Asia Economics Data Flash

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India weekly inflation: The hydra is back

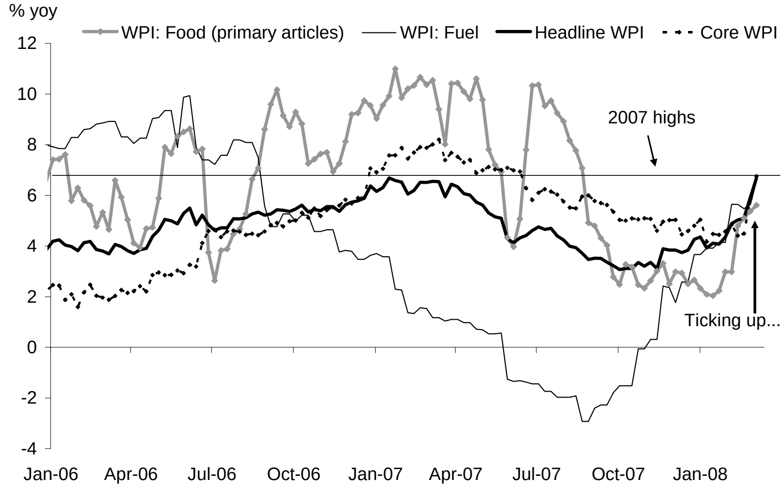
- **WPI inflation continued to accelerate to 6.68% yoy** in the week ending March 15, from 5.92% yoy a week earlier. The inflation print was well above expectations, significantly higher than the Reserve Bank of India's (RBI) comfort ceiling of 5%, and touched the highs of January 2007 (see Exhibit 1). From its trough of 3.1% in October 2007, WPI inflation has more than doubled. The benchmark 10-year government bond yield jumped 10 bp, while the rupee (INR) appreciated 0.74% against the USD by 2 pm today over the close on March 27.

- **Acceleration driven by greater pass-through of elevated global commodity prices.** Core inflation hastened to 6.8% yoy from 5.9% yoy a week earlier, driven by price hikes by steel producers. Metal products accounted for 22% of the rise in inflation. Fuel price inflation rose to 6.6% from 5.6% in the previous week, contributing 21% to the inflation print, driven by elevated global oil prices spilling over into non-administered domestic components such as naphtha.

- **Large price increase portends significant government action.** With inflation driven by high commodity prices, the government has reduced import duties, banned exports and increased minimum export prices of certain food commodities in order to curtail inflation. Going forward, we expect a clampdown by the government on all inflationary commodities, especially food and metal products, through excise and customs duty cuts, increasing export prices, and forced price cuts.

- **Although the probability of a rate hike has increased, we think the RBI will keep rates on hold.** The spike in inflation removes nearly all possibility of a rate cut and indeed, has increased the probability of a rate hike. However, we think that the RBI will not hike rates in its next meeting on April 29 as demand is slowing, credit growth moderating, and the current run-up in inflation is more supply-side and global-commodity driven. Instead, we expect greater use of the exchange rate to soften import prices and continued mopping up of INR liquidity.

Exhibit 1: Inflation on the rise



Source: CEIC, Goldman Sachs Economics Research.

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