

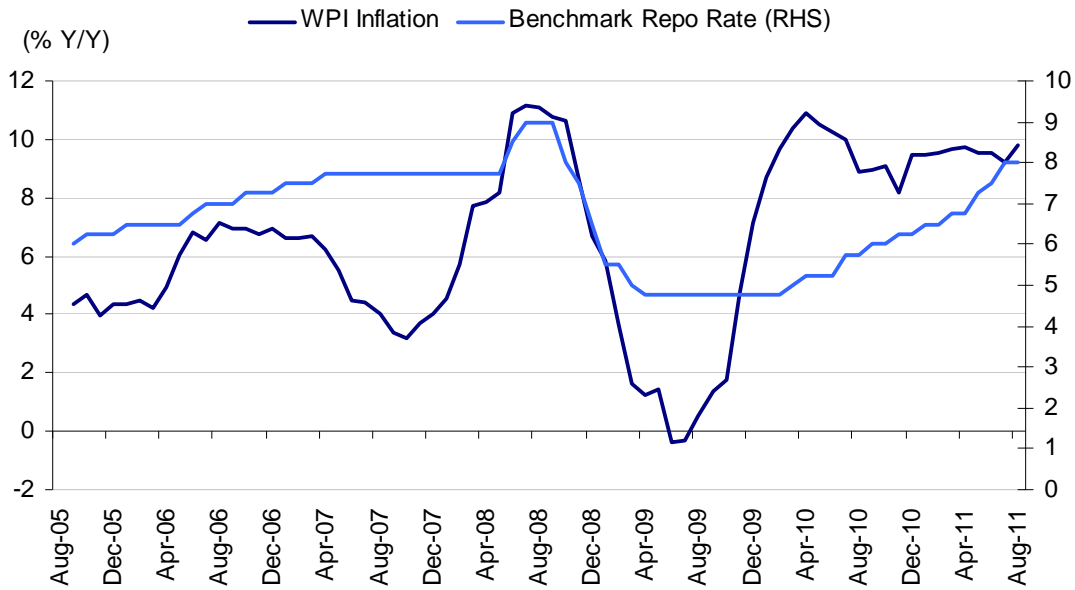


India: Broad based price pressures drive August WPI inflation to 12-month high

India's long withstanding battle against high inflation continues even as the ongoing moderation in economic activity gains traction amidst headwinds from a worsening global macro environment alongside rising interest rates. India's wholesale price index (WPI) inflation jumped to a 12-month high of 9.8% y/y in August from 9.2% in July, above consensus (9.5% y/y), suggesting no let-up in price pressures over the last month. On a sequential seasonally adjusted basis, we estimate headline inflation to have gained at a faster clip of 0.6% m/m from 0.1% m/m in July. Looking ahead, we expect WPI to have likely peaked and price trends are expected to slow, albeit gradually, amidst ongoing policy response to remove bottlenecks in food supply, favourable monsoon, and a gradual demand compression due to high interest rates and worsening prospects on the global front. We thereby expect prices to ease broadly during the last quarter. The stickiness in prices, however, raises marginal upside risk to our average WPI estimate of 9.0% y/y in 2011.

- We maintain our stance of no further rate hike as downside growth risks outweigh those of inflation going ahead: Policy settings are becoming even more complex for the Indian authorities as inflation notches higher, even as downside risks to growth increase. With the RBI having made future policy actions data dependent, the latest inflation print will be an important input for the September 16th monetary policy meeting. However, we maintain that the case for another rate hike by the RBI still looks weak given the backdrop of rapidly worsening global and domestic growth outlook, rising volatility across financial markets and inability of tighter monetary policy to contain high inflation and anchor inflation expectation. We thereby maintain that policy rates in India have peaked and the RBI will stay put while remaining vigilant on inflation as growth concerns begin to take centre stage.
- Broad based acceleration in price pressures: The pick-up was driven by a broad based acceleration in price pressures as price gains across all categories, including food, fuel and manufactured non-food (core prices) depicting discernible gains, both on a year-on-year as well as seasonally adjusted month-on-month basis.
- Food prices rise sharply in August: Food prices grew at the fastest clip since January 2011, surging 9.1% y/y in August from 8.0% in July. Apart from structural factors, persistent food price pressures chiefly reflect a poor supply response, renewed pressures from an upside revision in Minimum Support Prices (MSP) for farm produce and the impact of recent escalation in global food prices owing to poor crop conditions.
- Substantial cost pressures, pricing power continues to keep the core at elevated levels: Core inflation (non food manufactured category) continues to persist at highly elevated levels of 7.7% y/y, compared to its historical average of 4.4% amidst considerable cost pressures and pricing power. Meanwhile, administered price revisions, particularly LPG, and a rise in freely priced fuel products, including aviation turbine fuel and naphtha kept fuel inflation high.

India: Inflation continues to move higher despite aggressive policy tightening



| India Inflation | | | | | | | |
|--|------------------------------|------------|--------|--------|--------|--------|--------|
| % Change Y/Y | | Aug/11 | Jul/11 | Jun/11 | May/11 | Apr/11 | Mar/11 |
| Headline | | 9.8 | 9.2 | 9.5 | 9.6 | 9.7 | 9.7 |
| | Primary Articles (Non food) | 19.8 | 19.1 | 20.3 | 24.4 | 25.6 | 23.0 |
| | Food | 9.1 | 8.0 | 8.0 | 8.1 | 9.0 | 6.8 |
| | Fuel | 12.8 | 12.0 | 12.8 | 12.3 | 13.0 | 12.5 |
| | Manufactured Non-food (Core) | 7.7 | 7.6 | 7.7 | 7.4 | 6.8 | 8.5 |
| % Change M/M (Non Seasonally Adjusted) | | Aug/11 | Jul/11 | Jun/11 | May/11 | Apr/11 | Mar/11 |
| Headline | | 0.6 | 0.6 | 0.5 | 0.2 | 1.7 | 0.9 |
| | Primary Articles (Non food) | 1.7 | -1.4 | -1.3 | -2.4 | 5.0 | 0.4 |
| | Food | 0.5 | 1.5 | 1.0 | 0.3 | 3.1 | -0.8 |
| | Fuel | 0.8 | 2.5 | 0.7 | 0.6 | 1.2 | 2.7 |
| | Manufactured Non-food (Core) | 0.3 | -0.2 | 0.4 | 0.5 | 0.6 | 1.5 |
| % Change M/M (Seasonally Adjusted*) | | Aug/11 | Jul/11 | Jun/11 | May/11 | Apr/11 | Mar/11 |
| Headline | | 0.6 | 0.1 | 0.3 | 0.2 | 0.7 | 0.9 |
| | Primary Articles (Non food) | 0.8 | 0.5 | -2.2 | -1.8 | 2.1 | -0.9 |
| | Food | 0.5 | 0.6 | 0.8 | 0.5 | 1.3 | 0.2 |
| | Fuel | 0.6 | -0.3 | 0.3 | 0.1 | 1.2 | 1.5 |
| | Manufactured Non-food (Core) | 0.3 | 0.0 | 0.5 | 0.6 | -0.4 | 1.3 |

*BBVA estimates

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Regards

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