

## Economics

16 September 2011 | 8 pages

# India Macro Flash

## RBI Hikes Rates by 25bps in Line With Expectations; Reiterates Inflation Concerns but Tone is a Lot More Dovish

- **Repo Rate Raised to 8.25%** — In line with expectations, the RBI raised the operating policy rate – the repo (liquidity injection) rate by 25bps to 8.25%. (Pre-crisis, the repo rate stood at 9%). This would result in the reverse repo rate being automatically adjusted to 7.25%, while the Marginal Standing Facility (MSF) rate would be 9.25%. While today's statement appears clearly more dovish than recent ones; RBI's concerns on inflation do keep the window open for further rate actions.
- **Expresses concerns on growth: domestic and global** — While continuing to voice concerns on a slowdown in growth, today's policy undertone appears more dovish. Moreover, the RBI has also cautioned that '*risks to growth projections for FY12 made in the July review are on the downside*'. This is due to (1) a deteriorating global macro environment; (2) moderating domestic growth (as evidenced by IIP, PMI, sectoral trends). The RBI has conceded that this was partly exacerbated by a demand slowdown to which the tight monetary policy stance was contributing.
- **... But Maintains Anti-Inflationary Stance** — Despite global concerns, the RBI remains focused on containing inflation expectations; stating that '*a premature change in the policy stance could harden inflationary expectations...diluting the impact of past policy actions*'. With the WPI remaining strong at 9.8%, it has expressed concern on (1) demand pressures reflected in non-food manufactured inflation (2) suppressed inflation due to an incomplete pass through of global oil prices; electricity tariffs not reflective of an increase in input prices and structurally high food inflation (3) a depreciating rupee. As mentioned earlier (see [August Inflation Edges Higher to 9.8%; RBI Dilemma Increases – Commodities and Currencies Are Key, Going Forward](#)), we think the path for inflation would be determined by the extent to which any decline in commodity prices is offset/neutralized by exchange-rate depreciation.
- **RBI's Dilemma Increases: Managing Inflation and Growth** — Today's move marks the 12th rate action since the RBI began tightening in Mar10; with the repo rate raised by 350bps. Taking into account the transition from surplus to deficit liquidity, effective tightening is 500bps. The deteriorating global macro has resulted in many central banks pausing (UK, South Korea, Malaysia, Philippines) and Brazil cutting rates. This puts the RBI in an unenviable position of balancing slowing growth and rising inflation.
- **Monetary Implications** — Going forward, odds favor a pause in rates for now; but key factors shaping policy decisions would be (1) domestic growth (2) global financial conditions and (3) domestic inflation trends, which would largely be determined by the interplay of commodity and currency movements. Key to track would be the host of data that will be released prior to the October 25<sup>th</sup> policy (*IIP, WPI, PMI, tax revenues, cement despatches, auto sales*) as well as the constantly evolving global environment.

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# Key Highlights

## INFLATION WORRIES PERSIST

- With the WPI trending at 9.8% currently and non-food manf prod inflation at 7.8% the RBI has persisted with its anti-inflationary stance
- Trends going forward would be determined by the interplay between commodity prices and currency depreciation.
- For instance between Aug08 and Mar09; the rupee depreciated 19%; but oil prices came off by 59%. This resulted in WPI moderating from 11% to 2% and allowed space for easing.

