

## India Flash

## Softening inflation hints at stable policy rates

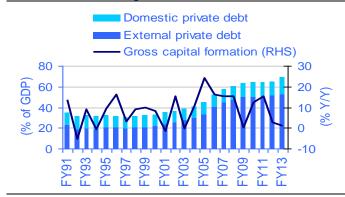
WPI inflation declined for a third consecutive month in February to 4.7% y/y (consensus: 5.0% y/y), from 5.1% in January, led by a continued easing of primary food and fuel price inflation. A bumper winter crop and lower global commodity prices were the main factors, and contributed to a similar easing of CPI inflation to 8.1% y/y in February from 8.8% in January. However, core CPI (excluding food and fuel) inched up to 3.1% y/y from. 3.0% previously, reflecting underlying demand pressures and the influence of the weak rupee on input prices. Looking ahead, price pressures are likely to remain elevated despite a stabilizing rupee. While the recent trend of moderating inflation leaves scope for RBI to hold policy rates at its April 1 meeting (repo rate at 8.0%), we expect RBI to signal a tightening bias in view of potential upside risks to prices, although we believe the rate hike cycle as likely ended.

- All eyes on national elections A strong mandate is crucial to rekindle investment
  activity. Recent activity indicators, chiefly the February PMI (52.5 vs 51.4 m/m) and January industrial
  production (+0.1% y/y vs. -0.2% previous month) have surprised positively. Looking ahead, however, a
  convincing recovery will depend on pickup in private investment. Investors remain wary of a fractured
  mandate in upcoming national elections (April 7th to May 16th), which might derail fiscal consolidation, stifle
  progress on investment reforms and raise credit quality concerns from global rating agencies.
- External vulnerability risks linger despite improved current account balance. Even while policy measures have helped to stem India's current account deficit (2.5% of GDP in 2013 vs. 5.0% in 2012), the economy remains vulnerable to volatility in external capital flows given rising asset quality concerns amongst public sector banks and a surge in corporate leverage with greater exposure to external debt (See Chart-1). Sector-wise, non-performing loans are largely concentrated in infrastructure (20%), iron and steel (18%) and power sector (13%), the resolution of which is linked closely to the pace of project clearances going forward.

Table-1
February WPI inflation falls to a 9-month low on easing food and fuel inflation

India WPI Inflation							
% Change Y/Y		Weight	Feb-14	Jan-14	Dec-13	Nov-13	Oct-13
Headline		100	4.68	5.0	6.40	7.5	7.2
	<b>Primary Articles</b>						
	(Non food)	4	5.1	4.4	6.0	7.4	7.1
	Food	26	5.6	6.2	9.5	13.6	12.7
	Fuel	15	8.7	10.0	10.9	11.1	10.5
	Manufactured						
	Non-food (Core)	55	3.1	3.0	3.3	3.0	2.9

Chart -1
External vulnerability risks linger given a run up in private sector external leverage while local investments weakened



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