

<http://blogs.wsj.com/indiarealtime/2013/03/15/here-comes-an-india-rate-cut/>

The Wall Street Journal

INDIA REALTIME
The daily pulse of the world's largest democracy

March 15, 2013, 12:46 PM

Here Comes an India Rate Cut

By Kunal Kumar Kundu



Divyakant Solanki/European Pressphoto Agency
The wholesale price index for February was up 6.84% from a year earlier.

India's official inflation gauge for February was a setback to hopes that prices would continue to ease, with food a particular concern, but that shouldn't stop the central bank cutting interest rates on Tuesday.

The wholesale price index for February was up 6.84% from a year earlier, accelerating from 6.62% in January. The figure for December was also revised upward to 7.31% from 7.18%.

This wasn't unexpected after data Tuesday showed the consumer price index rose 10.91%, the fastest increase since the new series was introduced in January 2011. Research firm CEIC Data said India's consumer price inflation for February was among the highest in the world, ahead of the countries such as Egypt, Pakistan and Russia.

Food inflation was 11.4% in February, slightly lower than January's 11.9% but the second highest in two years. Its contribution to India's headline inflation was 28.5%. Worryingly, the food inflation index continues to move up despite the high base effect. Monetary policy can't do much to fight food inflation. Soaring prices of food grain and high-protein products ensure it stays at an elevated level.

The government's fiscal consolidation effort — mainly increasing administered prices of oil products — has kept inflation strong. But fiscal discipline will have positive impact in the longer run.

Reassuringly, core inflation — headline inflation stripped of volatile food and energy prices — for February eased substantially to 3.79%, the first time it has dipped below 4% since March 2010.

Indian companies still lack pricing power as domestic demand shows no big sign of revival. Consumers are pulling back as they are squeezed by high inflation and borrowing costs. In February, India's domestic passenger car sales plunged 26%, the steepest fall in 12 years.

Data Tuesday showed a 2.36% expansion in industrial activity for January, coming in after two months of contraction. But this is unlikely to be sustained.

India seems to be in a classic stagflation situation with economic growth for 2012-13 likely to be less than 5%, while inflation remains above the central bank's comfort zone. Despite this, the Reserve Bank of India should be encouraged by the recent budget pledge to focus on fiscal consolidation.

It will also be concerned about the falling growth rate, so a rate cut is likely when the bank meets Tuesday. The cut in the policy rate will be limited to 0.25%, and it will carry a cautious undertone.



The author is an economist based in New Delhi. These are his personal views.