

India Flash

Pick up in August WPI inflation limits RBI's policy options

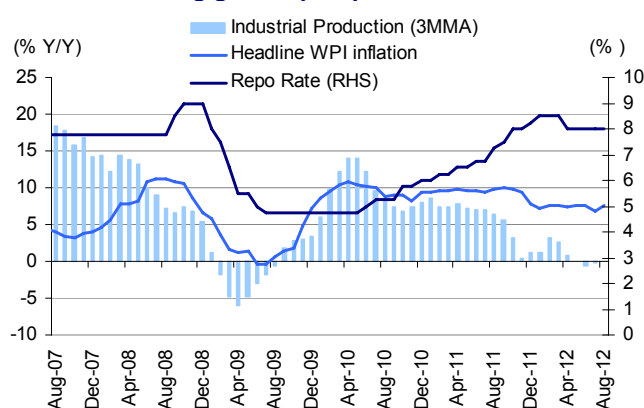
India's wholesale price inflation jumped in August to 7.6% y/y (Consensus: 7.1%) from 6.9% in July, driven by a broad based pick up in prices. Core inflation rose for a fifth straight month (5.7% y/y vs 5.4% previously) as a rise in global commodity prices fueled input cost pressures. Looking ahead, upside risks to our 7.3% inflation projection for 2012 have increased, particularly in light of yesterday's government decision to hike diesel prices and a probable extension of the liquidity led rally in global commodities following QE3. That said, a recovery in seasonal monsoon rains over the last month coupled with easing demand pressures should keep a lid on food and output prices going ahead. We expect the RBI to maintain status quo in its next policy meeting on September 17 given India's still-high inflation rate, but a 25bp cut in the cash reserve ratio to 4.5% is possible to help reduce funding costs by banks. We continue to expect further rate cuts of 50 bps in the last quarter of 2012 to address rising growth concerns.

- Industrial growth remains lackluster.** India's July industrial growth, released last Wednesday, was subdued at 0.1% y/y (Consensus: 0.5%), atop June's 1.8% amid weakening manufacturing activity. Tight lending conditions and high inflation hurt consumption demand while end-July power grid failure affected industrial production.
- Hike in regulated fuel prices – early steps to unlock the reforms process.** The Indian authorities yesterday announced key fuel price adjustments to reign in the high fiscal deficit and alleviate the rising subsidy burden of oil companies. The measures included; a 12% hike in diesel prices, the number of subsidized LPG cylinders at 6 per family per year and a cut in excise duty on petrol. While on aggregate, these measures are inflationary (notwithstanding second round effects, diesel hike directly adds 56 bps to WPI inflation) and provide marginal relief to India's fiscal overhang, they should help boost investor sentiment as a positive sign of reforms. Also in the offing are crucial investment reforms including opening India's aviation and broadcast sector for foreign investments. If sustained, the positive momentum in India's reforms process should allay fears of a negative rating action while providing room to RBI for policy maneuver to address slowing growth concerns.

Table 1
Indian Inflation

India WPI Inflation						
% Change Y/Y	Weight	Aug-12	Jul-12	Jun-12	May-12	Apr-12
Headline	100	7.6	6.9	7.6	7.5	7.5
Primary Articles (Non food)	4	13.8	13.1	7.2	8.6	1.4
Food	26	9.1	8.7	9.1	8.9	9.3
Fuel	15	8.3	6.0	12.1	11.5	12.1
Manufactured Non-food (Core)	55	5.7	5.4	5.3	5.2	5.1

Chart 1
High inflation provides limited headroom for RBI to address weakening growth prospects



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