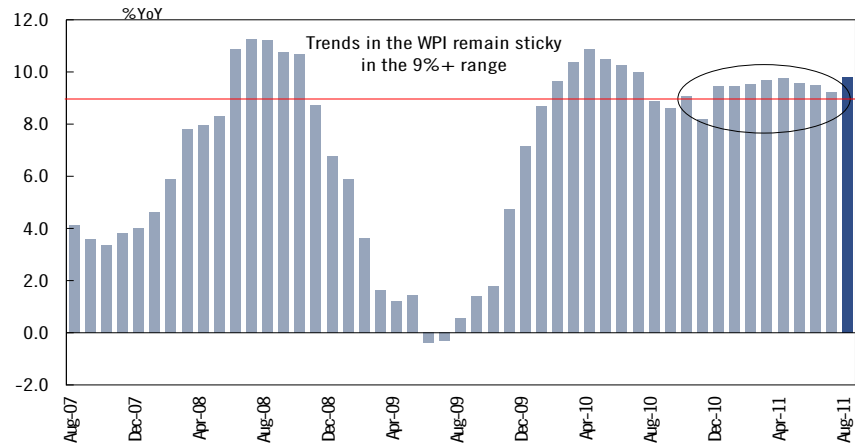
## DOMESTIC GROWTH MODERATING

- Growth in the past two quarters has slowed to sub-8% levels (7.8% and 7.7% during 4QFY10 and 1QFY11 respectively).
- Slowdown in GDP is further corroborated by a deceleration in IP growth, PMI, and other sectoral data

## GLOBAL CONDITIONS WORRYING

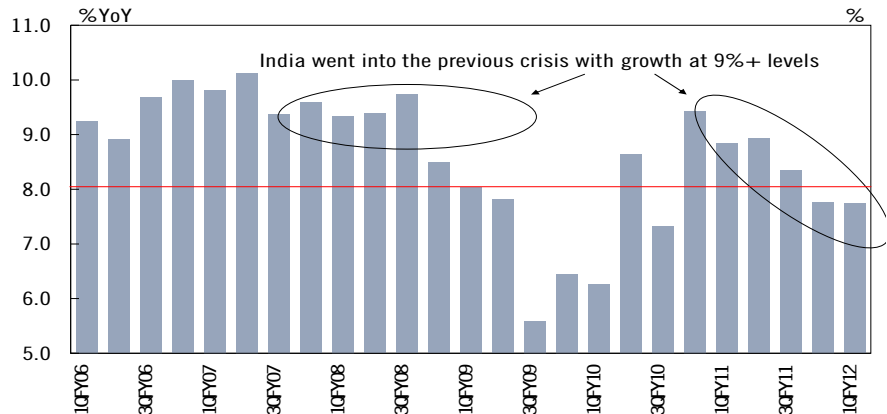
- Global conditions continue to worsen, with the RBI pointing out that *'there is growing consensus that sluggishness will persist longer than earlier expected'*.
- Global PMIs released earlier this month indicate that the Euro Zone, UK and China were below the 50-mark (pointing to a contraction) while the US inched closer to 50.

Figure 1. Trends in Headline WPI (%YoY)



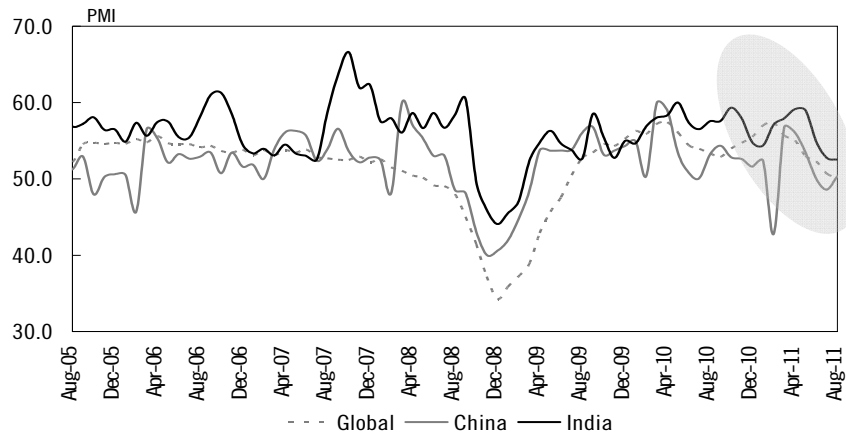
Source: Office of the Economic Advisor

Figure 2. Trends in Quarterly GDP (%YoY)



Source: CSO

Figure 3. Trends in the PMI (%)



