

INFLATION

A softer softening

September 11, 2008

Softening lower than expected

Wholesale price index (WPI)-based inflation for the week ending August 30 came in at 12.10% Y-o-Y, above expectations (Edelweiss—11.96%; consensus—12.01%), despite being lower than the previous week (12.34%). Amidst the backdrop of generally softening inflationary pressures, this week's number was expected to be particularly soft on account of a markedly favourable base effect.

Manufacturing remains key driver

On W-o-W basis, the primary driver of inflation was manufactured products' prices. Within this group, the bulk of contribution came from food products (e.g., sugar and certain edible oils), textiles, and certain minerals. There was an increase in primary articles' inflation, owing to higher prices of certain pulses, fruits and vegetables, cotton, rubber, and minerals. Fuel group prices remained unchanged.

On Y-o-Y basis, the pattern of weighted contribution of various commodity groups reveal that the present combined weighted contribution of fuel, food products, textiles, and metals has risen significantly in comparison to the previous year. WPI inflation (ex-fuel) is currently at 10.78% Y-o-Y against 5.67% a year ago.

Softer commodity prices to bring down inflation...

In the coming weeks, there can be softening in prices of certain commodities. The recent cut in aviation turbine fuel (ATF) prices by 16% (effective September 1), will be reflected in next week's WPI numbers. However, given the small weight of ATF in the WPI basket (0.16%), the impact is expected to be small—just ~ 6-7bps.

With the softening in international crude prices, other non-regulated crude oil-linked items (light diesel oil, naphtha, bitumen, and certain chemicals) may also witness a correction in prices. Ahead of state elections in November-December (in Madhya Pradesh, Chhattisgarh, Delhi, Rajasthan and Mizoram) and given the continued correction in international oil prices, there remains a possibility of rollback in prices of administered fuel group items as well.

Lowering in steel prices may also lead to a significant softening in inflation. A 5% reduction in prices will have an impact of ~30-35bps on inflation.

... albeit slowly, courtesy INR depreciation, adverse base

However, there has been significant volatility in exchange rates since mid-August. The INR-USD rates depreciated ~8% since August 11, closing at 45.56 on September 11 (23-month low). As a significant part of the WPI basket is linked to imports, a weak rupee may wipe off part of the benefits of falling commodity prices in international markets.

As a whole, although there are latent risks from prices of commodities like sugar, cotton and cotton textiles, rubber, pulses and edible oils, inflation is close to its peak. The base effect, however, stays adverse during the bulk of the third quarter and will not allow inflation to soften quickly. In Q4FY09, however, it is likely to witness a significant easing in headline inflation, on the back of: (1) cooling in commodity prices; (2) lagged effect of monetary tightening; and (3) a markedly favourable base effect. The Y-o-Y inflation number may calm down in the range of 8-9% by March 2009.

