NSE

Macro Preview

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Weak growth-inflation dynamics calls for another 25bps cut

Following three consecutive cuts in the policy rates in 2019 thus far and a change in the monetary policy stance to 'accommodative' in the last meeting to bolster growth, we expect the RBI's Monetary Policy Committee (MPC) to trim the policy repo rate by another 25bps cut on August 7th, 2019. The domestic macro environment has seen further deterioration since the last policy in June, based on high frequency indicators, e.g., auto sales, services PMI, and monthly merchandise trade performance. Inflation, however, has remained benign amid continued moderation in core inflation and a smaller-than-expected seasonal uptick in food prices. Several global multilateral agencies such as IMF and ADB have already slashed India's GDP growth forecasts for FY20, citing weak demand conditions. Moreover, the MPC is likely to derive comfort from the government's decision to stick to fiscal prudence in the Union Budget.

Weakening domestic growth impulses, coupled with an unsupportive global backdrop, may open room for another rate cut (25bps) in the second half of the fiscal, *ceteris paribus*. Key risks include a below-normal Southwest monsoon, potentially leading to a spike in food prices, and volatile crude oil prices amid geopolitical tensions.

- **Expect another 25bps rate cut accompanied by retention of an accommodative stance**: The RBI's Monetary Policy Committee, in its third bi-monthly policy review meeting of this fiscal scheduled for August 7th, 2019, is expected to reduce the policy rates by another 25bps (repo rate to be reduced from 5.75% to 5.5%). This would take the total quantum of rate cuts in 2019 thus far to 100bps. The MPC is expected to retain its monetary policy stance to 'accommodative', as weak domestic growth-inflation dynamics, coupled with an unfavourable global demand outlook, is likely to keep the room open for further monetary accommodation.

- **Inflation outlook remains benign…**: The average retail inflation (CPI) during Q1 FY20 at 3.07% is within the RBI's target of 3.0-3.1% for the first half, even as it rose to an eight-month high of 3.2% in June amid a smaller-than-expected seasonal uptick in food prices. In fact, CPI inflation has remained below the RBI's medium-term target of 4% for the 11th consecutive month. The core inflation (ex-food ex-fuel), on the other hand, continues to moderate, signalling weakening domestic and external demand. The crude oil prices have further softened (-6%/-15% from July/2019-peak levels) amid ongoing trade war concerns and geopolitical tensions in the Middle East.

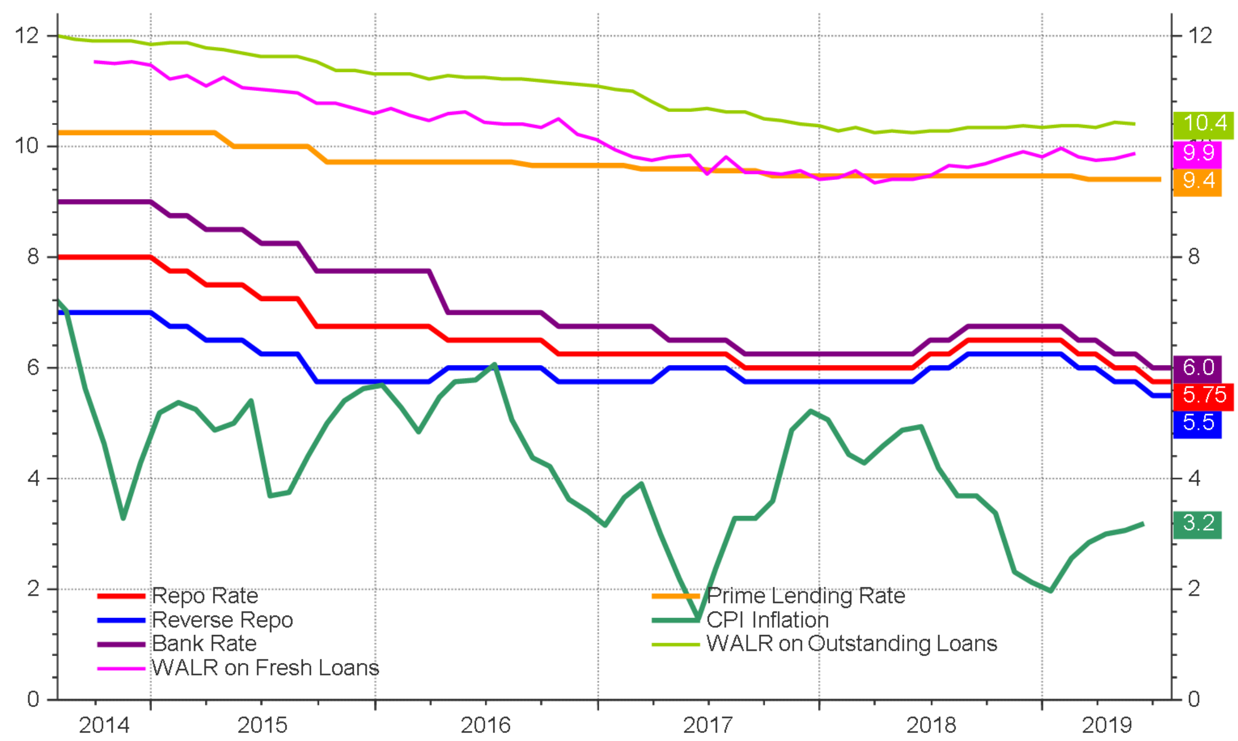
- **…but monsoon may play a spoilsport:** A delayed onset and a slow progress, barring last couple of weeks, has led to cumulative rainfall standing 13% below normal in the season thus far (as of July 28th, 2019), resulting in a reduced sowing this year. This is much lower than the IMD's forecast of cumulative rainfall of 96% of LPA. In fact, actual rainfall has been below the IMD's first forecast for the last five consecutive years. A below normal monsoon could lead to an unseasonal spike in vegetable prices, posing upside risks to inflation.

