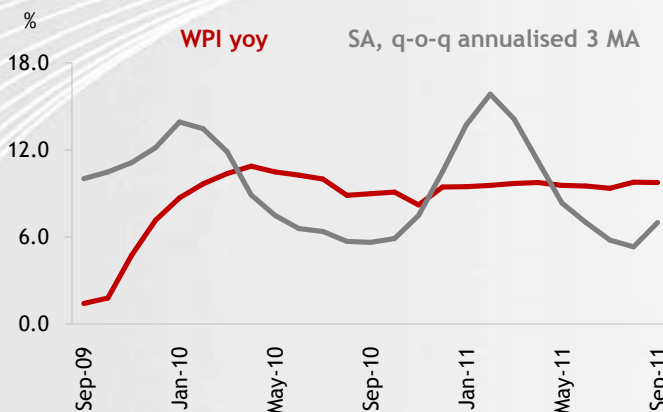


Weak rupee to wipe gains from easing crude oil prices

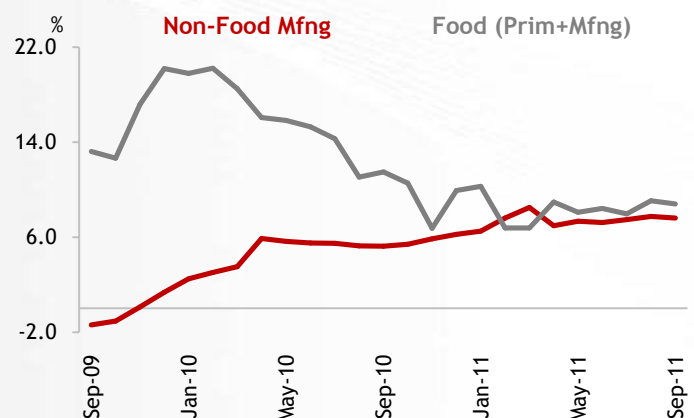
Overview: Inflation remained stubborn at 9.7 per cent in September 2011 compared to 9.8 per cent in August. There are little signs of a decline in core (non-food manufacturing) inflation, which at 7.6 per cent in September has now remained above RBI's comfort zone of 4.5-5.0 per cent, for last 18 months. As a result, we expect another 25 basis points hike in the RBI's mid-year monetary policy review on October 25th. For any gains from recent decline in international crude oil prices to reflect in lower inflation, rupee will have to appreciate to 47.0 per US\$ by December 2011.

- Inflation in the fiscal year so far (April to September 2011) stands at 9.6 per cent compared to 9.9 per cent during the same period of 2010 - indicating few signs of moderation. Inflation for July 2011 has also been revised upwards to 9.4 per cent from 9.2 per cent reported earlier.
- Food inflation stood at 8.8 per cent in September 2011 compared to 9.1 per cent in August. Despite good rains, we do not see much downside to food inflation due to substantial rise (in the range of 7 to 14 per cent) in minimum support prices of principal food grain commodities in 2011-12, which set the floor for market prices.
- Primary articles' inflation declined to 11.8 per cent in September, compared to 12.6 per cent in August. This was enabled by a sharper decline in non-food articles, namely; fibres and oil seeds. Fuel inflation rose to 14.1 per cent in September, from 12.8 per cent in August, reflecting the impact of petrol price hike during the month as well as higher prices of aviation turbine fuel, bitumen, furnace oil and other lubricants.
- Despite some softening of global crude oil prices in recent months, crude oil prices in September 2011 continued to be higher than a year ago. In addition, a depreciating rupee is pushing import costs further, raising inflation in domestic fuel prices which are linked to international prices. If international oil price remains at the current level of around US\$ 85 per barrel till December, which represents around 5.0 per cent annual decline in price, then rupee will have to appreciate to 47.0 per US\$ in order to reflect gains from lower oil prices into inflation.
- Core (non-food manufacturing) inflation remained worrisome at 7.6 per cent in September 2011 compared to 7.7 per cent in the previous month. Given that core inflation remains much higher than RBI's comfort zone of 4.5 to 5.0 per cent, we expect a 25 basis points hike in the mid-year monetary policy review on October 25th, 2011.

