India Flash

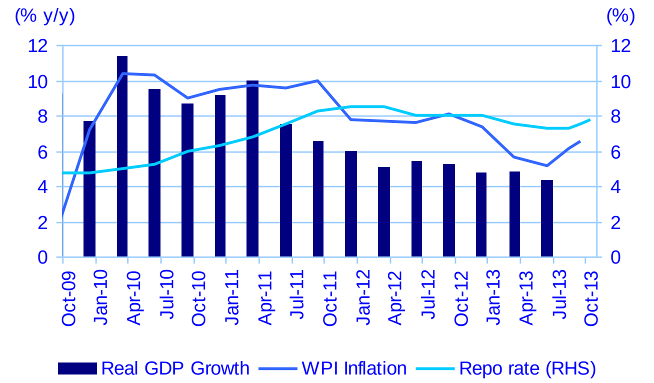
RBI hikes repo rate for a second consecutive month to stem inflation

In its ongoing bid to, “curb mounting inflationary pressures and manage inflation expectations in a situation of weak growth,” the Reserve Bank of India (RBI) announced a second successive repo rate increase of 25 bps to 7.75%. The move was in line with consensus, although we had anticipated a pause in view of easing external pressures and a stabilizing currency. On that score, the RBI further eased its exceptional liquidity tightening measures with a 25 bps cut in the upper bound of the operating corridor for banks (the so called Marginal Standing Facility rate), to 8.75% and through higher recourse to liquidity through term repos. The repo-MSF corridor has now been restored to its normal operating level of 100 bps (from 300 bps in July). Looking ahead, given the RBI’s expectations of “elevated” inflation in the months ahead (WPI and CPI inflation stand at 6.1% y/y and 9.8% y/y, respectively) and its emphasis on breaking “the spiral of rising price pressures”, we would not rule out further hikes in the repo rate over the coming months if inflation pressures fail to subside.

- **RBI trims growth forecast to 5% y/y for FY14, expects inflation pressures to sustain:** Against the backdrop of slowing consumption and investment demand, RBI cut India’s FY14 (year ending March 2014) average growth forecast to 5.0% from 5.7% previously (BBVA: 4.1%). The central bank expects a sequential pick up in growth momentum amid strengthening export growth, a pick up in agriculture output and the impact of ongoing investment reform measures. Meanwhile, RBI foresees inflation, both on the WPI and CPI front, to remain elevated as the impact of recent rupee depreciation offsets subdued demand and possible easing in food prices pressures on the back of favorable monsoon.

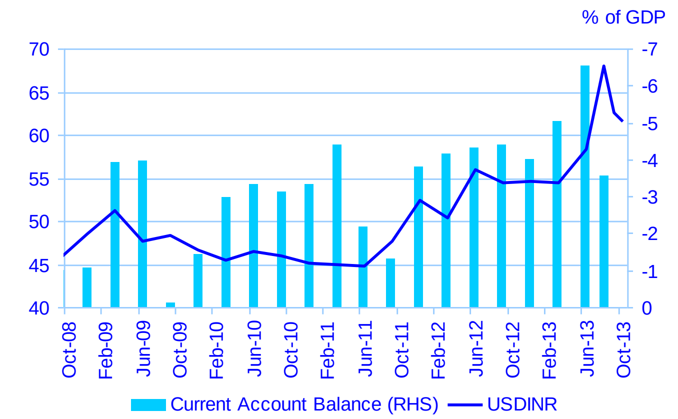
- **Final guidelines on foreign bank entry are to be released in the next two weeks:** As flagged in our recent Banking Watch, the new policy aims to provide greater flexibility to foreign banks that choose to operate under the existing wholly owned subsidiary structure (WoS). In turn, it is hoped that foreign bank expansion will foster financial inclusion and improve competition and efficiency.

Chart 1
RBI hikes repo rate to stem inflation, despite weakening growth momentum



Source: BBVA Research

Chart 2
Stabilizing currency with a narrowing current account deficit have eased external pressures



Source: BBVA Research

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

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