

Economic Analysis

Softer march CPI inflation reassures RBI's policy stance, raises scope for further rate cut

Sumedh Deorukhkar / Le Xia

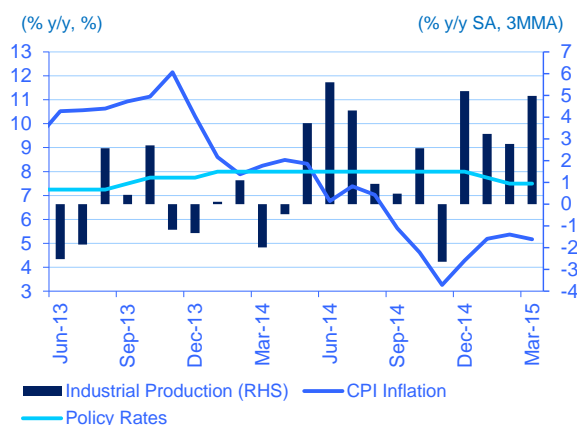
India's March CPI inflation outturn echoed ongoing disinflationary momentum across the economy and provides comfort to RBI given its present accommodative policy stance. The latest CPI outturn edged lower to 5.2% y/y compared to 5.4% y/y in February (BBVA Est.: 5.2%, Consensus Est.: 5.4%), led mainly by a broad-based let up in food inflation, which has a 46% weight in CPI, besides a pass through of slumping international crude oil prices into transport and communication. Core inflation, which excludes food and fuel, held steady near record low of 3.8% y/y as weak demand pressures and well anchored inflation expectations cause a gradual cool off in housing prices and softer services inflation.

Looking ahead, the Government's ongoing efforts to offset the effects of recent hailstorms and untimely rains on food crops by adequate supply side measures will determine CPI inflation trajectory in 2Q15. We expect CPI inflation to pick-up marginally this quarter, led largely by a gradual improvement in final demand, although staying well within RBI's comfort target of below 6% (BBVA Est. 5.6% y/y vs. 5.3% y/y in 1Q15).

Room for another policy rate cut but don't expect aggressive easing in 2015. RBI decided to maintain status quo on interest rates at 7.5% (benchmark repo) in its last credit policy on April 7th. It cited the need to wait and watch while the previous two front-loaded interest rate cuts fully transmit into lower bank lending rates. The transmission mechanism has not really worked quickly enough so that borrowing rates are now in accordance with such cuts; and this is despite a weak credit offtake. Looking ahead, given existing growth inflation dynamics, we expect another 25 bps policy rate cut as early as by June. However, room for further policy easing in 2015 is limited and contingent on 1) the extent of global financial market volatility ahead of imminent Fed rate normalization, 2) Government's progress on fiscal reforms and in easing food and energy supply bottlenecks and 3) the nature of monsoon rains starting June-July.

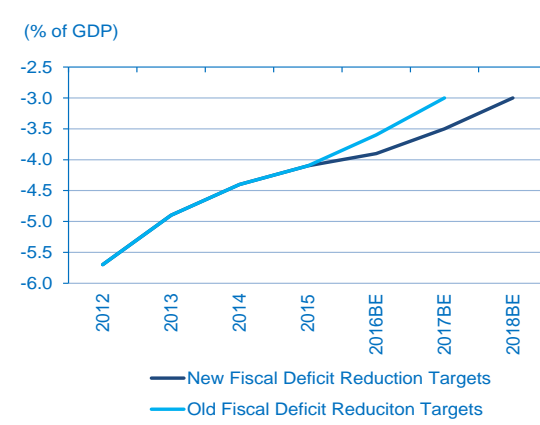
India much better prepared for imminent Fed rate normalization. India's improving fundamentals hold it in good stead against the imminent Fed interest rate lift off although a short term knee jerk reaction to local financial markets cannot be discounted. Unlike the QE taper tantrum in May 2013, India, today, is much better equipped to handle global financial volatility given its record high FX reserves at USD 343 bn, narrowing current account deficit and ongoing policy reforms. The outlook for growth is gradually improving with real GDP growth estimated at 7.6% y/y in calendar year 2015 compared to 7.2% last year.

Figure 1
Indian economy is in a sweet spot amid easing inflation and gradually improving growth...



Source: BBVA Research, CEIC

Figure 2
... but, Government's fiscal consolidation efforts will be a key for incremental RBI policy easing



*Fiscal year ending March; Source: BBVA Research, CEIC

DISCLAIMER

This document has been prepared by BBVA Research Department, it is provided for information purposes only and expresses data, opinions or estimations regarding the date of issue of the report, prepared by BBVA or obtained from or based on sources we consider to be reliable, and have not been independently verified by BBVA. Therefore, BBVA offers no warranty, either express or implicit, regarding its accuracy, integrity or correctness.

Estimations this document may contain have been undertaken according to generally accepted methodologies and should be considered as forecasts or projections. Results obtained in the past, either positive or negative, are no guarantee of future performance.

This document and its contents are subject to changes without prior notice depending on variables such as the economic context or market fluctuations. BBVA is not responsible for updating these contents or for giving notice of such changes.

BBVA accepts no liability for any loss, direct or indirect, that may result from the use of this document or its contents.

This document and its contents do not constitute an offer, invitation or solicitation to purchase, divest or enter into any interest in financial assets or instruments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

In regard to investment in financial assets related to economic variables this document may cover, readers should be aware that under no circumstances should they base their investment decisions in the information contained in this document. Those persons or entities offering investment products to these potential investors are legally required to provide the information needed for them to take an appropriate investment decision.

The content of this document is protected by intellectual property laws. It is forbidden its reproduction, transformation, distribution, public communication, making available, extraction, reuse, forwarding or use of any nature by any means or process, except in cases where it is legally permitted or expressly authorized by BBVA.