India Flash

RBI cuts rates again on subdued growth and improving inflation

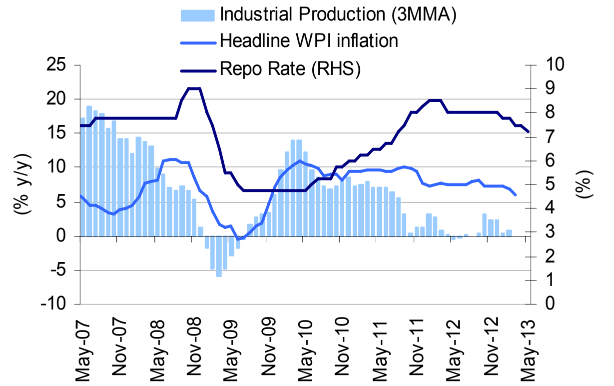
The Reserve bank of India (RBI) today cut its benchmark repo rate by 25 bps to 7.25% while maintaining the cash reserve ratio at 4.0%. While the decision to ease policy had been anticipated by many market participants, we had expected the rate cut to be delayed until the second half of the year given the two rate cuts earlier this year and recent signals from the RBI on "the limited room for easing." The accompanying statement to today's decision stressed the need to supplement monetary easing with structural measures to alleviate "supply bottlenecks, improve governance and step up public investment, alongside continuing fiscal consolidation." Looking ahead, we see room for a final 25bp rate cut in 2013, perhaps as early as the next policy meeting on June 17 unless delays in government policy execution or renewed inflationary pressures prompt the RBI to wait longer.

- **Growth expected to improve only modestly.** RBI pegged its FY14 (year ending March 2014) GDP growth forecast at a conservative 5.7% y/y (BBVA: 6.1%) up from 5.0% in FY13 with a pick up likely in the latter half. The RBI foresees subdued industrial activity; exports are expected to face headwinds from sluggish demand.

- **Supply side efforts critical to keep inflation low.** RBI expects WPI inflation to average 5.5% y/y in FY14 (BBVA: 5.8%) and aims to lower it to 5.0% y/y by March 2014. While acknowledging the recent decline in inflation (6.0% y/y in March), RBI cautioned that food price pressures, upward revisions in minimum support prices and rapid wage increases are leading to a wage-price spiral. These price risks warrant efforts to address supply constraints, particularly in the food and infrastructure sectors.

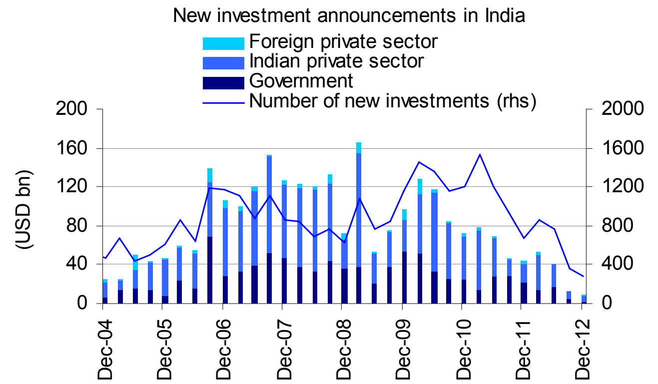
- **A large current account deficit and delays in investment reforms – chief risks to the growth outlook:** RBI warned that a still high current account deficit, weak investment sentiment, and tightening supply constraints are key risks to the growth outlook. In this context, we believe the government needs to deliver on three fronts: (i) fast-tracking approvals for big infrastructure projects; (ii) executing key legislative reforms, particularly land acquisition and environmental bills; and (iii) securing financing for infrastructure projects by mobilizing capital from global as well as domestic sources (for details see ***Taking Stock of India's Reforms***).

Chart 1
Decelerating growth and easing inflation prompt RBI to continue its rate cutting cycle



Source: RBI, BBVA Research

Chart 2
Weak investment sentiment forms a key risk to India's improving growth outlook



Source: CMIE, BBVA Research

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