Source: Markit

## Appendix – Inflation and Interest Rate Movements

Figure 4. Key Interest Rate Changes

Effective Since	Reverse Repo	Repo Rate	Cash Reserve Ratio	WPI Inflation	CPI Inflation
17-Feb-07	6.00	7.50	5.75 (+0.25)	6.1	7.6
3-Mar-07	6.00	7.50	6.00 (+0.25)	6.5	6.7
31-Mar-07	6.00	7.75	6.00	5.9	6.7
14-Apr-07	6.00	7.75	6.25 (+0.25)	6.3	6.7
28-Apr-07	6.00	7.75	6.50 (+0.25)	6.0	6.7
4-Aug-07	6.00	7.75	7.00 (+0.50)	4.4	7.3
10-Nov-07	6.00	7.75	7.50 (+0.50)	3.2	5.5
26-Apr-08	6.00	7.75	7.75 (+0.25)	8.0	7.8
10-May-08	6.00	7.75	8.00 (+0.25)	8.2	7.8
24-May-08	6.00	7.75	8.25(+0.25)	8.2	7.8
12-Jun-08	6.00	8.00(+0.25)	8.25	10.9	7.7
25-Jun-08	6.00	8.50(+0.50)	8.25	10.9	7.7
5-Jul-08	6.00	8.50	8.50 (+0.25)	11.2	8.3
19-Jul-08	6.00	8.50	8.75 (+0.25)	11.2	8.3
30-Jul-08	6.00	9.00(+0.25)	8.75	11.2	8.3
30-Aug-08	6.00	9.00	9.00 (+0.25)	11.2	9.0
11-Oct-08	6.00	9.00	6.50 (-2.50)	10.6	10.4
20-Oct-08	6.00	8.00 (-1.00)	6.50	10.6	10.4
25-Oct-08	6.00	8.00	6.00(-0.50)	10.6	10.4
3-Nov-08	6.00	7.50(-0.50)	6.00	8.6	10.4
8-Nov-08	6.00	7.50	5.50(-0.50)	8.6	10.4
8-Dec-08	5.00(-1.00)	6.50(-1.00)	5.50	6.6	9.7
5-Jan-09	4.00(-1.00)	5.50(-1.00)	5.50	5.9	10.4
17-Jan-09	4.00	5.50	5.00(-0.50)	5.9	10.4
4-Mar-09	3.50(-0.50)	5.00(-0.50)	5.00	1.5	8.0
21-Apr-09	3.25(-0.25)	4.75(-0.25)	5.00	1.2	8.7
29-Jan-10	3.25	4.75	5.75(+0.75)	8.7	16.2
19-Mar-10	3.5(+0.25)	5.00(+0.25)	5.75	10.4	14.9
20-Apr-10	3.75 (+0.25)	5.25 (+0.25)	6.00(+0.25)	10.9	13.3
2-Jul-10	4.00(+0.25)	5.50(+0.25)	6.00	10.0	11.3
27-Jul-10	4.50 (+0.50)	5.75(+0.25)	6.00	10.0	11.3
16-Sept-10	5.00(+0.50)	6.00(+0.25)	6.00	8.6	9.8
2-Nov-10	5.25(+0.25)	6.25(+0.25)	6.00	8.2	8.3
16-Dec-10	5.25	6.25	6.00	9.5	9.5
25-Jan-11	5.50 (+0.25)	6.50 (+0.25)	6.00	9.5	9.3
17-Mar-11	5.75(+0.25)	6.75(+0.25)	6.00	9.7	8.8
3-May-11	6.25 (+0.50)	7.25(+0.50)	6.00	9.6	8.7
16-Jun-11	6.50(+0.25)	7.50(+0.25)	6.00	9.5	8.6
26-Jul-11	7.00(+0.50)	8.00(+0.50)	6.00	9.2	8.4
<b>16-Sept-11</b>	<b>7.25(+0.25)</b>	<b>8.25(+0.25)</b>	<b>6.00</b>	<b>9.8*</b>	<b>8.4*</b>

