

India Flash

RBI cuts repo rate, signaling an increased focus on growth

As expected, the Reserve Bank of India (RBI) cut its benchmark repo rate and Cash Reserve Ratio (CRR) by 25 bps each to 7.75% and 4.0% respectively. The move was the first rate cut since April 2012, with the RBI basing its decision on: (i) a moderation in inflation; (ii) deceleration in growth; and (iii) tight liquidity conditions. RBI's decision to act comes after recent steps taken by the government to improve the investment climate and ease supply bottlenecks. WPI inflation eased to 7.3%/y/y in 4Q12 from 7.9% y/y in the previous quarter as continued softening in core and fuel prices offset higher food inflation. Looking ahead, with inflation trending lower, the RBI's baseline scenario suggests a reasonable likelihood of further modest policy easing in 2013, in line with our expectations of an additional 75bps in cuts by the end of 2013. That said, the RBI acknowledged that room for further easing remains "limited" due to upside risks to inflation, and the presence of "twin" deficits in the external current and fiscal accounts. Against this backdrop, the timing of further easing, including at the next policy meeting on March 19, will depend upon the evolution of growth-inflation dynamics and progress in reducing twin deficits.

- RBI slashes growth and inflation projections.** In line with our expectations, the Central Bank lowered India's growth estimates for FY13 (year ending March 2013) to 5.5% y/y (BBVA: 5.6%) from 5.8% previously and its WPI inflation projection for March 2013 to 6.8% y/y (BBVA: 6.8%) from 7.5% previously.
- Important to better manage India's twin deficits risks.** With the current account deficit at record levels (5.4% of GDP in 3Q12) and the April-November fiscal deficit already at 80% of budget estimates, the Indian economy remains more vulnerable to shocks than most emerging markets. India's high CAD is a consequence of its high fiscal deficit, which together have adversely affected macro stability. Despite policy efforts, the quality of fiscal adjustment remains a concern and cumulative trends in revenue remain bleak. We expect FY13 deficit to overshoot the official target of 5.3% of GDP (BBVA: 5.7%), unless the government resorts to creative accounting by deferring subsidy over-runs to next year.

Chart 1
RBI cuts the repo rate and cash reserve ratio by 25 bps each amid moderating inflation pressures

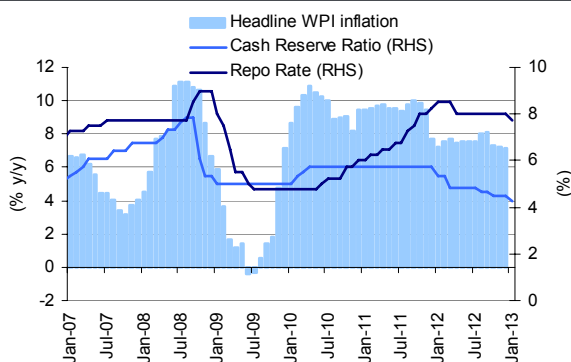
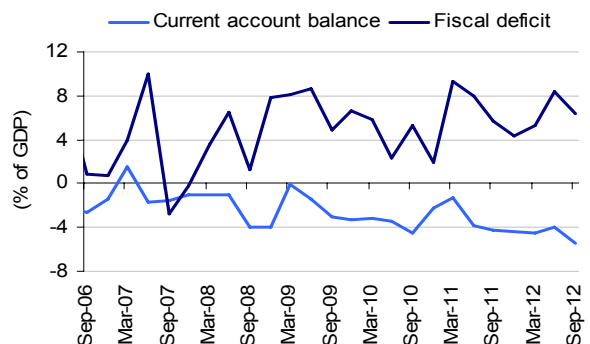


Chart 2
India's widening twin deficits pose a risk to macro stability



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

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