

India Flash

Price pressures remain as WPI inflation stays at 9.7% y/y in October

India's inflation remains elevated, at 9.7% y/y in October according to data released today, unchanged from the previous month (consensus: 9.6%). The outturn comes despite signs of slowing growth momentum and an aggressive tightening stance by the RBI. Month on Month seasonally adjusted trends, although volatile, are also on the high side, reaching 0.9% m/m from 0.8% m/m in September according to our estimates. Looking ahead, we expect inflation to remain high owing to exchange rate pass through of recent rupee weakness, supply side pressures, and an ongoing transmission of previous rise in global commodity prices. The stickiness in prices raises marginal upside risk to our average WPI projection of 9.3% y/y in 2011 while further complicating RBI's policy dilemma. However, in light of rising downside risks to growth and with demand compression already in the pipeline owing to lagged impact of past policy tightening, we expect RBI to remain on hold going ahead.

- **Price pressures remain high due to higher minimum support prices, rising income levels and absence of supply side reforms, largely offsetting the favorable impact of record food production and normal monsoons.** While food inflation has softened from an average of 14% y/y during 2010, it still remains significantly elevated with food inflation clocking 9.9% y/y in October, up from 8.8% in the previous month. Food inflation has been driven largely by protein rich items, mirroring rising income levels and changing dietary composition of Indian households, particularly in rural areas.
- **Core inflation stands steady at 7.6% y/y in October reflecting persistence of generalized inflationary pressures.** Core inflation (manufactured non food products inflation) stood steady at 7.6% y/y, driven by chemicals and metal prices. While high input cost pressures coupled with a weakening rupee underpin the core, recent softening in global commodity prices should help alleviate price pressures, albeit with a lag.
- **High risk of currency depreciation induced price pressures going ahead.** With imports accounting for almost 22% of India's GDP, a depreciating rupee emerges as a key risk to domestic inflation going ahead. Several imported items jointly constitute a considerable share of the WPI basket, chief being petroleum and crude products, which have a 32% share in imports and a 10% weight in WPI. The ongoing rupee weakness has partially offset the magnitude of softening in global commodity prices. In this context, while the Indian crude basket in US dollar terms has declined by almost 8% since July 2011, in rupee terms prices have increased by about 11% during the same period.
- **The fuel price index gained 14.8% y/y, its steepest rise since October 2008.** Despite moderating global crude prices, inflationary pressures in the fuel group are likely to sustain due to incomplete pass through and weakening rupee. Meanwhile, a coal price hike may be on the cards going ahead reflecting rising input costs and a pass through of previous increase in global coal prices. In addition, electricity prices are likely to be revised upwards as well in many states over the near term.

Chart 1
Core inflation refuses to ebb despite aggressive policy tightening

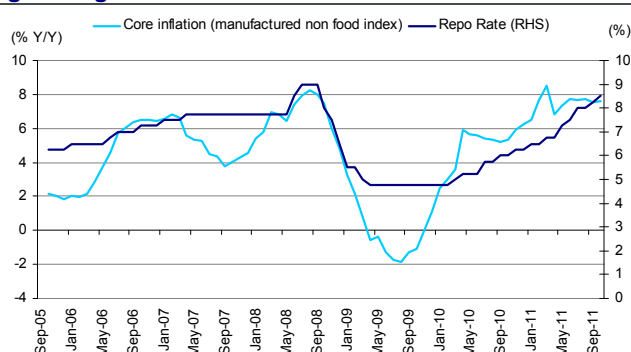


Table 1
India Inflation Table:

India Inflation						
% Change Y/Y	Oct-11	Sep-11	Aug-11	Jul-11	Jun-11	May-11
Headline	9.7	9.7	9.8	9.4	9.5	9.6
Primary Articles (Non food)	12.2	18.2	19.8	19.7	20.3	24.4
Food	9.9	8.8	9.1	8.2	8.0	8.1
Fuel	14.8	14.1	12.8	12.0	12.8	12.3
Manufactured Non-food (Core)	7.6	7.6	7.7	7.7	7.7	7.4
% Change M/M (Non Seasonally Adjusted)						
Headline	0.6	0.6	0.5	0.7	0.5	0.2
Primary Articles (Non food)	-1.7	1.0	1.2	-0.9	-1.3	-2.4
Food	1.5	1.2	0.3	1.7	1.0	0.3
Fuel	1.0	0.8	0.8	2.5	0.7	0.6
Manufactured Non-food (Core)	0.4	0.1	0.3	-0.1	0.4	0.5
% Change M/M (Seasonally Adjusted*)						
Headline	0.9	0.8	0.6	0.3	0.4	0.2
Primary Articles (Non food)	-0.4	2.7	1.4	0.8	-1.8	-1.8
Food	0.8	1.0	0.6	0.6	0.8	0.5
Fuel	1.5	1.3	0.9	-0.1	0.6	0.2
Manufactured Non-food (Core)	0.6	0.4	0.3	0.0	0.6	0.6

*BBVA estimates

Stephen Schwartz
stephen.schwartz@bbva.com.hk
+852 2582 3218

Sumedh Deorukhkar
sumedh.deorukhkar@grupobbva.com
+91 2266301855

BBVA

RESEARCH



| 43/F., Two IFC, 8 Finance Street, Central, Hong Kong | Tel.: +852 2582 3111 | www.bbva.com

Before you print this message please consider if it is really necessary.

This email and its attachments are subject to the confidentiality terms established in the corresponding regulations and are intended for the sole use of the person or persons indicated in the header. They are for internal use only and cannot be distributed, copied, conveyed or furnished to third parties without prior written consent from BBVA. If this message has been received erroneously, it is forbidden to read, use or copy any of the contents and you are asked to inform BBVA immediately by forwarding the email to the sender and eliminating it thereafter.