Why we expect India to cut rates again this week

The balance of risk is tilted towards one more 25 basis point policy rate cut by the Reserve Bank of India this week. This would probably mark the end of the current easing cycle

Reserve Bank of India Governor Shaktikanta Das

3.75% RBI policy rate forecast

25bp cut this week

Loose consensus for an RBI rate cut

The Reserve Bank of India's Monetary Policy Committee is meeting on Thursday, 6 August, to decide the course of the policy. The consensus is skewed towards a further 25 basis point cut to key policy rates; at the time of this writing, 18 out of 29 estimates in the Bloomberg survey favoured a rate cut and the rest no change.

We also think we'll get a 25bp rate cut, bringing the RBI repurchase rate down to 3.75% and the reverse repo rate to 3.10%. These will be marked to be a record low for both rates, after eight cuts in the repo rate and nine in the reverse repo rate in the current easing cycle that has been underway since early 2019.

We also share the consensus view that the central bank will leave commercial banks' cash reserve ratio unchanged at 3.00%. Nor do we anticipate any change to the accommodative policy bias as growth outweighs inflation as the policy driver. That said, we think we are near the end of this easing cycle.

Nose-diving economy warrants lower rates

The monetary easing expectations stem from prospects of a prolonged economic slump ahead resulting from an un-abating spread of the Covid-19 pandemic. India is the third worst-affected country in the world (after the USA and Brazil) with total infections poised to cross the two-million mark in the coming days.

Clearly, the April-June quarter, the first quarter of the fiscal year 2020-21, recorded its worst economic performance, probably in the living memory. We forecast close to 12% year-on-year GDP contraction in that quarter; the data is due on 31 August.

Supporting this, exports crashed by 37% YoY and imports were worse with a 53% plunge. These dented manufacturing sharply. The statistical office refrained from publishing the industrial production data recently, but the output of key infrastructure sectors (coal, crude oil, natural gas, petroleum products, fertilisers, steel, cement, and electricity) shrank 25% YoY in April-June, suggesting that the headline IP couldn't be any better than this.

The deteriorating fiscal situation also suggests action

Further reinforcing the need for more monetary accommodation are the deteriorating public finances as these are constraining the scope for any more fiscal stimulus.

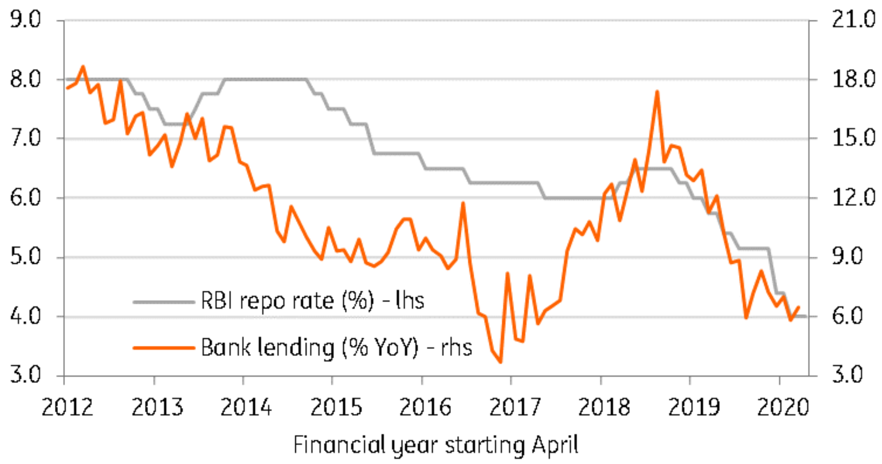
The fiscal deficit is through the roof

The contracting economy has dented government revenue, while stimulatory policy has boosted spending, shooting the fiscal deficit through the roof. The deficit in 1Q FY20-21 surged 53% YoY to INR 6.62 trillion and this was 83% of the official target for the entire fiscal year. This stems from a 47% YoY fall in revenue and a 13% rise in expenditure. Our view of the deficit equivalent to 6.5% of GDP this fiscal year remains at risk of an upside miss.

Record government borrowing to plug the budget gap is another reason why interest rates should fall further to ease the debt servicing burden. Despite aggressive RBI rate cuts so far this year the 10-year government bond yield has been sticky downward, at around 5.8% currently.

Meanwhile, the noise about monetisation of the deficit with direct purchases of government bonds by the central bank has been prevalent. This is despite the RBI dashing such hopes in an off-cycle policy announcement in April, while some of its former policymakers continued to warn against this policy option, calling it as highly inflationary.

Aggressive monetary easing is still failing to stimulate lending



Source: CEIC, ING

Headwinds to lower rates

Talking about inflation, it has risen above the RBI's 2-6% policy range in recent months. Supply disruption and panic buying brought food prices back in play as the key inflation driver. And a recent hike in excise duty and retail fuel prices have pressured utilities and transport costs. We expect inflation to remain above or near the RBI's policy limit for the remainder of the year.

While high inflation explains why some favour a stable rate decision this week, another argument supporting it is a weak currency. The INR has been an underperforming emerging market currency this year with about 5% year-to-date depreciation. Although it gained some ground recently on the back of broad US dollar weakness and one-off inflows in India's telecom sector, we see nothing on the horizon to help it erase underperformance in the rest of the year.

Our end-2020 USD/INR forecast remains at 76.50 (spot 75.05).

Author

Amrita Naik Nimbalkar
Junior Economist, Global Macro
amrita.naik.nimbalkar@ing.com

Alissa Lefebre
Economist
alissa.lefebre@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.schroder@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