Bundle | 2 August 2018

Good MornING Asia - 2 August 2018

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In this bundle

India

India: Reserve Bank hikes rates for second time

Although the Reserve Bank of India's (RBI) tightening cycle has yet to fully play out, evolving growth-inflation dynamics will likely cut it short. We...

Indonesia

Indonesia: Inflation inches higher in July

Inflation mildly accelerated to 3.18% from the 18-month low of 3.1% in June. The central bank's policy action can continue to focus on currency stability

Article | 1 August 2018 India

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Source: Shutterstock

6.5%

RBI Repurchase Rate

A 25bp hike today

As expected

No RBI policy surprise

In its second policy tightening this year, the RBI lifted the benchmark policy interest rates by 25 basis points today, taking the repo rate to 6.50% and reverse repo rate to 6.25%. There was no change to the 4% reserve requirement rate for the banking sector.

However, unlike the June rate hike, today's decision wasn't a unanimous vote by all six policy committee members. There was one dissenter. Still, the outcome was in line with the broad consensus, including ING's forecast. Hence, we expect little to no market impact.

RBI statement in detail

- **Inflation:** The RBI raised its inflation forecast for the second half of FY2018-19 (financial year runs from April to March) to 4.8% from 4.7%. Although a slight rise, the statement notes that a larger than average increase in minimum support prices (MSP) for farmers will have a direct impact on food inflation and then to headline inflation. Further, inflation in items excluding food and fuel has been broad-based and has risen significantly in recent months, reflecting greater pass-through of rising input costs and improving demand conditions.
- Some relief is likely from good monsoon support to the farm sector and a reduction in Goods and Services Tax for several goods and services. But the upside inflation risks outweigh the downside risks due to supply disruptions to oil prices and elevated household inflation expectations.
- **Growth:** There was no change to the RBI's GDP growth forecast for FY2019 from its 7.4% projection in the June policy statement. The statement points to evenly balanced growth risks, with good monsoon support to farm output and MSP prices contributing to improved rural demand. It also said good corporate earnings and FDI inflows would support investment. On the downside, rising trade tensions could adversely impact exports.

ING policy view

The minutes of today's meeting to be released later this month will provide more insight into policymakers' thinking. While we believe the current tightening cycle has further room to run, the extent of tightening will depend on how India's growth-inflation dynamics evolve going forward.

We have already seen some signs of tapering in GDP growth starting from the April-June quarter. Although exports gained some traction in May and June, this hasn't stimulated manufacturing enough to push GDP growth higher while a wider trade deficit has meant a larger negative contribution of net exports to GDP growth. Higher global trade tariffs will be the potential dampener on exports and GDP growth going forward. This is why we recently cut our growth forecast for FY2018-19 from 7.2% to 6.7%.

Consumer prices will remain sticky as a weak currency and administrative price hikes will likely keep inflation above the RBI's 4% policy goal within a band of +/-2%. We maintain our 4.7% inflation forecast for the current financial year.

With growth and inflation potentially moving in undesirable directions, the current tightening phase looks to be shorter. We have already pencilled in one more 25 basis point rate hike at the next meeting in October. This will still leave ample accommodation from the 200 basis points of rate cuts implemented over the last three years. Nonetheless, we don't see any near-term respite from the ongoing upward pressure on government bond yields and the USD/INR exchange rate. Our end-2018 forecast USD/INR rate is 71.5 (spot 68.5).

Indonesia: Inflation inches higher in July

Inflation mildly accelerated to 3.18% from the 18-month low of 3.1% in June. The central bank's policy action can continue to focus on currency stability

Source: Shutterstock

3.18%

As expected

July inflation rate

Moderate inflation likely in 2018 and 2019

Inflation in 2018 will come close the BI's target rate of 3.5%

Inflation gradually accelerated to 3.18% in July from June's 3.1%. Base effects continue to keep inflation moderate. Inflation in July 2017 was 3.9%. Favourable base effects will continue until this quarter, likely keeping inflation in the coming months below the central bank's point inflation target of 3.5% this year. Non-food inflation such as utilities, transport, communication and finance as well as administered prices moderate the higher non-processed and processed food inflation. The government's favourable fiscal position in the first half allows further increases of subsidies for energy. The government's fiscal balance is less than 1% of GDP and significantly below this year's fiscal deficit programme of 2.1% of GDP. In an election environment, the utilisation of the fiscal leeway to moderate inflation would be important for the re-election bid of President Jokowi. As a result, the weak Indonesian rupiah (IDR) has not had a significant impact on inflation. IDR has weakened by 6% year-to-date. We expect inflation to remain near Bank Indonesia's (BI's) point inflation target of 3.5% this year and next. We expect average inflation of 3.4% and 3.8% in 2018 and 2019, respectively. Under normal circumstances, BI would have little reason to adjust policy rates further. But the Bank remains vigilant about a weakening IDR which may generate financial sector instability. With recent IDR stability, the chances for BI to retain current policy rate settings at the 16 August meeting are high. However, we still expect another 25 basis point rate hike before the year ends.