

India Flash

June WPI inflation unlikely to move the needle on policy rates at RBI's July 30th meeting

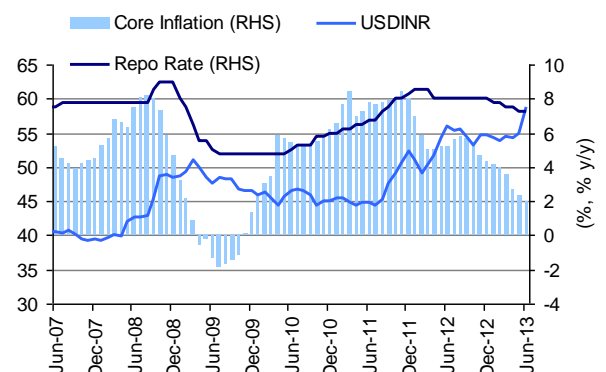
India's WPI inflation edged up in June although at a lower-than-expected pace of 4.9% y/y (consensus: 5.0%; prior 4.7%) as higher food inflation and a pick up in input prices offset easing demand pressures. The jump in food prices was led by temporary supply distortions and should ease going forward as favourable monsoon trends boost agriculture output. Meanwhile, core inflation fell for the tenth successive month to 2.0% y/y from 2.4% in May amid weak domestic pricing power. Looking ahead, we expect WPI inflation to inch higher and average 5.5% y/y over 2H13 as upward energy price adjustments, the impact of rupee depreciation (-8% against the USD since May) and pre-election fiscal spending offset weak final demand and lower food inflation. Despite sluggish growth and improved inflation dynamics, we think ongoing external vulnerability concerns and accompanied currency pressures will probably keep RBI on hold at its July 30th meeting. That said, we continue to see scope for another 25 bps policy cut in the coming months, once external market pressures subside.

- Growth woes deepened for Indian industry last quarter.** Recent activity indicators have been weaker than expected, which suggests industry GDP growth likely slowed further in Q2 (April – June '13). May industrial production declined 1.6% y/y (+1.9% y/y in April) led by contraction in manufacturing and mining activity against expectations of positive growth (+1.5% y/y). Likewise, a pullback in commercial vehicle sales, weaker non-oil-gold imports and declining new project starts reflect easing domestic demand, slack investment activity and unfavorable external funding conditions. Looking ahead, we expect a gradual recovery in capital expenditure amid ongoing policy support for faster project clearances and approval.
- We maintain cautious optimism on economic recovery - external vulnerability is the key risk ahead.** Although growth concerns continue to linger, we maintain a positive 2H13 outlook on India's economic recovery with full year 2013 GDP estimate at 5.7% y/y from 5.1% y/y in 2012. Ample rainfall, easing domestic liquidity, regulatory reform measures, pre-election capital spending boost and an improving US growth outlook signal improving growth inflation dynamics. In this context, rising external financing pressures are a key risk. The steep rupee depreciation, currency volatility, and higher bond yields amid rising external debt could keep RBI on an extended policy pause while restricting space for fiscal spending amid higher import bill.

Table 1
WPI inflation edges up on higher food inflation

India WPI Inflation						
% Change Y/Y	Weight	Jun-13	May-13	Apr-13	Mar-13	Feb-13
Headline	100	4.9	4.7	4.8	5.7	7.3
Primary Articles						
(Non food)	4	7.6	4.9	7.6	9.3	10.7
Food	26	8.6	7.6	6.5	8.2	10.8
Fuel	15	7.1	7.3	8.3	7.8	10.6
Manufactured						
Non-food (Core)	55	2.0	2.4	2.9	3.6	4.1

Chart 1
Currency pressures to restrict scope for RBI easing



Source: RBI, BBVA Research

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