

WPI inflation down to 3-year low as economy slumps

Though consumer inflation getting back to double digits probably puts paid to hopes of a 50 bps rate cut on January 29, almost any indicator a central bank should look at is at a multi-year low. At 7.18%, WPI inflation in December is at a three-year low, the last time such an inflation was seen was in December 2009 when inflation was 7.15%; inflation in manufactured products fell to 5.04%, a level last seen in November 2010. Strip away food products within manufacturing and you get to RBI's definition of core inflation, and this was down to 4.2%, a level that's not too far away from the RBI's desired level of 4%. Indeed, were it not for the consistent surge in foodgrain prices—at 18.7% in December, inflation in foodgrains is higher than it has been for several years. Indeed, if inflation continues to slow as projected, analysts are looking at a 75-100 bps rate cut by the end of the calendar year. A rate cut in itself will do little to spur capital investments as these have been held up for different reasons—apart from issues like land and environment clearances, the fact is that large segments of India Inc are in no position to raise even the necessary equity to go ahead with projects. But what a rate cut will do is to give immediate relief to corporate balance sheets, especially for SMEs. In the case of rate-sensitive sectors, such as automobiles, a pick up in credit, and hence demand, looks near certain.

Apart from the fact that inflation levels are now within RBI's comfort limits, the WPI data show how all-pervasive the industrial slowdown is. WPI inflation for basic metals and metal products, down to 3.37% in December was 9.75% as recently as July; WPI inflation for irons and semis was near flat at 0.96% in December as compared to 12.03% in July. The same lack of demand can be seen in the fact that deposits growth in banks in the fortnight ended December 28 grew at 11.1%, a lower growth than that seen in many years. Exports, similarly, continued to fall for the 8th straight month, though the rate of fall seems to have slowed—December exports fell just 1.9% yoy compared to a fall of 4.2% in November.

Whether RBI chooses to go in for a rate cut—and 25 bps or 50 bps—will depend on whether it chooses to be consistent or not. Though RBI's stated policy variable has been the modified core inflation, in recent monetary policy statements RBI has confounded all watchers by changing its goalposts from WPI to core inflation to CPI and even, in the August statement, to the output gap.

Here come the rate cuts

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