

# India Economic Flash

## RBI is likely to keep policy rates unchanged on June 3<sup>rd</sup> meeting as April inflation outturns paint a mixed picture

India's inflation outturns for April were mixed and provided little respite for policymakers seeking clarity on the inflation trajectory. In a positive surprise, the April WPI inflation eased to 5.2% y/y from 5.7% in March (Consensus: 5.8%) with core WPI edging lower to 3.4% y/y from 3.5% previously. However, the CPI, which is RBI's benchmark inflation indicator, rose to a three month high of 8.6% y/y in April from 8.3% in March (Consensus: 8.5%), due to the base effect and higher food inflation. It is noted that the CPI has a much higher weight on food (50%) compared to 26% for the WPI. Untimely rains and hailstorms have hampered India's winter crop, raising pressure on near term food inflation. Meanwhile, core CPI was unchanged at 7.8% y/y suggesting weak consumption demand and the impact of a strengthening rupee. Headline inflation trajectory remains in line with our expectations, both for the CPI (2014 average at 8.5%) as well as the WPI (at 5.6%).

Looking ahead, we expect India's inflation to inch higher in the near term led by rising food prices. The nature of monsoon rains in 3Q14 as well as the new government's policy actions to reduce the fiscal deficit and address supply side bottlenecks will be key to India's medium term inflation trajectory and in turn for RBI's policy decisions. Official weather forecasters predict a sub-normal monsoon for India this year. Against this backdrop, we expect RBI to keep policy rates on hold at its June 3<sup>rd</sup> policy meeting and for most of 2014 with a bias towards further tightening if inflation pressures fail to subside meaningfully and more consistently.

### All eyes on tomorrow's election results – Taming inflation should be a top priority for the new government.

India's much awaited national election results are due tomorrow with exit polls predicting a comfortable win for the opposition BJP led alliance headed by Mr. Modi. However we caution over the dubious record of exit polls in predicting actual poll outcomes in India. That said, the odds are certainly in favor of a stable Modi led government with a larger base of popular support. Given India's significant macro challenges it is premature to expect the new government to be an immediate game changer. Of high priority is the need to work closely with the RBI in stemming inflation pressures through supply side reforms, fiscal consolidation and subsidy reduction.

Chart-1  
**RBI to keep policy rates unchanged on June 3<sup>rd</sup> as CPI inflation stays elevated led by high food prices**

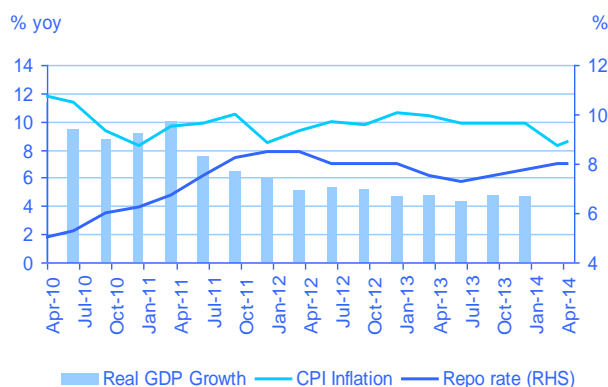
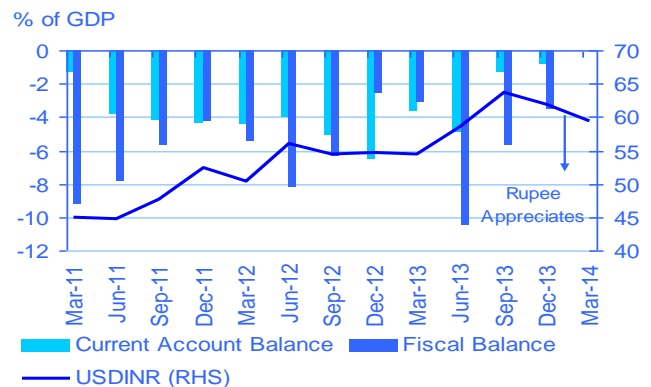


Chart-2  
**Improving external trends and hopes of a strong and stable government post elections foster rupee appreciation**



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