

India Flash

May WPI inflation softens further, but currency pressures likely to keep RBI on hold next week

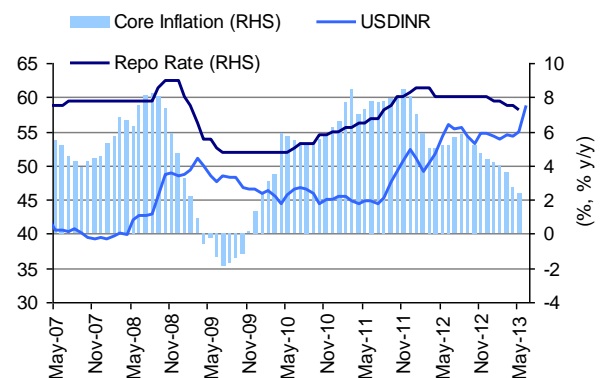
India's wholesale price inflation softened further in May to a lower-than-expected 4.7% y/y (consensus: 4.8%; prior 4.9%), the lowest level since August 2009, as easing demand pressures and lower fuel prices offset higher food inflation. Core inflation fell for the ninth successive month to 2.4% y/y from 2.7% previously amid weak domestic pricing power and softer global commodity prices. Looking ahead, most domestic factors - subdued growth, positive monsoon prospects, weak final demand and lower minimum support price revisions - suggest a benign inflation outlook. However, the recent steep rupee depreciation (-5% since May), which was mainly the fallout of the broad-based selloff in EM assets due to possible QE tapering, poses some upside risk to prices and market stability, in turn dampening prospects of a RBI policy rate cut on June 17th. We continue to see scope for another 25 bps policy cut in the coming months, once exogenous market pressures subside.

- Commodity currency interplay to shape monetary policy actions looking ahead.** The recent steep depreciation in the Indian rupee (-5% against the US dollar since May) has complicated RBI's monetary policy reaction function despite subdued growth and easing inflationary trends. The weaker rupee has pushed up the domestic price of imported crude oil (up 4.6% since May), which accounts for a third of India's import basket, even as global oil prices fell in US dollar terms. With tradable items accounting for almost 57% of the WPI basket, the ongoing adverse commodity-currency interplay, would limit RBI's scope for policy easing going forward.
- Weak growth trends warrant further traction on policy reforms.** Sequential activity indicators including motor vehicle sales, cellular subscriptions, and industrial production suggests growth continues to remain weak. Looking ahead, expediting pending reforms, particularly on land acquisition and easing structural bottlenecks in power and mining sector is critical. In this context, government's recent assurance of swift action to resolve issues related to coal blocks allocation and pricing, natural gas pricing, revising foreign direct investment limits and accelerating capital spending would support medium term growth. We expect India's full year 2013 growth to average 5.7% y/y, up from 5.1% y/y in 2012.

Table 1
WPI inflation softens further in May on weak demand

India WPI Inflation						
% Change Y/Y	Weight	May-13	Apr-13	Mar-13	Feb-13	Jan-13
Headline	100	4.7	4.9	5.7	7.3	7.3
Primary Articles (Non food)	4	4.9	7.6	9.3	10.7	13.0
Food	26	7.6	6.3	8.2	10.8	11.0
Fuel	15	7.3	8.8	7.8	10.6	9.3
Manufactured Non-food (Core)	55	2.4	2.7	3.5	4.0	4.1

Chart 1
Recent steep rupee weakness limits scope for RBI easing



Source: RBI, BBVA Research

Sumedh Deorukhkar
sumedh.deorukhkar@bbva.com
+91 2226598581

Stephen Schwartz
stephen.schwartz@bbva.com.hk
+852 2582 3218