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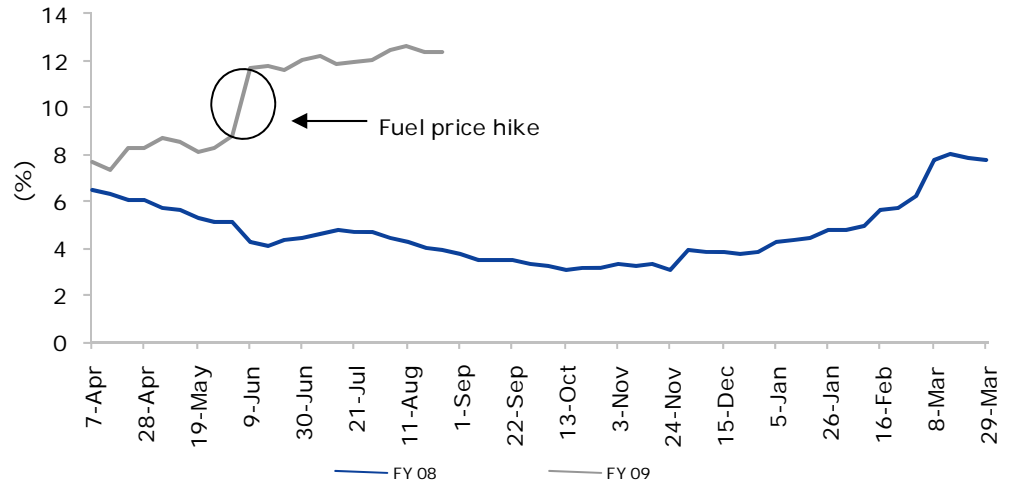
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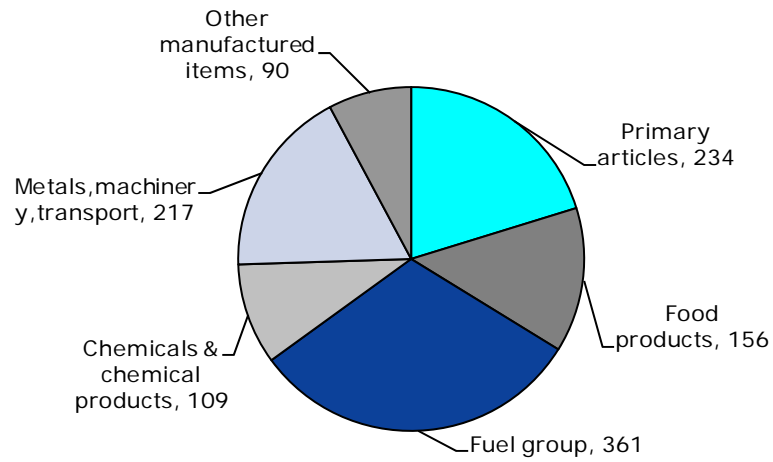
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Inflation—down, not out



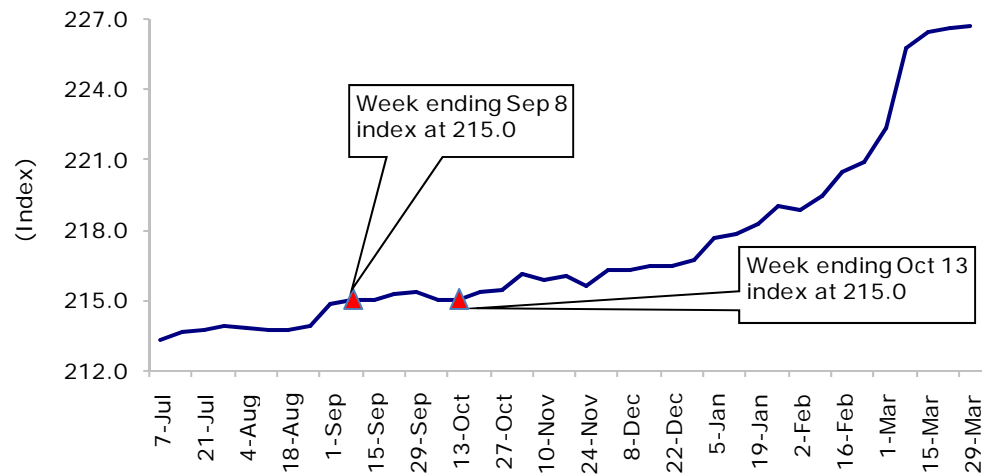
Source: Bloomberg, Office of economic adviser Note: Numbers are provisional

Weighted contribution to WPI inflation



Note: All contribution in basis points Source: Office of economic adviser, Edelweiss estimates

