Inflation back in the RBI's comfort zone after 3 years

Country's headline inflation fell below 5 per cent in April, dropping within the RBI's comfort zone for the first time in more than three years and fuelling market hopes for more monetary easing to revive flagging economic growth.

The wholesale price index rose 4.89 per cent from a year earlier and was the lowest inflation rate since November 2009 and well below the 5.50 per cent forecast by analysts in a Reuters poll. It was more than a full per centage point lower than the 5.96 per cent rise in March.

Inflation has been a persistent headache for policymakers struggling to breathe life into Asia's third largest economy, and has been a major factor in the declining popularity of the government of Prime Minister Manmohan Singh.

The low number quickly sparked gains in the bond and share markets, while the rupee was little changed.

"It is a frenzy. The market is pricing in a rate cut," said Ashish Vaidya, head of treasury at UBS in Mumbai.

Earlier this month, the RBI cut interest rates by a quarter point for the third time since January, to reduce the policy repo rate to 7.25 per cent.

The bond market rallied to a three-year high, with the benchmark 10-year bond yield dropping 4 basis points, while stocks were up and the rupee strengthened slightly to 54.61/62 per dollar versus Monday's close of 54.73/74.

Global commodity cooling

Inflation was mainly cooled by a moderation in food and fuel costs helped along by lower global commodities prices.

Food inflation slumped to 6.1 per cent from 8.7 per cent a month ago on lower wheat, meat and egg prices. Fuel rose 8.8 per cent on the year after a rise of 10.2 per cent in March.

Non-food manufacturing inflation, which the central bank monitors to gauge demand-driven price pressures, slowed to 2.8 per cent in April from 3.5 per cent a month ago, after the international price of iron ore and steel dropped.

"With food prices expected to remain stable, manufacturing prices weak due to slow growth, and commodity prices stable, inflation in expected to be on a broad downtrend for the next six months and this, we believe, opens up room for more rate cuts," said Rahul Bajoria, Regional Economist at Barclays Capital in Singapore.

Government data showed on Monday that annual retail inflation slowed by a full per centage point to a 14-month low of 9.39 per cent in April.

"We think there is a possibility of as much as 75 basis points more rate cuts in the next six months, including 25 basis points at the next policy (review) in June," Bajoria said.

Gold takes off sheen

Not everyone was so upbeat. Indranil Pan, chief economist at Kotak Mahindra Bank, expects caution from the RBI until inflationary risks abate and the current account deficit improves.

"Since RBI expects inflation to rise post September, I don't think the governor will risk cutting rates aggressively," Pan said.

The current account gap widened to a record high 6.7 per cent of GDP in the December quarter, driven by heavy oil and gold imports and lower exports.

After cutting rates this month, the RBI said the external deficit as the biggest risk "by far" to the economy and a factor limiting room for more easing.

Those worries were highlighted by data on Monday that showed a massive gold buying spree lay behind a jump of more than 72 per cent in the April trade deficit.

Slowing inflation is a relief for the Congress-led ruling coalition, which needs an economic revival to help it in state elections this year and a national election due by May 2014.

But there could also be a downside -- while persistent cooling in non-food manufacturing prices bodes well for the inflation outlook, it also points to weak consumer demand that could further dent any hope of a fast economic rebound.

Country's growth in 2012/13 was likely the lowest in a decade, and is not expected to much surpass 6 per cent in 2013/14.

(Economic Times)