

## India's RBI cuts more than consensus by 35bp

The Reserve Bank of India's decision to cut rates by another 35 basis points today will undoubtedly worsen the Indian rupee's plight during the ongoing emerging market turmoil. Meanwhile, renewed tensions over Kashmir won't have been helpful for the currency either. We are revising our end-2019 USD/INR forecast higher to 72.0 from 70.0 (spot 70.8)



Reserve Bank of India's new Governor Shaktikanta Das

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# 5.40%

RBI Repurchase Rate

After 35 basis point cut today

Lower than expected

## Our high-conviction, low probability call fails

Exceeding the consensus expectations of a 25bp cut, the Reserve Bank of India (RBI) Monetary Policy Board decided to provide even more of a boost to the economy with a 35bp cut today. And, just as widely expected, there was no change to the banks' cash reserve ratio, currently 4%.

We were one of the 'only' two odd ones out in the consensus with our call for an RBI policy pause. Most of the 38 other participants in the Bloomberg poll forecast a 25bp rate cut, with a few even forecasting a 50bp cut. Our conviction for no change stemmed from the fact that the RBI had got well ahead on the easing curve with three rate cuts (for a total of 75bp) in as many meetings earlier this year. Moreover, we judged that prudent policy wouldn't want to fuel inflation, which is already slowly creeping up this year on the back of rising food prices, an excessive fiscal policy boost during the elections, and currency weakness since last year.

Further strengthening our conviction was Governor Das' recent remarks that the easing already undertaken was more than the sum of the rate cuts so far, as he viewed the very shift of the RBI policy bias from neutral to easing in the June meeting as amounting to an extra 25bp rate cut.

### Is aggressive easing required...?

The consensus view may have been helped by the shift in the RBI policy stance from 'neutral' to 'accommodative' at the last meeting in June. Likewise, recent data signaling continued weak growth prospects could have supported a rate cut view. While these are valid factors supporting the consensus view, we differed, as earlier policy decisions weren't all necessarily consistent with the RBI's prevailing stance (it's easy to find from past statements).

In terms of data, yes, there have been more signs of economic weakness, though we don't see any more downside to overall GDP growth from a five-year low of 5.8% in the final quarter of FY2019 (January-March 2019). Indeed, loose macro policies should prevent growth from weakening further, while favourable base-effects should have begun to push growth higher from the first quarter of FY2020 (April-June 2019) and continue to do so in the rest of the year. Furthermore, the resiliency of the economy to current trade turmoil is also reinforced by roughly 2% export growth in the first six months of 2019 compared with falling exports from other Asian countries this year.

On inflation, we admit that it isn't out of control just yet and that the RBI can afford few more doses of easing in the event that growth does get worse from here on.

### ... as it adds to the INR's ongoing plight?

The emerging-market turmoil this week triggered by a spike in the USDCNY exchange rate above 7 saw the INR reasserting its status as Asia's weakest currency. And the outlook for the currency has turned more negative still with the move by the government this week to withdraw autonomy from the disputed state of Jammu and Kashmir - escalating border tensions.

In the steepest depreciation among Asian currencies this week, the INR has lost 1.9% of its value against the USD, taking the exchange rate past the 70 level last seen in late February - another of our high-conviction, low probability forecasts, though it's paid off, unlike our RBI policy call.

Judging from the limited negative impact on the INR from the RBI rate cut as of writing, we can only conclude that the cut was already largely priced in. That said, the larger than expected rate

cut today may well foreshadow continued policy easing and further currency weakness ahead. As such, we are revising our end-2019 forecast for USD/INR from 70.0 to 72.0 (spot 70.8).