

India: RBI's surprise rate cut appears premature

The Reserve Bank of India (RBI) has ignored the inflationary consequences of the fiscal splurge and eased policy in support of the government's drive to boost growth before the elections. We think the markets will view such a policy move as premature and the rupee will be the main victim



Source: Shutterstock

6.25% RBI repo rate
25 basis point cut
Lower than expected

An RBI rate cut with neutral policy stance

The RBI Monetary Policy Committee voted 4-2 to cut the key policy rate by 25 basis points, taking the repurchase rate to 6.25% and the reverse repo rate to 6.00%. The decision was surprising in

that very few, only eight out of 38 participants in the Bloomberg survey anticipated it. As widely expected, there was no change to the banks' reserve requirement rate of 4.00%. The MPC also switched its policy stance to 'neutral' from 'calibrated tightening', which was a unanimous decision by all members.

What's more amazing though is the sharp swing in the policy perception within the MPC. Until late 2018, all but one member expressed caution on inflation and advocated a tighter stance with stable rates, whereas all favoured a neutral stance and the majority voted for a rate cut today.

A change in policymakers' thinking

MPC member	Dec-2018 meeting	Feb-2019 meeting
Governor Patel => Das *	Tight - no change in rate	Neutral - rate cut
Dr. R. H. Dholakia	Neutral - no change in rate	Neutral - rate cut
Dr. Pami Dua	Tight - no change in rate	Neutral - rate cut
Dr. Michael Patra	Tight - no change in rate	Neutral - rate cut
Dr. Chetan Ghate	Tight - no change in rate	Neutral - no change in rate
Dr. Viral Acharya	Tight - no change in rate	Neutral - no change in rate

* Shaktikanta Das replaced Urjit Patel as RBI governor after the later resigned in December.

Source: RBI policy statements and meeting minutes, ING Bank

Benign inflation, strong growth outlook

The [RBI statement](#) began by noting that, "These decisions are in consonance with the objective of achieving the medium-term target for consumer price index (CPI) inflation of 4 percent within a band of +/- 2 percent while supporting growth". Inflation for the current quarter (the final quarter of FY2019 ending in March) is projected at 2.8%, picking up to 3.2-3.4% in 1H FY2020 and then to 3.9% in 3Q FY2020. This outlook rests on expectations of continued food and fuel price trends, the transitory nature of currently high healthcare and education costs, and moderating household inflation expectations. The upside risks stem from volatile vegetable prices, an abnormal monsoon, and the fiscal boost to aggregate demand.

Headline inflation is expected to remain contained below or at its target of 4 percent. - Governor Das.

The central bank forecasts an acceleration of GDP growth to 7.4% in FY2020 from 7.2% estimated for the current financial year, supported by strong credit growth, softer crude oil prices, and the lagged impact of the weak currency on net exports.

A premature policy move

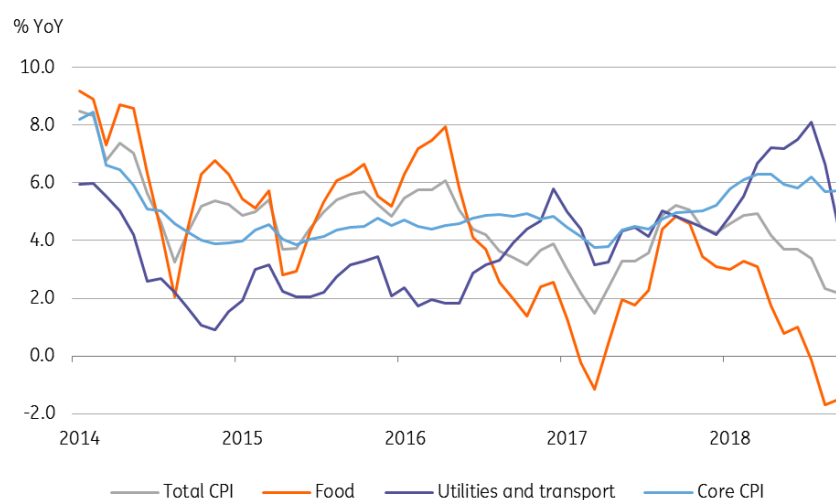
It was a surprise that the RBI eased policy on the grounds of inflation continuing to be benign. Indeed inflation is unlikely to hit the RBI's 4% policy mid-point anytime soon. But we expect the underlying pressure to remain upward. Food price inflation has bottomed as the January CPI data is expected to show, while the adverse base effect will likely push it higher going forward. High core inflation, running at about 6% in the current financial year, reflects still elevated inflation expectations. The loose fiscal policy and a weak currency are the other factors likely to push prices

up going forward. We expect average inflation of 3.6% in 1H FY2020, rising to 5.4% in 2H 2020.

As such, we consider the decision to cut the policy interest rate premature. The key question it poses is: why do we need a loose monetary policy when the fiscal policy is already supporting growth well above 7%? Maybe a political push from the incumbent government aiming for a second term.

