India Flash

RBI delivers another rate cut but casts caution on further easing

As anticipated, the Reserve bank of India (RBI) cut its benchmark repo rate by 25 bps to 7.5% while maintaining the Cash reserve ratio at 4.0% (BBVA est:3.75%). Today's move follows a 25 bps cut at the RBI's last policy meeting in January, and aims to stimulate investment activity as inflationary pressures abate and the government executes much-needed fiscal reforms. The accompanying policy statement struck a cautious tone, however, hinging further policy easing on favorable inflation and current account dynamics, noting that the, "headroom for further cuts remains quite limited". Recent weak activity indicators, such as capital spending and auto sales, and policy implementation bottlenecks pose downside risks to our full-year 2013 growth projection (6.5% y/y). Looking ahead, we continue to expect an additional 50 bps cuts in the repo rate during the second half of 2013, contingent on stable global commodity prices and further traction in the government policy execution.

- **Core inflation is stabilizing but sticky food prices warrant supply side response.** India's core inflation eased for the sixth successive month in February to 3.8% y/y from 4.1% previously, signaling demand compression, easing global commodity prices and weak pricing power, in turn providing comfort for RBI to ease rates. Although abating, upside risks to inflation continue to emanate from upward adjustments to administered fuel prices, sticky food inflation and potential hikes in minimum support prices. In this context, we continue to expect India's WPI inflation to average 6.6% y/y in 2013.

- **Implementation bottlenecks dampen reform momentum.** A series of investment reforms announced since last September have yielded only modest results so far as the authorities grapple with policy execution. In particular, issues related to land acquisition, environmental clearances, coal supply linkage and power purchase agreements have led to an overhang of stalled infrastructure projects, hampering the investment climate.

- **Steps to contain the "twin" fiscal and current account deficits risks are encouraging but not enough.** Recent policy measures, including budgetary steps towards fiscal consolidation, boosting domestic savings, stimulating exports and curbs on gold imports bode well for India's fiscal and current account balance. However, risks remain as the new Union budget was based on relatively optimistic revenue assumptions while lacking big structural reforms to stimulate growth and attract greater foreign capital.

Chart 1
Lower core inflation provides room for RBI to cut rates

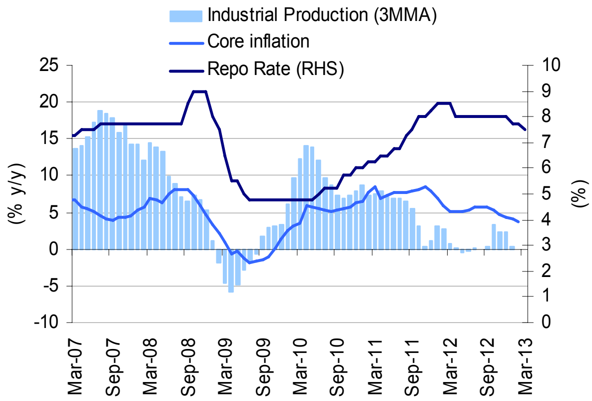
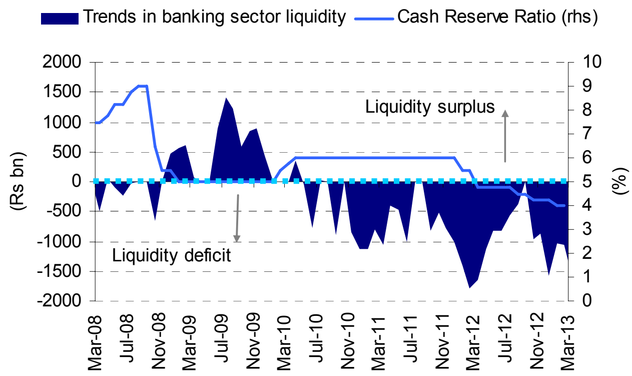


Chart 2
Tight liquidity to bring more CRR cuts and OMOs



Sumedh Deorukhkar
sumedh.deorukhkar@bbva.com
+91 2226598581

Stephen Schwartz
stephen.schwartz@bbva.com.hk
+852 2582 3218

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