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## India Flash

## September WPI inflation inches higher on fuel price hikes

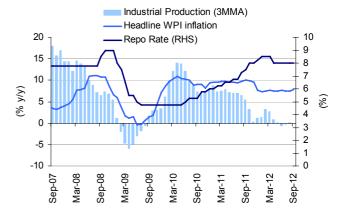
India's wholesale price inflation inched higher in September to 7.8% y/y (Consensus: 7.7%) from 7.6% in August, driven mainly by a 12% hike in diesel prices (on September 13<sup>th</sup>), which added about 56 bps to the latest outturn. Excluding fuel, however, WPI inflation slowed to 7.0% y/y in September from 7.4% previously while core inflation (excluding both fuel and food) held steady at 5.6% y/y. Looking ahead, we expect inflation risks to remain broadly balanced with WPI inflation averaging 7.7% for 2012 as easing demand pressures and a high base effect are offset by second round impact of energy price hikes on transportation and food prices and the risk of a liquidity led rally in global commodities. Even as inflation pressures persist, significant weakness in India's growth momentum coupled with complementary fiscal and pro-investment reforms by the government leave room for the RBI to cut the repo rate by 25 bps at its October 30<sup>th</sup> policy meeting. Together with the expected move on October 30, we continue to expect total rate cuts of 50 bps in the last quarter of 2012 to address growth concerns.

- Industrial growth recovered slightly in August but remains lackluster. India's August industrial production
  grew 2.7% y/y (-0.2% in July), beating expectations of 1.0%, driven mainly by a favorable base effect and
  moderate pick up in manufacturing activity. A crucial, albeit late, recovery in monsoon rains helped producer
  sentiment during August, particularly boosting the consumer goods sector. That said, industrial growth continues
  to remain subdued in 2012, averaging just 0.5% y/y compared to 4.8% y/y in 2011.
- Implementing fiscal reforms Key to allay India's ratings threat. Ratings agency S&P last week warned that India's investment grade rating (at BBB-) faces a one-third likelihood of a downgrade to junk status in 24 months if political, economic, fiscal or external factors deteriorate. More importantly, it notes that India's outlook would be revised to stable if it successfully lowers fiscal deficit and improves the investment climate. S&P's comment came in despite recent efforts by the government to enact growth supportive reforms and cut fiscal spending. In this context, implementation remains to key to the series of recently announced policy reforms, which include higher foreign investments in key sectors such as retail, hike in regulated fuel, divestments in public sector companies, time bound implementation of Goods and Services Tax, broad outline on cash transfers and announcement of a 5 year fiscal consolidation plan.

## India's Inflation table

India WPI Inflation							
% Change Y/Y	,	Weight	Sep-12	Aug-12	Jul-12	Jun-12	May-12
Headline		100	7.8	7.6	7.5	7.6	7.5
	Primary Articles						
	(Non food)	4	10.0	13.8	13.3	7.2	8.6
	Food	26	8.5	9.1	9.0	9.1	8.9
	Fuel	15	11.9	8.3	8.4	12.1	11.5
	Manufactured						
	Non-food (Core)	55	5.6	5.6	5.7	5.2	5.2

High inflation provides limited headroom for RBI to address weakening growth prospects



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