- **Growth slowdown becoming more pervasive**: Following a five-year low GDP print of 5.8% in Q4 FY19, growth slowdown seems to have intensified, becoming more pervasive. This is signalled from several high frequency indicators—1) India's export/import bill declined by 9.7%/9% in Jun—the steepest decline in 41/35 months, reflecting weak domestic and global demand; 2) Service PMI slipped into the contraction zone in June for the first time since May 2018; 3) Auto sales continue to decline, with the passenger vehicle segment seeing a decline of 18.4% in Q1 FY20. The IMF and ADB recently slashed their FY20 GDP growth forecasts for India from 7.3% and 7.2% respectively to 7.0%.

- **More rate cuts in the offing?** Amidst a benign inflation trajectory and weakening growth outlook, we believe there is room for a total of 50bps incremental rate cuts in this fiscal, *ceteris paribus*. Performance of SW monsoon in August, coupled with the global growth scenario and financial market volatility, would be key indicators that would dictate the rate trajectory going forward.

Figure 1: Policy rates reduced by 75bps since start of 2019; expect another 25bps cut on August 7th

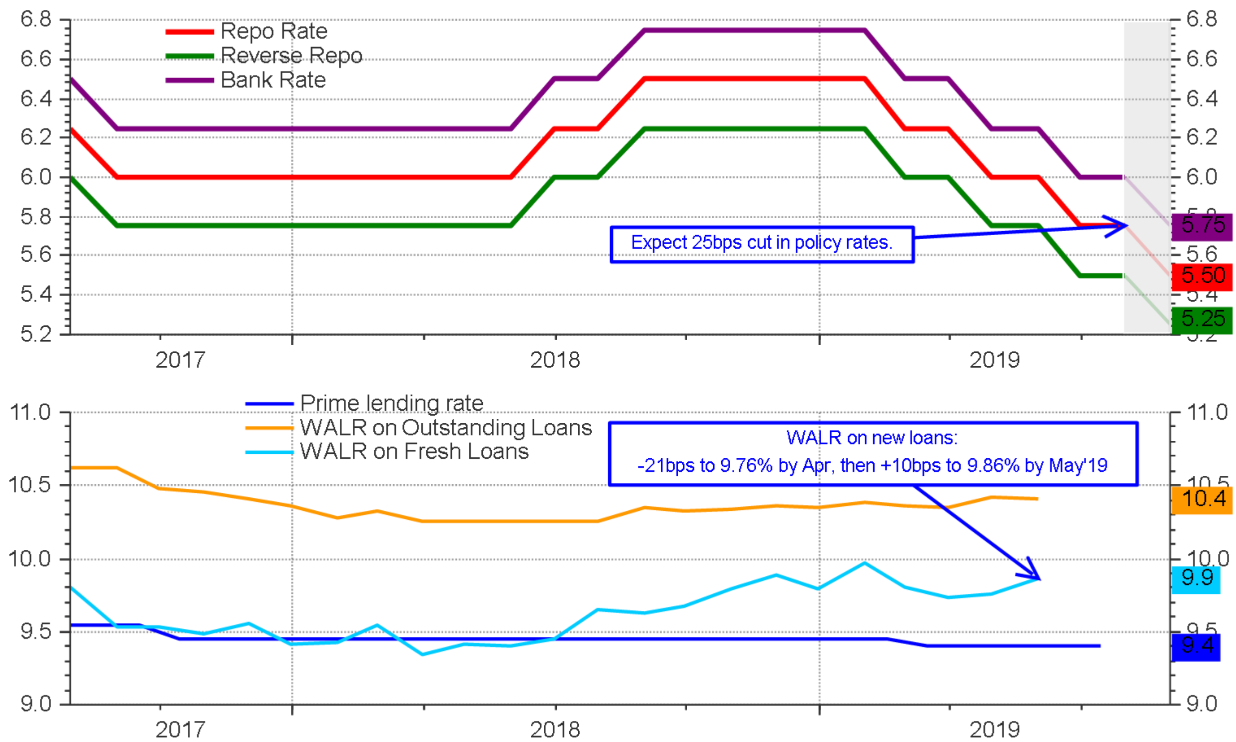
India policy rate, inflation, lending rate (%)



Source: RBI, Thomson Reuters. WALR: Weighted Average Lending Rate

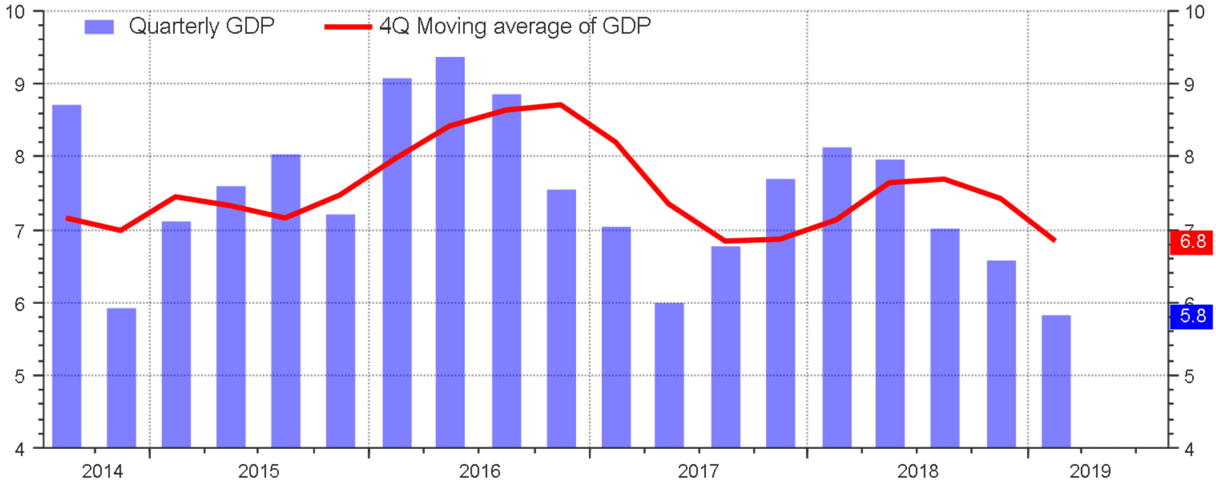
Figure 2: Whither Transmission? Repo -75bps; 'New loan' WALR -11bps, 'Old loan' WALR +3bps

Policy rate and lending rates (%)



Source: RBI, Thomson Reuters. WALR: Weighted Average Lending Rate

Figure 3: Q4FY19 GDP growth came in at a 20-quarter low



Source: RBI, Thomson Reuters

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