

INFLATION

In the worry zone?

January 14, 2009

■ WPI inflation: High on low base and rising prices

The Wholesale Price Index- (WPI) based inflation rate jumped to 7.31% Y-o-Y for December 2009 (4.8% during the previous month), in line with consensus estimates (Consensus: 7.3%). Inflation for the same period in 2008 was ~6.15% Y-o-Y, when the index had posted one of its largest monthly declines.

During December, apart from the base effect, sustained rise in primary articles' prices played their part in pushing up inflation. Measuring inflation as a build-up from March 2009, WPI rose ~8.02% Y-o-Y against ~1.86% in the previous year, with food articles' prices rising ~18.3% Y-o-Y against ~6.75% during the corresponding period in the previous year while fuel prices rose 7.54% Y-o-Y against a decline of ~3% during the same period last year. Manufactured products were up by 5.4% against a 2.55% rise in the corresponding period last year.

Table 1: Movement in inflation sub-groups

(%, YoY)	Weight	Dec-09	Nov-09	Dec-08
WPI	-	7.3	4.8	6.2
Primary articles' group	22.0	14.9	11.8	11.2
Food articles	15.4	19.2	16.7	10.0
Fuel group	14.2	4.3	(0.9)	(0.2)
Manufactured products' group	63.8	5.2	4.0	6.6
Food products	11.5	26.4	24.7	4.2
Textiles	9.8	5.7	3.6	10.5
Chemicals & chemical products	11.9	4.6	4.0	6.1
Basic metal alloys & products	8.3	(7.3)	(9.0)	12.6
Machinery & Machine Tools	8.4	(0.2)	(1.7)	3.9

Source: Office of Economic Adviser

■ Current inflation hump to be short lived

Going by the recent pick-up in the index, we expect the base (in addition to supply-side pressures) to play an increasingly larger role in the forthcoming months till the fiscal end. At the same time, we believe, the current hump in the inflation trajectory will be short lived with the peak likely during March-April 2010. Larger part of H2CY10 should see WPI inflation settling at ~5% Y-o-Y.

■ CRR hike likely by January end

Rising inflation tends to immediately fuel expectations of policy tightening. However, considering the fact that the current spell of inflation is largely driven by supply-side factors or base effect, the role of monetary policy can at best be limited. The RBI could adopt steps to contain inflation and inflationary expectations without derailing growth prospects. With the recovery pace still being gradual and a slow rate of credit offtake, we expect announcement of a CRR hike in the January policy meeting. The reaction from RBI is likely to be gradual and controlled so as to avoid any generalized pressure on interest rates. Thus, while CRR may be hiked, both repo and reverse repo rates are likely to remain unchanged.

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