

India Flash

Pickup in August WPI inflation limits RBI's room for maneuver

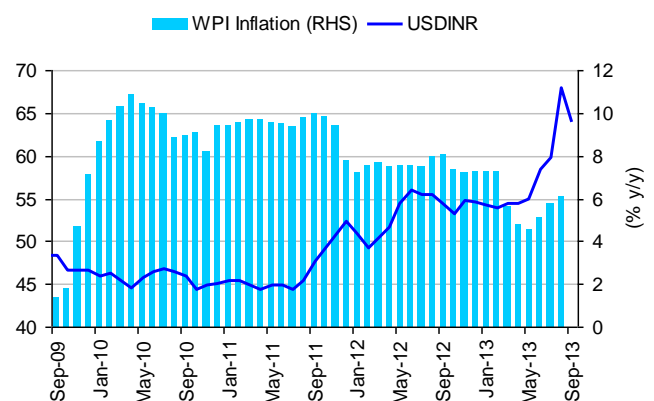
India's wholesale price inflation rose by more than expected in August, to 6.1% y/y (BBVA: 5.6%; consensus: 5.7%; prior 5.8%), its highest level in 6 months (see Chart and Table below). The increase was led by a 12.4% y/y increase in food prices on supply disruptions from heavy rains. Encouragingly, core inflation continued to fall, to just 2.0% y/y amid slowing demand and a high base effect. Nevertheless, the rise in WPI inflation, exacerbated by recent rupee weakness, poses upside risk to our end-2013 projection of 5.5%, and places further pressure on the government to address supply side bottlenecks by easing energy supply constraints and upgrading infrastructure. Meanwhile, for its part, the RBI continues to face challenges of curbing inflation and stabilizing the rupee amidst capital outflows and slowing growth (4.4% y/y in 2Q13). In that context, we expect the RBI to keep rates unchanged at its upcoming policy meeting on September 20, which will be Raghuram Rajan's first as the new RBI Governor (see our Flash [here](#)), while reiterating its commitment to maintaining tight liquidity. We expect RBI to adopt a more growth supportive stance by early 2014 as external pressures ease from efforts to contain the budget deficit, reinvigorate reforms, and curtail the current account deficit.

- Growth may slow further in the near term.** Recent high frequency indicators suggest India's recovery will be delayed as easing domestic demand offsets a pick up in exports. August PMI readings were soft, although July industrial production, released last Thursday, surprised to the upside (+2.6% vs. consensus: -0.9%). High interest rates and fragile consumer and business confidence in the wake of recent rupee weakness are likely to weigh on domestic demand, putting our full-year growth projection of 5.7% at considerable downside risk.
- Though easing, currency pressures remain.** Improving external conditions and the RBI's recent steps to ease external financing constraints, as laid out by the new Governor on September 4, have brought about some strengthening of the rupee in the past two weeks, to 62-63 per USD, from a low point of almost 69 in late August (Chart). For rupee gains to be sustained, the government, in our view, will need to complement RBI's efforts with steps to address rising fiscal deficit concerns, food and raw materials supply bottlenecks, and stalled public investment projects, none of which will be easy in a pre-election year.

Table
August WPI rises to a 6-month high led by a sharp pick up in food prices, while core inflation has eased

India WPI Inflation						
% Change Y/Y	Weight	Aug-13	Jul-13	Jun-13	May-13	Apr-13
Headline	100	6.1	5.8	5.2	4.6	4.8
Primary Articles (Non food)	4	1.1	5.5	7.7	4.9	7.6
Food	26	12.4	9.5	8.9	7.7	6.5
Fuel	15	11.3	11.3	7.5	7.3	8.3
Manufactured Non-food (Core)	55	2.0	2.3	2.2	2.5	3.0

Chart
The rupee has appreciated from its weak point in late August



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