Reserve Bank of India Cuts Interest Rates Again

- **The Reserve Bank of India cut its benchmark interest rates for the fourth consecutive time by 35 basis points (bps) to 5.40% to underpin a slowing economy. Markets had expected a 25 bps cut.**
- **The central bank introduces a degree of uncertainty with a rate cut that breaks with global conventions of 25 bps increments though it reaffirms its dovish stance.**

The Reserve Bank of India (RBI) lowered the benchmark repo and reverse repo rates by 35 basis points to 5.40% and 5.15%, respectively (chart 1). The unconventional increment was defended as Goldilocks solution: 25 bps was deemed inadequate in view of evolving global and domestic economic developments, while 50 bps was considered excessive, particularly in light of actions already taken. Today's move was the fourth consecutive interest rate reduction, bringing the benchmark rate to its lowest since 2010. There was unanimous agreement of the six-member Monetary Policy Committee (MPC) to reduce the rate, though two members supported only a 25 bps cut. The RBI maintained its accommodative monetary policy stance signalling either reductions or status quo ahead.

The decision to ease monetary policy further is intended to reverse the sharp slowdown in India's economic activity. The MPC expressed particular concerns regarding a sharp slowdown in investment activity, along with a continuing moderation in private consumption growth, leading the central bank to lower its FY20 GDP growth forecast to 6.9% from 7.0%. It also cited slowing global economic momentum, elevated trade tensions, and geo-political uncertainty in its decision. We expect India's real GDP growth to average 6.5% y/y this year compared with a 7.4% advance in 2018. In 2020, the economy's momentum will likely recover somewhat on the back of supportive policies, with output gains reaching 7.0% y/y.

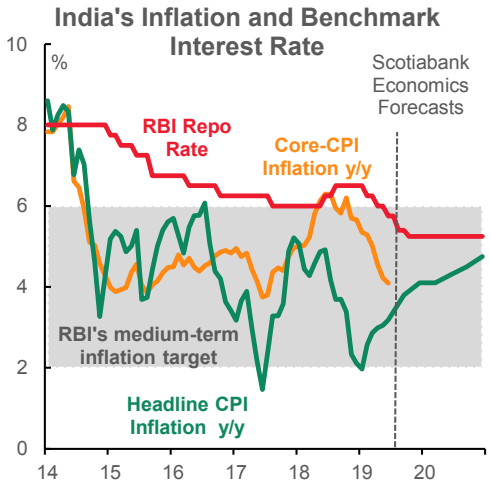
Price pressures in India remain manageable with headline inflation hovering at 3.2% y/y in June, comfortably within the RBI's annual inflation target of 4% ±2%. Inflation will likely creep gradually higher over the coming months, extending the trend that has been in place since the recent low point of 2% y/y in January (chart 1). Nevertheless, we expect price pressures to stay within the central bank's target band through 2020. While core inflation—currently at 4.1% y/y—remains above the headline metric, it continues to show signs of moderation. Given contained inflation dynamics and weak economic growth momentum, we assess that the RBI has room for one more rate reduction in the current easing cycle, likely to take place in the final months of 2019.

We maintain our careful observation of the following risks to inflation: 1) financial market volatility and potential depreciation pressure on the Indian rupee; 2) volatile food prices; 3) international crude oil price developments; 4) the ongoing slowdown in global activity that may translate to softer commodity prices and weaker demand-driven price pressures; and 5) the southwest monsoon (June–September) rainfall, which is playing catch-up after a below-normal start to the season. The monsoon's impact on prices is two-fold; drought conditions will likely raise food prices while adversely impacted rural incomes may result in weaker demand-driven inflation.

CONTACTS

Tuuli McCully, Head of Asia-Pacific Economics
65.6305.8313 (Singapore)
Scotiabank Economics
tuuli.mccully@scotiabank.com

Chart 1



Sources: Scotiabank Economics, Bloomberg.