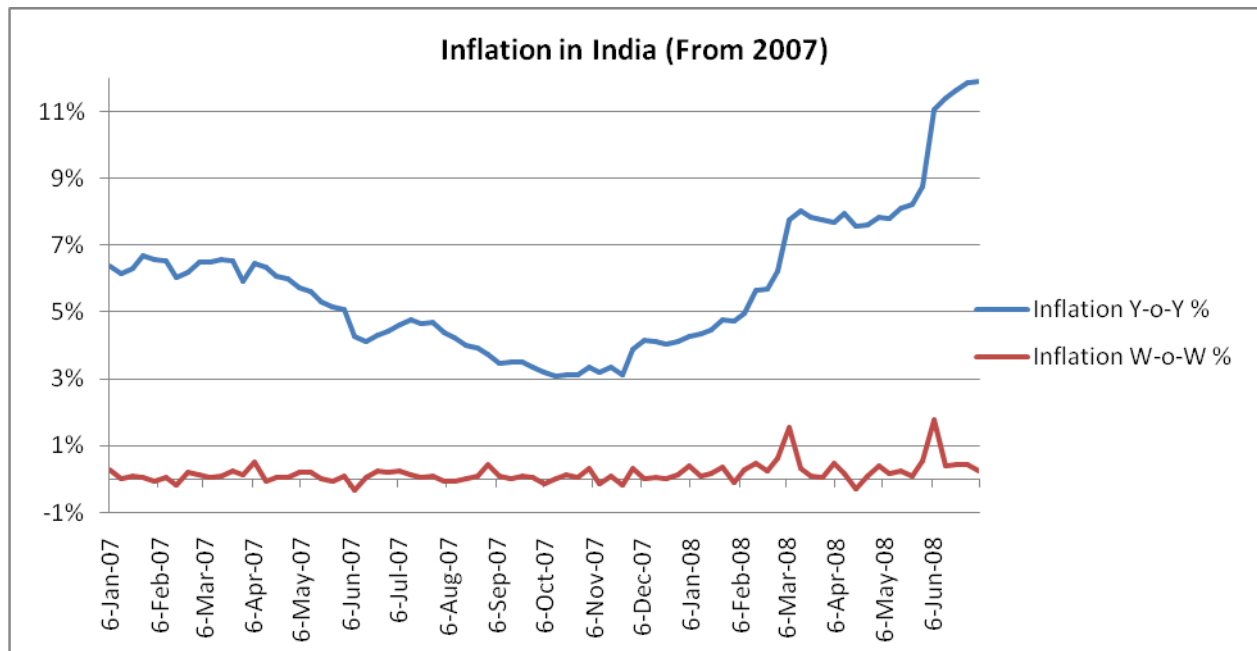
We try and plot the more likely scenario (statistically), which is the mean of the last decade growth and growth witnessed in 2008 YTD, which leads to a growth rate of 0.23% W-o-W. Let's see how Inflation numbers look in this case.

In such a scenario, we may see inflation going to above 16% by Dec'08 and may continue to sustain 14% levels till May'09.

Appendix:



Source: www.debttonnet.com, SPA Research



Source: www.debttonnet.com, SPA Research



Double digit Inflation...till when???

Equity Research Desk

17th July, 2008

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1. Analyst ownership of the stock - No
2. Group/Directors ownership of the stock - No
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Hitendra Gupta	Research Analyst	hitendra.gupta@spasecurities.com
Tarun Surana	Research Analyst	tarun.surana@spasecurities.com
Abhishek Kothari	Research Analyst	abhishek.kothari@spasecurities.com
For more information Visit us at www.spacapital.com		
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NEW DELHI		
25, C-Block Community Centre, Janak Puri, New Delhi - 110 058 Tel: (011) 25517371, 25515086, Fax: (011) 25532644 B- 1A- 132, Sector-51, Noida - 201301 Ph: 0120 - 4241222-26 Fax: 0120 - 4241227 409, Qutab Plaza, DLF City, Phase- I, Gurgaon Ph: 0124 - 4380090-94 Fax: 0124 - 4380089		
KOLKATA		
Diamond Chambers, Room no. 8-O, 8th Floor, 4 Chowringhee Lane, Kolkata - 700016 Tel: (033) - 22521537 Fax: (033) - 22521540		
BANGALORE		
703 & 704, 7th Floor, Brigade Tower, 135, Brigade Road, Corporation Division no. 61, Bangalore - 560025 Ph: 080 - 41148395		
JAIPUR		
UL-15, Amber Tower, Sansar Chand Road, Jaipur - 302001. Tel: (0141) 5107044/5107144 Fax: 5107144		
CHENNAI		
3H, 3rd floor, East Coast Chambers, 92/34, G.N.Chetty, T. Nagar, Chennai - 600014 Tel: (044) 52071380-82 Fax: 52071379		
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**Inst. Dealing Desk: 10A, 10th Floor, Mittal Court, Nariman Point, Mumbai – 400 021
Tel. No. : 022-40439000, Fax No. 22871192/22846318 Email: cms@spacapital.com**