

India Flash

Benign core inflation builds case for policy easing next week

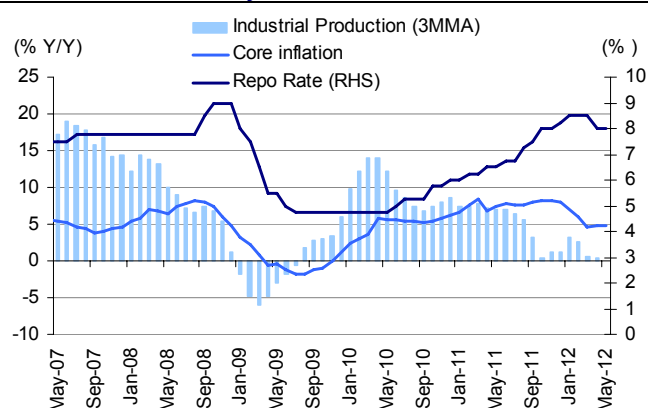
India's wholesale price inflation rose in May, to 7.55% y/y (Consensus: 7.5%) from 7.23% in April driven mainly by higher food and fuel prices. However, as anticipated, core inflation remained contained, at 4.8% y/y, on weak economic activity, base effects and tight liquidity. The benign outturn for core inflation—a third consecutive month below the critical 5.0% threshold—and falling international oil prices provide room, in our view, for further monetary policy easing to support growth. We expect the RBI to cut the repo rate and cash reserve ratio by at least 25 bps each, at the next policy meeting on June 18. Our current growth projection of 6.8% for CY2012 is subject to significant downside risk given the weak Q1 GDP outturn (5.3% y/y).

- Growth yet to bottom.** Weak investor sentiment has led to a sharp deceleration in India's growth, which hit a 9-year low of 5.3% y/y in 1Q12. We expect growth to bottom in 2Q12 as most real activity indicators, led by industrial production, cement dispatches, vehicle sales, power demand and tax collections continue to disappoint. Earlier this week, India's industrial production outturn suggested that growth stalled (+0.1% y/y vs -3.2% in March) in April as a contraction in capital goods production and negative seasonality factors offset gains in the consumer goods segment. On a 3 month moving average basis, IP growth edged lower to 0.4% y/y from 0.6% previously.
- Divergence in headline and core inflation to persist.** Looking ahead, we expect the divergence in headline and core inflation to continue as rising food prices, imminent energy price hikes and the sharp rupee depreciation offsets waning demand pressures. Food inflation would remain elevated on higher vegetable and protein rich food items, driven by supply side bottlenecks and seasonality factors. The nature of on going monsoon season would also play a critical role in shaping the direction of food prices. India's monsoon rains have been 36% below average in the first week, thereby presenting upside risk to food inflation going ahead.

Table 1
India's inflation table

India WPI Inflation						
% Change Y/Y	Weight	May-12	Apr-12	Mar-12	Feb-12	Jan-12
Headline	100	7.5	7.2	7.7	7.4	6.9
Primary Articles (Non food)	4	8.5	1.6	-0.8	-2.5	0.7
Food	26	9.0	9.1	8.7	5.9	1.5
Fuel	15	11.5	11.0	12.8	13.6	14.6
Manufactured Non-food (Core)	55	4.8	4.8	5.0	5.9	7.0

Chart 1
Benign core inflation, rapid growth deterioration to prompt near term rate action by the RBI



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