

India Flash

India's inflation declines on base effects and easing food prices

India's headline wholesale price inflation eased in line with expectations for December, to a two year low of 7.5% y/y (consensus: 7.4%) from 9.1% in November. The decline was driven by a combination of favorable base effects and moderating food prices. However, excluding food, price pressures remained high, especially for fuel products and manufactured goods. On a sequential, seasonally adjusted basis, we estimate headline inflation to have gained 0.54% m/m in December from 0.29% in the previous month. Today's outturn, coupled with last week's better than expected November industrial production will be important inputs for the RBI's policy meeting on January 24. We expect the RBI to remain on hold and commence a rate easing cycle in the second quarter of 2012. However, we would not rule out a cut in the Cash Reserve Ratio of 50bps at next week's meeting amid indications of further tightness in liquidity conditions.

- **Core inflation still high.** Core inflation edged only slightly lower to 7.8% y/y in December 2011 (7.9% previously), signaling persistent cost pressures, pricing power and the impact of rising import prices thanks to a weakening rupee. On a seasonally adjusted basis, we estimate core inflation to have gained 0.74% m/m in December compared to 0.63% in the previous month.
- **Risk of renewed inflationary pressures could restrain monetary easing before 2Q12.** Unlike 2008, when inflation saw a steep drop, giving scope for a marked easing in monetary as well as fiscal policy, the approach towards policy easing this time around will be more cautious and nuanced. Monetary policy easing will also be constrained by potential upside risks to imported inflation from a sharp depreciation of the rupee.

Chart 1

Favorable base effects amid easing food prices drive headline inflation to a 2 year low in December

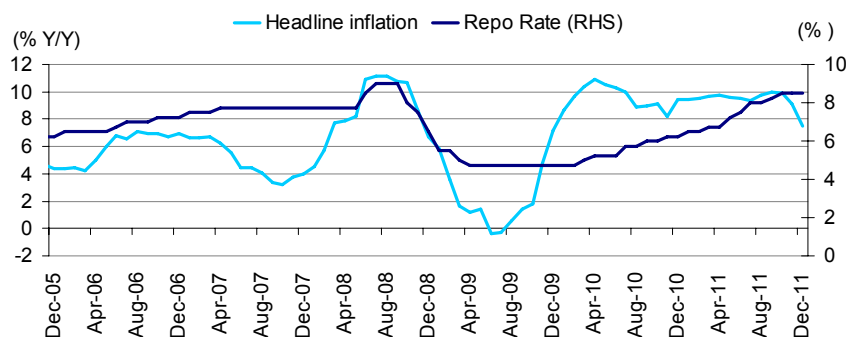


Table 1

India's Inflation by components

India Inflation							
% Change Y/Y	Weight	Dec/11	Nov/11	Oct/11	Sep/11	Aug/11	Jul/11
Headline	100	7.5	9.1	9.9	10.0	9.8	9.4
Primary Articles (Non food)	4	1.5	3.2	7.4	14.6	18.2	15.8
Food	26	2.6	7.9	9.3	9.1	9.2	8.2
Fuel	15	14.9	15.5	14.8	14.0	12.9	12.0
Manufactured Non-food (Core)	55	7.8	7.9	8.2	8.0	7.7	7.7
% Change M/M (Non Seasonally Adjusted)							
Headline	100	0.0	-0.1	0.5	0.8	0.5	0.7
Primary Articles (Non food)	4	1.3	-1.2	-3.0	1.2	3.2	-2.7
Food	26	-1.8	-0.8	0.7	1.4	0.4	1.7
Fuel	15	0.6	0.9	1.0	0.7	0.9	2.5
Manufactured Non-food (Core)	55	0.5	0.2	0.6	0.5	0.2	-0.1
% Change M/M (Seasonally Adjusted*)							
Headline	100	0.5	0.3	0.7	1.0	0.6	0.3
Primary Articles (Non food)	4	0.3	-1.6	-1.4	1.6	2.7	-2.2
Food	26	-0.3	-1.1	-0.1	1.0	0.7	0.6
Fuel	15	1.5	1.8	1.8	1.4	0.9	-0.1
Manufactured Non-food (Core)	55	0.7	0.6	0.7	0.8	0.3	0.1

*BBVA estimates

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