Now that elections are just around the corner, we aren't expecting the RBI to move policy again this year. However, as inflation accelerates above 5%, the tightening pressure will return. We believe the next RBI policy will be a 25 basis point tightening by the end of FY2020.

CPI inflation by key components



Source: Bloomberg, CEIC, ING

INR to remain Asia's weakest currency

Government bonds gained and the Indian rupee weakened in a knee-jerk reaction to the RBI's decision.

It's unlikely to be a lasting relief for bonds as the supply overhang to plug a persistently wide fiscal deficit will continue to pressure yields higher. The INR7.04 trillion government borrowing plan for FY2020 announced in the budget a week ago represents an over 30% increase from the revised INR 5.35 trillion borrowing in the current year. This will not only pressure borrowing costs higher but also will cause a significant crowding out of private investment, thereby weighing on GDP growth.

The INR has been the worst performing Asian currency since last year. Despite persistent wide relative interest rate differentials, the lower domestic rates will sustain the INR's underperformance throughout 2019. We maintain our view of the USD/INR rate re-testing 73 in the near-term.

ING's key economic forecasts for India

India (FY starting April)	FY2015	FY2016	FY2017	FY2018 f	FY2019 f	FY2020 f
Real GDP (% YoY)	8.2	7.1	6.7	7.1	6.8	7.2
CPI (% YoY)	4.9	4.5	3.6	3.5	4.5	5.0
Fiscal balance (% of GDP)	-3.9	-3.5	-3.5	-3.5	-3.4	-3.2
Public debt (% of GDP)	70.0	69.5	71.2	72.5	72.0	71.0
Current account (% of GDP)	-1.1	-0.6	-1.9	-2.6	-3.1	-2.9
FX reserves (mth of imports)	10.2	10.6	10.2	8.3	7.9	7.8
External debt (% of GDP)	182.1	168.2	171.4	160.0	162.2	175.5
RBI repo rate (% eop)	6.75	6.25	6.00	6.25	6.50	6.50
3M T-bill rate (% eop)	7.27	5.82	6.09	6.50	6.80	6.80
10Y govt. bond yield (% eop)	7.47	6.68	7.40	7.50	7.90	7.90
INR per USD (eop)	66.33	64.84	65.18	72.50	68.00	65.00

Sources: Bloomberg, CEIC, ING forecasts

Author

Amrita Naik Nimbalkar

Junior Economist, Global Macro

amrita.naik.nimbalkar@ing.com

Mateusz Sutowicz

Senior Economist, Poland

mateusz.sutowicz@ing.pl

Alissa Lefebvre

Economist

alissa.lefebvre@ing.com

Deepali Bhargava

Regional Head of Research, Asia-Pacific

Deepali.Bhargava@ing.com

Ruben Dewitte

Economist

+32495364780

ruben.dewitte@ing.com

Kinga Havasi

Economic research trainee

kinga.havasi@ing.com

Marten van Garderen

Consumer Economist, Netherlands

marten.van.garderen@ing.com

David Havrlant

Chief Economist, Czech Republic

420 770 321 486

david.havrlant@ing.com

Sander Burgers

Senior Economist, Dutch Housing

sander.burgers@ing.com

Lynn Song

Chief Economist, Greater China

lynn.song@asia.ing.com

Michiel Tukker

Senior European Rates Strategist

michiel.tukker@ing.com

Michal Rubaszek

Senior Economist, Poland

michal.rubaszek@ing.pl

This is a test author

Stefan Posea

Economist, Romania

tiberiu-stefan.posea@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Jesse Norcross

Senior Sector Strategist, Real Estate

jesse.norcross@ing.com

Teise Stellema

Research Assistant, Energy Transition

teise.stellema@ing.com

Diederik Stadig

Sector Economist, TMT & Healthcare

diederik.stadig@ing.com

Diogo Gouveia

Sector Economist

diogo.duarte.vieira.de.gouveia@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Ewa Manthey

Commodities Strategist

ewa.manthey@ing.com

ING Analysts

James Wilson

EM Sovereign Strategist

James.wilson@ing.com

Sophie Smith

Digital Editor

sophie.smith@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Adam Antoniak

Senior Economist, Poland

adam.antoniak@ing.pl

Min Joo Kang

Senior Economist, South Korea and Japan

min.joo.kang@asia.ing.com

Coco Zhang

ESG Research

coco.zhang@ing.com

Jan Frederik Slijkerman

Senior Sector Strategist, TMT

jan.frederik.slijkerman@ing.com

Katinka Jongkind

Senior Economist, Services and Leisure

Katinka.Jongkind@ing.com

Marina Le Blanc

Sector Strategist, Financials

Marina.Le.Blanc@ing.com

Samuel Abettan

Junior Economist

samuel.abettan@ing.com

Franziska Biehl

Senior Economist, Germany
Franziska.Marie.Biehl@ing.de

Rebecca Byrne

Senior Editor and Supervisory Analyst
rebecca.byrne@ing.com

Mirjam Bani

Sector Economist, Commercial Real Estate & Public Sector (Netherlands)
mirjam.bani@ing.com

