BBVA | RESEARCH

Economic Analysis
30 October 2012

India Flash

Staying cautious on inflation, RBI keeps repo rate unchanged

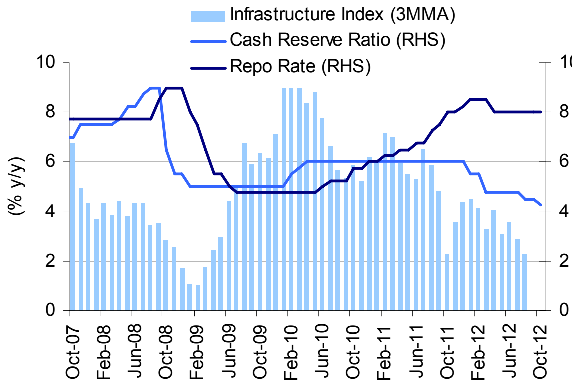
At its policy meeting today, the Reserve Bank of India left its benchmark repo rate unchanged at 8.0% (BBVA: 7.75%; Consensus: 8.0%), but cut the Cash Reserve Ratio (CRR) by 25 bps to 4.25% (BBVA: 4.25%). The decision was, according to the RBI Governor's statement, based on its "objective of containing inflation and anchoring inflation expectations," especially after a slight uptick in September's WPI to 7.8% y/y from 7.6% in August. The RBI acknowledged recent steps by the government to contain fiscal slippages and to stimulate growth through economic reforms, which "will open up space for monetary policy to restrain inflation and support growth." In the meantime, the RBI indicated it prefers to wait for the transmission of its "calibrated easing" to work through the economy. Meanwhile, the reduction in the CRR (which will infuse Rs. 175 bn of liquidity in the system) was intended to pre-empt a prospective tightening of liquidity conditions, thereby keeping liquidity comfortable to support growth.

Looking ahead, with inflation expected to peak by end-2012, the RBI's baseline scenario suggests a reasonable likelihood of further policy easing in 1Q13. Given RBI's cautious stance on inflation, we now foresee only limited scope for the rate easing cycle to commence during the remainder of 2012 (against our earlier expectations of an aggregate 50 bps cut to 7.5%). That said, the possibility of further easing at the RBI's next policy meeting on December 18 cannot be completely ruled out, especially if the government makes further progress with the implementation of fiscal reforms. The RBI's decision will also be influenced by the outturn of Q3 GDP (BBVA: 5.7% y/y vs. Q2 outturn 5.5% y/y), to be released on November 30.

- **RBI slashes growth projections and raises inflation outlook.** As expected, the Central Bank lowered its growth estimates for FY13 (year ending March 2013) to 5.8% y/y (BBVA : 5.8%) from 6.5% previously, and raised its WPI inflation projection for March 2013 to 7.5% y/y (BBVA: 7.5%) from 7.0% previously.

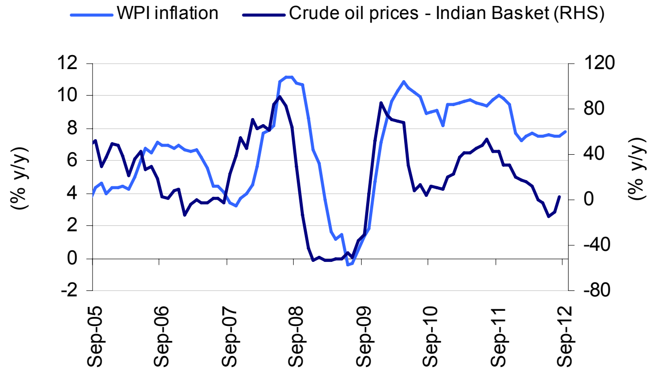
- **Steps to stem significant deterioration in asset quality of Indian banks.** Expressing concern over the significant increase in non-performing assets and restructured loans of Indian banks, particularly amongst the public sector, the RBI increased bank provisioning requirements on restructured loans from 2.0% to 2.7%. Furthermore, the RBI also directed banks to adhere strictly to available information on borrower's credit exposure.

Chart 1
Despite decelerating growth, stubborn inflation pressures keep RBI from lowering interest rates



Source: BBVA Research

Chart 2
Key upside risk to inflation trajectory stems from a pick up in global commodity prices, particularly crude oil



Source: BBVA Research

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