Movement of WPI index during FY08: Base-effect pain not over



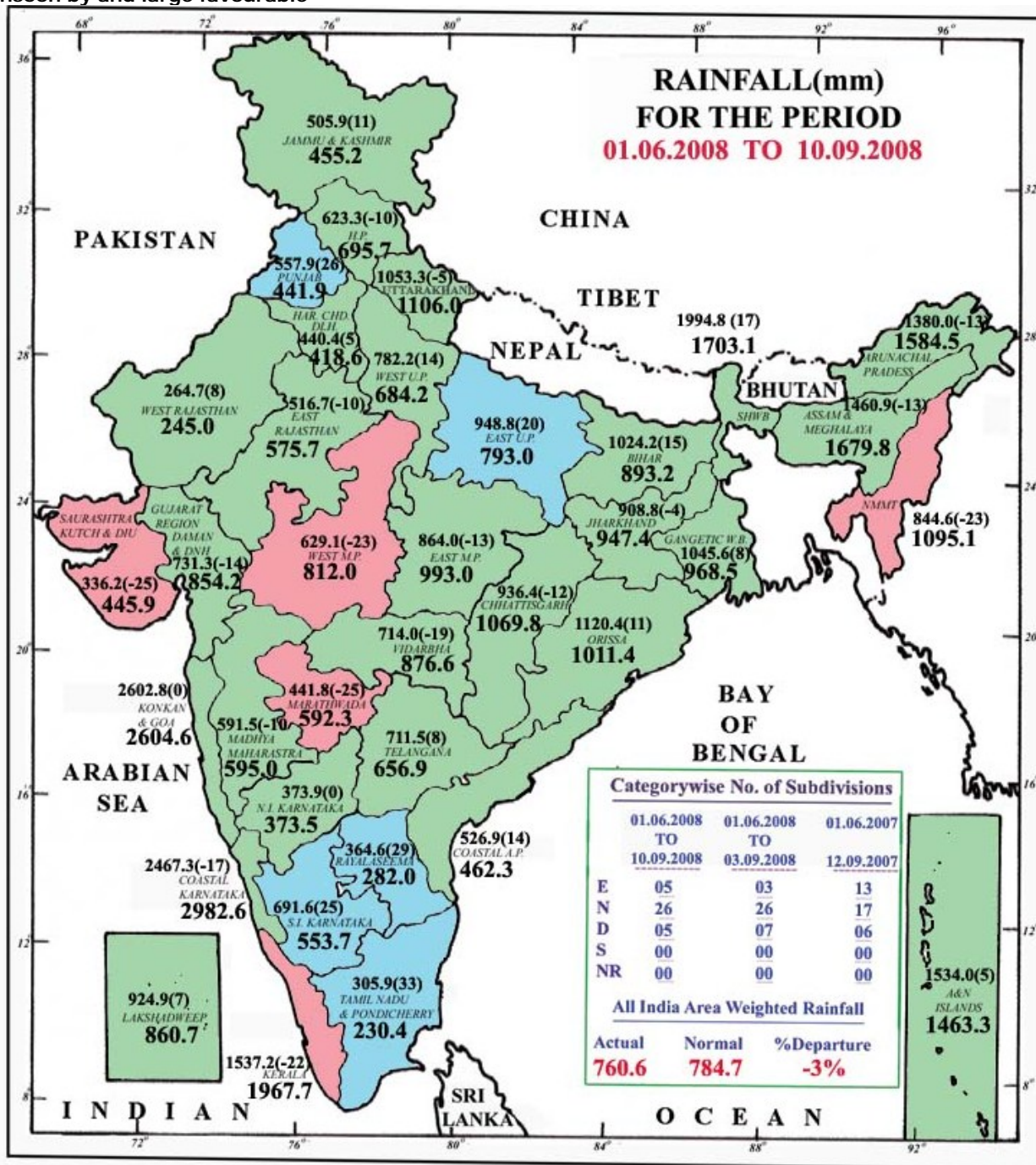
Source: Office of economic adviser

Movement across components

Inflation	Weight (%)	W-o-W(%)		Y-o-Y (%)		Weighted contribution (*)	
		30-Aug-08	WC# *	1-Sep-07	30-Aug-08	1-Sep-07	30-Aug-08
All Commodities	100.0	0.21	0.21	3.72	12.10	3.72	12.10
Primary articles	22.0	0.28	0.06	8.07	10.07	1.80	2.34
Food articles	15.4	0.17	0.03	7.08	4.58	1.12	0.75
Food grains	5.0	0.18	0.01	5.34	6.18	0.26	0.31
Cereals	4.4	0.09	0.00	6.29	5.87	0.27	0.25
Fruits & vegetables	2.9	0.71	0.02	8.82	(4.03)	0.30	(0.15)
Milk	4.4	-	-	10.73	6.44	0.43	0.28
Eggs, meat & fish	2.2	-	-	3.30	4.81	0.08	0.12
Non-food articles	6.1	0.32	0.02	12.03	17.95	0.67	1.07
Fibres	1.5	0.67	0.01	7.58	36.25	0.09	0.46
Oilseeds	2.7	0.16	0.00	25.93	18.86	0.57	0.50
Minerals	0.5	1.44	0.02	1.22	54.46	0.01	0.52
Fuel, Power, Light and Lubricants	14.2	-	-	(2.93)	16.94	(0.67)	3.61
Coal mining	7.0	-	-	-	9.84	-	0.19
Mineral oils	5.5	-	-	(3.96)	26.67	(0.53)	3.32
Electricity	1.8	-	-	(1.77)	1.39	(0.13)	0.10
Manufactured products	63.8	0.29	0.16	4.70	11.07	2.59	6.14
Food products	11.5	1.27	0.13	1.80	15.59	0.18	1.56
Beverages tobacco & tobacco products	1.3	-	-	10.60	7.73	0.16	0.13
Textiles	9.8	0.07	0.00	0.30	8.41	0.02	0.51
Wood & wood products	0.2	-	-	7.15	9.77	0.01	0.02
Paper & paper products	2.0	-	-	1.78	3.24	0.03	0.06
Leather & leather products	1.0	-	-	7.24	0.60	0.06	0.00
Rubber & plastic products	2.4	-	-	6.47	6.53	0.11	0.11
Chemicals & chemical products	11.9	0.04	0.00	5.33	9.68	0.59	1.09
