

Cash crunch pangs may force RBI to advance rate cut

Our Bureau

Tepid inflation outlook buoys expectation of 25 bps cut now, another easing after Budget

Mumbai, December 4:

Buoyed by moderating food inflation and under pressure to counter any negative impact on growth from the demonetisation move, the Reserve Bank of India is likely to cut its repo rate by 25 basis points from 6.25 per cent to 6 per cent in the bi-monthly monetary policy review on Wednesday (December 7).

Market players expect this rate cut to be followed up with another one after the Union Budget, which is being advanced by about a month this time. The repo rate (the interest rate at which banks borrow funds from RBI to tide over short-term liquidity mismatches) was cut from 6.50 per cent to 6.25 per cent on October 4. The rate-setting monetary policy committee said it expected the strong improvement in sowing, along with supply management measures, to improve the food inflation outlook.

Further, the committee reasoned, the accommodative stance and the comfortable liquidity conditions should support a revival of credit. The rate cut may now be required to counteract the likely slowdown effect on GDP growth arising from the demonetisation of ₹ 500 and ₹ 1,000 notes. In the second quarter, the economy grew at 7.3 per cent, against 7.1 per cent in the previous quarter. The latest quarterly GDP growth was, however, lower than in the same quarter last fiscal.

The consumer price index-based inflation reading for October, at a 14-month low of 4.20 per cent, may, however, allow the RBI to be accommodative.

An HSBC report said it had been expecting a rate cut in December on the back of moderating food prices. Growth concerns, an output gap (the difference between what an economy is producing and what it can produce) that will be negative for longer following demonetisation, and lower inflation, will open up some more space for easing, it argued.

“We add an additional 25 basis points rate cut for the February meeting. The risk to our view is that much of the growth drag turns out to be temporary, not requiring an additional rate cut. But until we see some data that suggests this, we hold on to two rate cuts,” it said

Edelweiss Securities said it expects a 25-50 basis points cut in repo rate on December 7. “We think it makes sense to front-load the monetary easing to limit the downside from demonetisation,” it reasoned. But the RBI, it said, might be constrained by “the changing global dynamics”: the rally in the US dollar and a hardening of US 10-year bond yields amid expectations of a fiscal stimulus in the US.

“Such a set-up does curtail the independence of emerging market central banks, including India... To that extent, a 25 bps or 50 bps cut becomes a close call,” it said.

DBS said the central bank might prefer to bring forward the rate cut to December to support growth and tap the favourable inflation outlook.

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