

Here's why RBI has room for rate cut now, not December

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Consumer inflation for August came in at 5.1% year-on-year and is expected to nudge closer to 4.5% y-o-y by December, well within the RBI's comfort zone. (Reuters)

With inflationary pressures ebbing and likely to fall further after a good monsoon, the Reserve Bank of India ([RBI](#)) could well trim the key repo rate by 25 basis points when it reviews monetary policy on October 4.

The central bank last cut the repo rate by 25 basis points to 6.5% on April 6, taking it to the lowest level in six years. The cut would be aimed at getting banks to drop loan rates thereby boosting demand for credit at a time when growth has been subdued.

Consumer inflation for August came in at 5.1% year-on-year and is expected to nudge closer to 4.5% y-o-y by December, well within the RBI's comfort zone. While there are

those who believe the central bank might hold off till December so as to get a better idea of the kharif output, others believe fairly good visibility on inflation would persuade the RBI to trim rates now. That's because banks have not lowered their lending rates meaningfully even though borrowing rates have dropped sharply in the money markets—both at the long and short ends.



Samiran Chakraborty, chief economist at Citibank, observed the August CPI had opened up the possibility of a 25 basis points rate cut in the October 4 policy. “The upside risks envisaged by the RBI

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good monsoon, he believes, should keep food prices in check estimating an

average 0.5% month-on-month seasonally adjusted increase till March next year which is marginally lower than in the corresponding period of FY16. “These factors can push headline inflation closer to 4% by December,” he wrote.

Saugata Bhattacharya, chief economist, Axis Bank, also believes the balance of probability lies in a 25 basis points cut given the expected deflationary forces for the rest of FY17. “With prices of vegetables and pulses easing, we are expecting inflation to come off meaningfully and therefore there is room for monetary easing,” Bhattacharya said adding inflation should average 4.3% in FY18.

Pranjul Bhandari, chief economist at HSBC believes that while there are some good reasons why a rate cut could materialise at the October 4 meeting, the base case is for a rate cut in December. “The recent fall in food prices has been sharper than expected, and cutting earlier keeps the RBI a safe distance away from possible Fed hikes. Yet, our base case is for a rate cut in December because two new inflation prints, expected to be well below 5% will be available” Bhandari wrote

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trended down sharply thanks to abundant liquidity. Since April, the central bank has injected Rs one lakh crore via open market operations (OMOs) after it altered its approach to banking system liquidity saying it would move from a deficit to a neutral level. The yield on the benchmark bond yields has come off sharply, by about 60 basis points, since June. On Friday, the yield closed at 6.82% down from 7.45% in early June. The fall in rates in the corporate bond markets has mirrored the fall in gilt yields. Banks, however, have not lowered rates significantly despite moving to marginal costs to arrive at the base rate and even though deposit rates have come off over the past year.

Loan growth, meanwhile, has been muted growing at sub-10% with a good number of companies opting to borrow via commercial paper (CP) for their short-term needs and demand for project finance staying subdued.