India: RBI leaves policy unchanged

Absent a cyclical weakening in the USD we expect the 65.00 level will prove to be a strong support for USD/INR to break through in the rest of the year

Consistent with a solid consensus forecast, the Reserve Bank of India kept monetary policy on hold today. The key policy rates, the repurchase rate and reverse repo rate, stood at 6.00% and 5.75% respectively after a 25bp cut at the previous meeting on August 2.

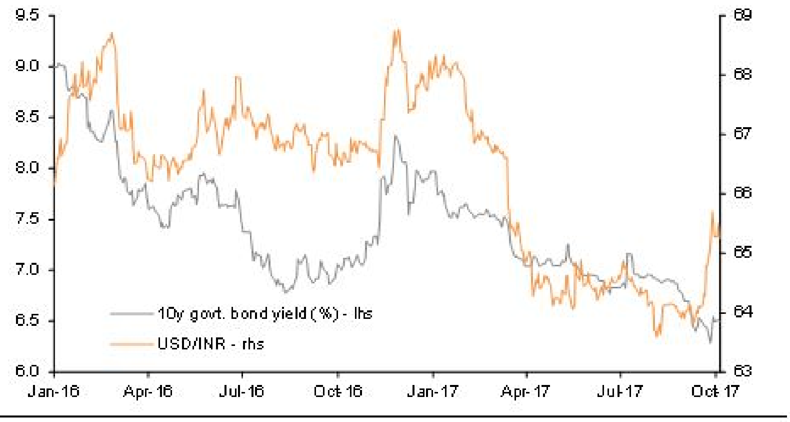
A reversal of the downward trend in CPI inflation in recent months and persistent downtrend in GDP growth, taking it to a three-year low of 5.7% in 1QFY18 (April-June, 2017), have altered the dynamics of RBI policy.

Going forward, we expect inflation to continue to grind higher and limit the scope for the RBI easing to support growth. As such, fiscal policy will take centre stage in boosting the economy. Earlier today the finance ministry announced a reduction in excise duty on gasoline and diesel in a bid to ease inflation pressure. We do not expect the impact to be notable. The biggest dilemma for people on the street is that even as the global oil price is hovering below half its level before the mid-2014 crash, domestic fuel prices remain close to their level three years ago.

Expansionary fiscal policy and the resultant negative implications for the rupee will also be inflationary. This and shift in the developed market monetary policies towards tightening suggests to us that the next move in RBI policy rates will most likely be higher, though we do not expect it to be anytime soon. The consensus is on-hold RBI through 2018.

The concerns about fiscal slippage will continue to exert weakening pressure on the INR and Indian government bonds. Absent a cyclical decline in the USD; we expect the 65.00 level will prove to be a strong support for USD/INR to break through in the rest of the year.

Stalled rally in the Indian government bonds and the INR



Source: ING, Bloomberg