Inflation pressures remain stubborn in September



Non-food manufacturing inflation remains firm



Note: Seasonal adjustment helps to strip out seasonal effects from a series

Source: Ministry of Industry and Commerce, CRISIL computations

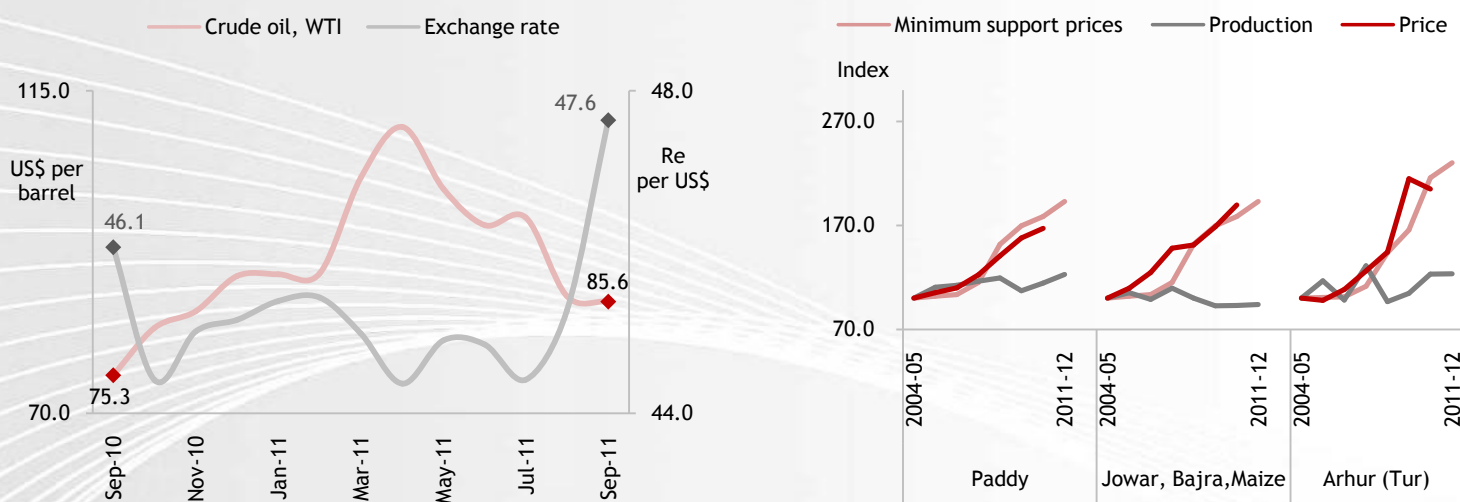
The seasonally-adjusted q-o-q annualized (SA) inflation reversed its declining trend in September 2011 and jumped to 7.0 per cent compared to 5.3 in August.

Both food and non-food manufacturing have stabilised at high levels in recent months.

Inflation in major inflation groups

(2004-05 base)	Weight	Jun-11	Jul-11	Aug-11	Sep-11	Apr-Sep	
						FY11	FY12
General	100.0	9.5	9.4	9.8	9.7	9.9	9.6
Primary	20.1	12.2	11.3	12.6	11.8	19.2	12.6
- Food articles	14.3	8.4	8.2	9.6	9.2	18.7	9.0
- Non-Food articles	4.3	18.6	15.5	17.8	14.8	16.8	19.1
- Minerals	1.5	27.0	25.0	23.4	24.8	27.2	25.5
Fuel	14.9	12.8	12.0	12.8	14.1	13.1	12.9
- Petrol	1.1	30.6	23.2	23.2	26.3	16.9	25.4
- Diesel	4.7	6.6	9.3	9.3	9.3	15.4	7.6
Manufacturing	64.9	7.4	7.5	7.8	7.7	5.6	7.4
- Food	9.9	8.4	8.0	9.1	8.8	14.0	8.6
- Non Food	55.0	7.2	7.5	7.7	7.6	5.5	7.4

Weaker currency and hike in MSPs add to inflation concerns



Source: Reserve Bank of India, Ministry of Industry and Commerce, CRISIL computations

- Despite a fall in crude oil prices since April 2011, they continue to remain higher than a year ago. In addition, rupee has sharply fallen against US\$, by 16.0 per cent compared to a year ago. Although this is currently adding upward pressure on the imported component of inflation, it is expected to be a transient phenomenon - the impact of which is unlikely to sustain until March 2012.
- The second-round pass-through of exchange rate depreciation into retail prices would be limited as firms would find it difficult to raise prices because of slowing private consumption growth.
- For 2011-12, minimum support price (MSP) for paddy has been hiked by 8.0 per cent, for jowar by 11.4 per cent and for arhar, moong and urad by 6.7, 10.4 and 13.8 per cent respectively. This, in conjunction with relatively low growth in production, especially of pulses will put upward pressure on the market prices going forward. 1st advance estimates of food grain production for 2011-12 have placed production growth for paddy at 7.0 per cent, for jowar at 0.9 per cent and arhar and urad at 0.3 per cent and 0.6 per cent respectively. Production of moong is expected to decline by 30.2 per cent in 2011-12.

Contacts:

Vidya Mahambare
Senior Economist
Email: vmahambare@crisil.com
Phone: +91-22-33428038

Dipti Saletore
Economist
Email: dsaletore@crisil.com
Phone: +91-22-3342 8019

About CRISIL Limited

CRISIL is a global analytical company providing ratings, research, and risk and policy advisory services. We are India's leading ratings agency. We are also the foremost provider of high-end research to the world's largest banks and leading corporations.

About CRISIL Research

CRISIL Research is the country's largest independent and integrated research house with strong domain expertise on Indian economy, industries and capital markets. We leverage our unique research platform and capabilities to deliver superior perspectives and insights to over 1200 domestic and global clients, through a range of research reports, analytical tools, subscription products and customised solutions.

Disclaimer:

CRISIL Limited has taken due care and caution in preparing this Report. Information has been obtained by CRISIL from sources, which it considers reliable. However, CRISIL does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. CRISIL Limited has no financial liability whatsoever to the subscribers / users / transmitters / distributors of this Report. The Centre for Economic Research, CRISIL (C-CER) operates independently of and does not have access to information obtained by CRISIL's Ratings Division, which may in its regular operations obtain information of a confidential nature that is not available to C-CER. No part of this Report may be published / reproduced in any form without CRISIL's prior written approval.

CRISIL Privacy Notice

CRISIL respects your privacy. We use your contact information, such as your name, address, and email id, to fulfill your request and service your account and to provide you with additional information from CRISIL and other parts of The McGraw-Hill Companies, Inc. you may find of interest. For further information, or to let us know your preferences with respect to receiving marketing materials, please visit www.crisil.com/privacy. You can view McGraw-Hill's Customer Privacy Policy at http://www.mcgrawhill.com/site/tools/privacy/privacy_english



Last updated: 31 March, 2011

CRISIL Ltd is a Standard & Poor's company