

India Flash

Indian inflation picks up in February on higher food prices

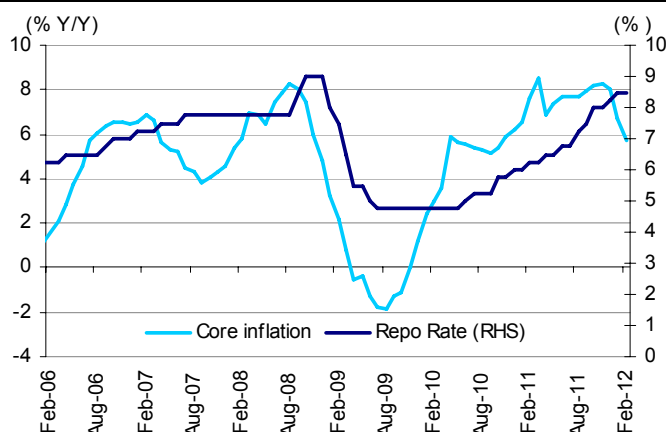
After a four-month moderating trend, wholesale price inflation unexpectedly rose in February, to 6.95% y/y from 6.55% in the previous month (BBVA: 6.4% y/y; consensus: 6.7%). The upturn was driven by a jump in food prices (5.9% y/y vs 1.6% in January). However, core inflation declined to 5.7% y/y from 6.7% the previous month. Today's outturn, coupled with Monday's release of better-than-expected January industrial production and concern about the inflationary risks of rising oil prices, all make an interest rate cut at tomorrow's RBI policy meeting somewhat less likely than we had previously anticipated. We still expect a rate cut of 25bps if not tomorrow, then at April's policy meeting, in view of the significant deceleration in investment activity, moderation in core inflation, and likelihood of fiscal consolidation in the upcoming Union Budget to be announced on March 16.

- **Rise in food prices likely to be temporary, with inflation still under control.** The rise in food inflation in February was driven primarily by lower base effects, and should remain stable going ahead. Reassuringly, core inflation eased, reflecting moderating input costs and demand compression. Going forward, we expect core inflation to continue easing, but the pace of moderation in headline inflation may be checked by the influence of rising oil prices and weaker currency. In this context, our inflation outlook for an average of 6.5% y/y for the full year 2012 poses some upside risk.
- **The likelihood of a rate cut tomorrow has diminished, although we would not rule it out.** The higher than expected inflation outturn may cause the RBI to defer a rate cut at tomorrow's policy (following the 75bp cut in the CRR announced last Friday), in contrast to our previous expectations of 25 bps easing. We continue to believe that growth concerns outweigh inflation risks in the period ahead. Given the lagged effect of monetary policy actions and the likelihood of fiscal consolidation in the upcoming Union Budget, we remain biased towards a 25 bps repo cut, if not tomorrow, then at April's meeting.

Chart 1
India's Inflation table

India Inflation							
% Change Y/Y	Weight	Feb/12	Jan/12	Dec/11	Nov/11	Oct/11	Sep/11
Headline	100	7.0	6.6	7.7	9.5	9.9	10.0
Primary Articles (Non food)	4	-2.6	0.6	1.8	3.4	7.4	14.6
Food	26	5.9	1.6	2.7	7.9	9.3	9.1
Fuel	15	12.8	14.2	15.0	15.5	14.8	14.0
Manufactured Non-food (Core)	55	5.7	6.7	8.0	8.3	8.2	8.0

Table 1
Core inflation continues to ease amid negative output gap, higher base effect



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