Non-metallic mineral products	2.5	0.37	0.01	11.02	3.04	0.25	0.07
Basic metals alloys & metals products	8.3	-	-	6.12	21.23	0.58	2.04
Machinery & machine tools	8.4	-	-	8.65	5.51	0.54	0.36
Transport equipment & parts	4.3	-	-	1.22	5.51	0.04	0.18

Source: Bloomberg, Office of economic adviser, Edelweiss research
#: weighted contribution *Percentage points

Monsoon by and large favourable



LEGEND :

- EXCESS (E)**
+ 20% OR MORE
- NORMAL (N)**
+19% TO -19%
- DEFICIENT (D)**
-20% TO -59%
- SCANTY (S)**
-60% TO -99%
- NO RAIN (NR)**
-100%
- NO DATA**

NOTES:

- (a) Rainfall figures are based on operational data.
- (b) Small figures indicate actual rainfall (mm), while bold figures indicate normal rainfall (mm). Percentage departures of rainfall are shown in brackets.

Source: IMD

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Recent Research

Date	Company	Title
4-Sep-08	Inflation	Softening continues
01-Sep-08	External Sector	Trade deficit remains high
01-Sep-08	Economy Release Calendar	September
29-Aug-08	GDP	In line with expectations
28-Aug-08	Inflation	Down, not out

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Accumulate	Reduce	Sell	Total
Rating Distribution*	101	58	15	7	191

* 9 stocks under review / 1 rating withheld

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	84	71	36

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 20% over a 12-month period
Accumulate	appreciate up to 20% over a 12-month period
Reduce	depreciate up to 10% over a 12-month period
Sell	depreciate more than 10% over a 12-month period

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