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Indian inflation falls to two-year low

By James Crabtree in Mumbai

India's stubbornly high inflation rate has dipped to its lowest level since 2009, raising hopes of early interest rate cuts and a return to higher growth ahead of important upcoming elections.

Prices rose by only 7.5 per cent during December compared with the same period the year before, having grown at close to double digit rates for much of last year. In November, inflation stood at 9.1 per cent.

Although sharp, the fall was broadly in line with economists' expectations, and also followed a welcome drop in the politically sensitive rate of food inflation during December ahead of March elections in the bellwether state of Uttar Pradesh.

Monday's data will provide welcome relief for policymakers who have introduced more than a dozen interest rate increases over the last 18 months, before pausing in December on concerns about slowing industrial production.

The figures follow a number of other positive developments in Asia's third-largest economy, where industrial production figures and the value of the rupee have both risen since the start of 2012, following sharp falls last year.

In spite of Monday's figures, Indian inflation remains higher than other major developing markets, including China and Brazil. Even so Indian industrial leaders have argued for early rate cuts to boost faltering growth, which dropped below 7 per in the second half of 2011.

Sajjan Jindal, Chairman of JSW, India's third largest private steel company by market capitalisation, said: "Given today's figures it seems as if inflation is looking a bit more controlled, and so it is time for the RBI to begin to cut rates."

Some academic experts also argue for an immediate cut. Ashima Goyal, Professor of economics at the Indira Gandhi Institute of Development Research in Mumbai and an advisor to the RBI, said: "We have had a long period of persistent inflation, but my recommendation is that the central bank should now cut rates, because i think we have over-corrected in our policies."

Despite this the Reserve Bank of India, which meets next week to consider its options, has shown signs of continuing caution. Sonal Varma, a Mumbai-based economist at Nomura, said: "This is a large fall, but underneath core inflation has not declined much. Because of this we do not expect the Reserve Bank of India to reverse their current rate pause policy until May."

Analysts suggested that December's inflation fall was in part the result of statistical good fortune, including sharp falls in the cost of food items and an easing in global commodity prices since this time last year, leaving the problems of chronic supply constraints in India's economy unaddressed.

Rohini Malkani, chief economist at Citigroup India, said: "The decline is partly to do with commodity price movements since last December [2010], and actually has little to do with the actions of policymakers. Unfortunately it will be used to say that their measures have worked when they have not."

Other experts believe that only a new push for major economic reforms, such as the re-introduction of plans to allow foreign investment in India's retail sector following the end of the current election cycle, will be sufficient to sustain high growth in the world's largest democracy.

Eswar Prasad, senior professor at Cornell University, said: "The Indian economy is at a turning point. A strong and concerted set of reforms could revive growth and put the economy back on track. The alternative may be a slide back to modest 'Hindu' rates of growth."