

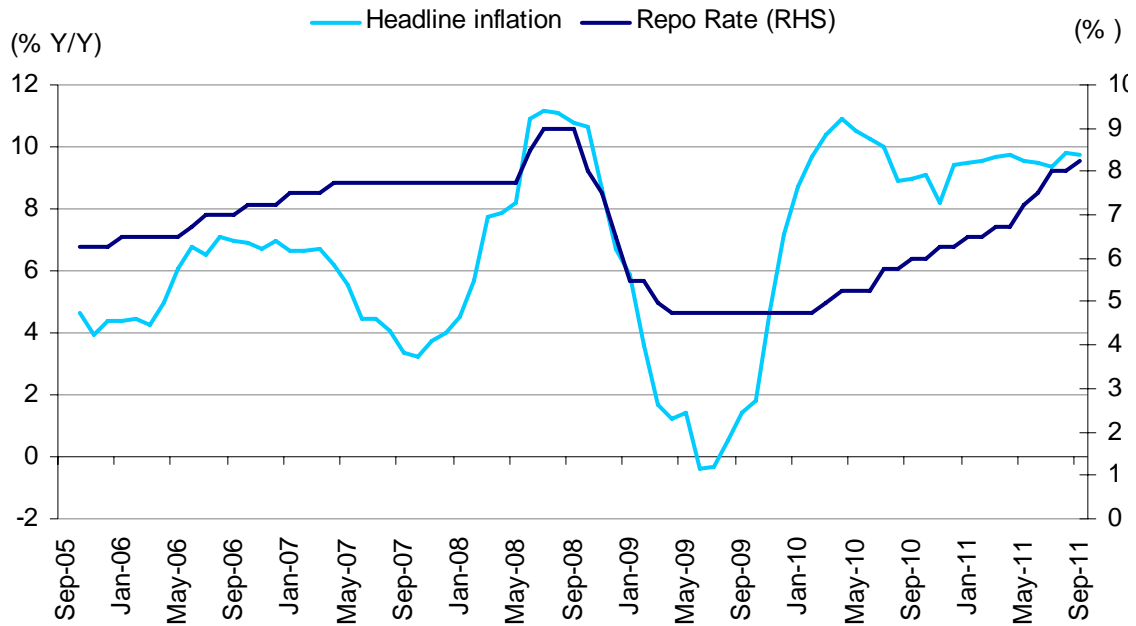


India's inflation ebbs marginally in September, shows signs of peaking out

With many central banks either pausing or easing policy rates in response to the worsening global macro environment, the RBI faces a dilemma as it seeks to balance slowing growth and unrelenting inflation pressures. In this context, the latest WPI inflation data print for September, released today, provided little respite to policymakers. India's wholesale price index (WPI) inflation ebbed marginally to 9.7% y/y in September from a 12-month high of 9.8% y/y in August, matching consensus expectations. Going forward, price trends suggest a gradual moderation. We expect average WPI inflation to clock 9.3% y/y for 2011. We have lowered our growth estimates to 7.6% y/y for the 2011 from 8.1% earlier against the backdrop of deteriorating global and domestic macro environment.

- **We maintain our expectations of no further rate hikes as downside growth risks outweigh those of inflation going ahead:** The September WPI inflation data will be a key input for policy review on October 25th policy meeting. We expect monetary policy to remain on hold given significant downside risks to growth, but the possibility of another 25 bps hike have increased after the RBI Governor, in a recent speech, reiterated the central bank's anti-inflationary stance even at the cost of growth. Sufficient deceleration in the economy is already underway, exacerbated by the worsening global macro environment. August industrial production slowed to a lower than expected 4.1% y/y (3.8% previously), dragged by a contraction in mining activity and lacklustre growth in manufacturing while buoyant growth in electricity provided some support. For Indian corporates, rising variable costs coupled with continued slowdown in capex has begun to hurt corporate revenue growth.
- **Marginal let up in price pressures:** September inflation readings show marginal let up in price pressures, significantly above RBI's comfort zone. The headline was driven mainly by an increase in fuel prices (up 14.1% y/y vs 12.8% in August) while the core and food price index edged lower to 7.6% y/y and 8.8% y/y respectively from 7.7% and 9.1% in the previous month.
- **The weakening rupee presents an upside risk to inflation going forward:** The significant weakness in USD/INR over since September has increased import costs, thereby presenting upside risk to inflation going ahead. The rupee slid 5.9% in September, down about 10.5% from the 2011 high of 43.85% in July, making it the worst performer in Asia. RBI has expressed its unease over the steep decline in rupee over the past month. The weakening rupee has offset the effect of declining global crude oil prices. While crude oil prices have dipped between July 1st and October 2011, the weakness in rupee has pushed up the net rupee price of oil by almost 3%.

Chart 1: Inflation eases marginally in September, remains elevated nevertheless



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