

# India Flash

## June WPI inflation softens, but elevated food prices may keep the RBI cautious on imminent rate cuts

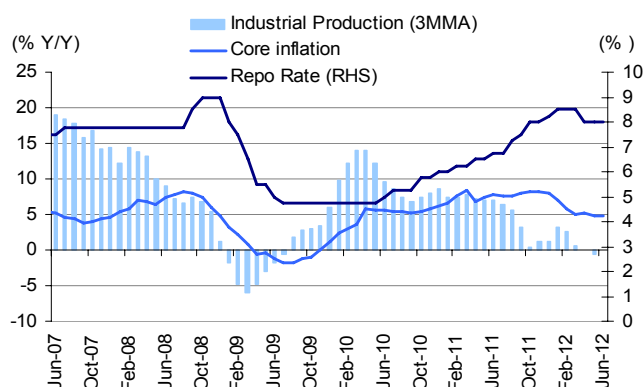
India's wholesale price inflation softened in June to 7.25% y/y from 7.55% in May as a let up in fuel and non food articles offset elevated food inflation. The outturn was below expectations (consensus: 7.6% y/y) and, reassuringly, easing demand pressures kept core inflation contained at 4.9% y/y. Looking ahead, inflation risks remain, as high food prices, upside pressures from a sub-par monsoon, and imminent hikes in regulated fuel prices offset easing demand pressures. We thus expect the RBI to keep rates unchanged at its meeting on July 31, all the more so as the monetary authorities await further actions by the government to rein in the fiscal deficit. We continue to expect further rate cuts of 50 bps in 2012, pushed towards 4Q12.

- Sub-par monsoons – a key risk to growth, inflation and deficit.** Following a poor start, India's monsoon rains continue to be below normal. If the trend continues, this would weigh further on growth and consumer demand, aggravate the food supply shock and increase fiscal slippage due to higher subsidy allowance. Food price inflation remains elevated at 9% y/y in June with risks to the upside if monsoon disappoints. While a partial revival in monsoon rains over the past two weeks have allayed fears of a drought, they still remain 22% below average.
- Activity indicators led by industrial production remain weak.** Sequentially, most real activity indicators, led by industrial production, cement dispatches, commercial vehicle sales, and tax collections remain weak. India's May industrial production out-turn, released last Thursday, posted a higher than expected reading of 2.4% y/y (consensus: 1.8%) from -0.9% in April, driven mainly by basic and consumer goods segments. But underlying weakness persist with a less volatile three month moving average suggesting IP contracted (-0.6% y/y) in May, the first time since July 2009.
- Expect government to act on executable reforms.** So far this year, fiscal spending has largely supported consumption while investments reforms, particularly in the infrastructure space, remain on the backburner. Looking ahead, we believe that deteriorating growth prospects, elevated inflation, limited fiscal space and political roadblocks would make it highly difficult for India to implement major policy reforms. However, we expect a positive momentum on reforms that are already in the pipeline. These include fast tracking infrastructure investments, clarity on tax issues, raising FDI limits on various sectors and addressing coal and power shortage.

Table 1  
Indian Inflation

India WPI Inflation						
% Change Y/Y	Weight	Jun-12	May-12	Apr-12	Mar-12	Feb-12
<b>Headline</b>	<b>100</b>	<b>7.3</b>	<b>7.5</b>	<b>7.5</b>	<b>7.7</b>	<b>7.6</b>
<b>Primary Articles (Non food)</b>	<b>4</b>	<b>6.8</b>	<b>8.5</b>	<b>1.4</b>	<b>-0.8</b>	<b>-2.5</b>
<b>Food</b>	<b>26</b>	<b>9.0</b>	<b>9.0</b>	<b>9.3</b>	<b>8.7</b>	<b>5.9</b>
<b>Fuel</b>	<b>15</b>	<b>10.3</b>	<b>11.5</b>	<b>12.1</b>	<b>12.8</b>	<b>15.1</b>
<b>Manufactured Non-food (Core)</b>	<b>55</b>	<b>4.9</b>	<b>4.8</b>	<b>5.1</b>	<b>5.0</b>	<b>5.8</b>

Chart 1  
Benign core inflation provides room for RBI to ease policy rates in the coming months



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