Timothy Rahill

Credit Strategist
timothy.rahill@ing.com

Leszek Kasek

Senior Economist, Poland
leszek.kasek@ing.pl

Oleksiy Soroka, CFA

Senior High Yield Credit Strategist
oleksiy.soroka@ing.com

Antoine Bouvet

Head of European Rates Strategy
antoine.bouvet@ing.com

Jeroen van den Broek

Global Head of Sector Research
jeroen.van.den.broek@ing.com

Edse Dantuma

Senior Sector Economist, Industry and Healthcare
edse.dantuma@ing.com

Francesco Pesole

FX Strategist
francesco.pesole@ing.com

Rico Luman

Senior Sector Economist, Transport and Logistics
Rico.Luman@ing.com

Jurjen Witteveen

Sector Economist
jurjen.witteveen@ing.com

Dmitry Dolgin

Chief Economist, CIS

dmitry.dolgin@ing.de

Nicholas Mapa

Senior Economist, Philippines

nicholas.antonio.mapa@asia.ing.com

Egor Fedorov

Senior Credit Analyst

egor.fedorov@ing.com

Sebastian Franke

Consumer Economist

sebastian.franke@ing.de

Gerben Hieminga

Senior Sector Economist, Energy

gerben.hieminga@ing.com

Nadège Tillier

Head of Corporates Sector Strategy

nadege.tillier@ing.com

Charlotte de Montpellier

Senior Economist, France and Switzerland

charlotte.de.montpellier@ing.com

Laura Straeter

Behavioural Scientist

+31(0)611172684

laura.Straeter@ing.com

Valentin Tataru

Chief Economist, Romania

valentin.tataru@ing.com

James Smith

Developed Markets Economist, UK

james.smith@ing.com

Suvi Platerink Kosonen

Senior Sector Strategist, Financials

suvi.platerink-kosonen@ing.com

Thijs Geijer

Senior Sector Economist, Food & Agri

thijs.geijer@ing.com

Maurice van Sante

Senior Economist Construction & Team Lead Sectors

maurice.van.sante@ing.com

Marcel Klok

Senior Economist, Netherlands

marcel.klok@ing.com

Piotr Poplawski

Senior Economist, Poland

piotr.poplawski@ing.pl

Paolo Pizzoli

Senior Economist, Italy, Greece

paolo.pizzoli@ing.com

Marieke Blom

Chief Economist and Global Head of Research

marieke.blom@ing.com

Raoul Leering

Senior Macro Economist

raoul.leering@ing.com

Maarten Leen

Head of Global IFRS9 ME Scenarios

maarten.leen@ing.com

Maureen Schuller

Head of Financials Sector Strategy

Maureen.Schuller@ing.com

Warren Patterson

Head of Commodities Strategy

Warren.Patterson@asia.ing.com

Rafal Benecki

Chief Economist, Poland

rafal.benecki@ing.pl

Philippe Ledent

Senior Economist, Belgium, Luxembourg

philippe.ledent@ing.com

Peter Virovacz

Senior Economist, Hungary

peter.virovacz@ing.com

Inga Fechner

Senior Economist, Germany, Global Trade

inga.fechner@ing.de

Dimitry Fleming

Senior Data Analyst, Netherlands

Dimitry.Fleming@ing.com

Ciprian Dascalu

Chief Economist, Romania

+40 31 406 8990

ciprian.dascalu@ing.com

Muhammet Mercan

Chief Economist, Turkey

muhammet.mercan@ingbank.com.tr

Iris Pang

Chief Economist, Greater China

iris.pang@asia.ing.com

Sophie Freeman

Writer, Group Research

+44 20 7767 6209

Sophie.Freeman@uk.ing.com

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

James Knightley

Chief International Economist, US

james.knightley@ing.com

Tim Condon

Asia Chief Economist

+65 6232-6020

Martin van Vliet

Senior Interest Rate Strategist

+31 20 563 8801

martin.van.vliet@ing.com

Karol Pogorzelski

Senior Economist, Poland

Karol.Pogorzelski@ing.pl

Carsten Brzeski

Global Head of Macro
carsten.brzeski@ing.de

Viraj Patel
Foreign Exchange Strategist
+44 20 7767 6405
viraj.patel@ing.com

Owen Thomas
Global Head of Editorial Content
+44 (0) 207 767 5331
owen.thomas@ing.com

Bert Colijn
Chief Economist, Netherlands
bert.colijn@ing.com

Peter Vanden Houte
Chief Economist, Belgium, Luxembourg, Eurozone
peter.vandenhoute@ing.com

Benjamin Schroeder
Senior Rates Strategist
benjamin.schroeder@ing.com

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

Gustavo Rangel
Chief Economist, LATAM
+1 646 424 6464
gustavo.rangel@ing.com

Carlo Cocuzzo
Economist, Digital Finance
+44 20 7767 5306
carlo.cocuzzo@ing.com