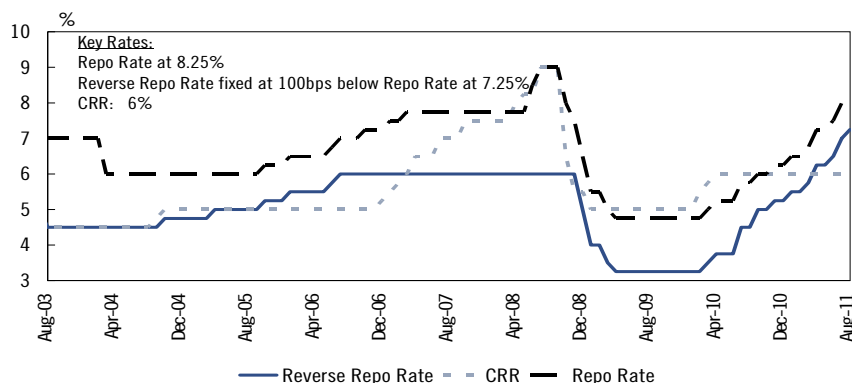
\* WPI data post Jan08 is new base. Latest CPI data is for Jul. Latest WPI data is for August. Source: RBI, Labour Bureau, Office of the Economic Advisor

**Repo Rate** – The RBI’s lending rate or liquidity injection rate is now the only ‘independently varying’ policy rate. This is at 8.25%

**Reverse Repo Rate** – This is the liquidity absorption rate and is pegged at 100bps below the repo rate to help improve monetary transmission. This is currently at 7.25%.

**Marginal Standing Facility** – This allows banks to borrow overnight to the tune of 1% of NDTL at a rate that is 100bps above the repo rate (currently 9.25%)

Figure 5. Trends in Key Domestic Rates (%)



Source: RBI

# Statistical Snapshot

Figure 6. India – Macroeconomic Summary, FY00-13E (%)

Year to 31 March	FY00	FY01	FY02	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12E	FY13E
<b>National Income Indicators*</b>														
Nominal GDP (Rs bn)	20,279	21,840	23,676	25,500	28,617	32,422	36,925	42,937	49,864	55,826	65,503	78,756	91,357	104,147
Nominal GDP (US\$ bn)	467	478	493	528	624	721	834	950	1,240	1,214	1,382	1,728	2,021	2,347
Per Capita GDP (US\$)	467	469	474	500	582	662	754	847	1,090	1,052	1,180	1,454	1,675	1,916
Real GDP growth (%)	6.0	4.4	5.8	3.8	8.5	7.6	9.5	9.6	9.3	6.8	8.0	8.5	7.6	8.2
Agriculture growth (%)	0.5	-0.2	6.3	-7.2	10.0	1.6	5.1	4.2	5.8	-0.1	0.4	6.6	2.5	3.0
Industry growth (%)	4.6	6.4	2.7	7.1	7.4	9.4	9.7	12.2	9.7	4.4	8.0	7.9	6.8	8.0
Services growth (%)	9.5	5.7	7.2	7.5	8.5	9.4	11.0	10.1	10.3	10.1	10.1	9.4	9.2	9.5
<b>By Demand * (%YoY)</b>														
Consumption	7.2	3.0	5.3	2.3	5.4	1.9	8.6	7.6	9.3	8.2	8.7	8.0	7.0	7.9
<i>Pvt Consm</i>	6.1	3.4	6.0	2.9	5.9	1.7	8.5	8.3	9.3	7.7	7.3	8.6	7.0	8.0
<i>Public Consm</i>	13.2	0.9	2.3	-0.4	2.6	3.4	8.9	3.7	9.5	10.7	16.4	4.8	7.0	7.5
Gross Fixed Capital Formn	11.2	0.0	7.4	6.8	13.6	20.7	16.2	13.8	16.2	1.5	7.3	8.6	3.0	9.0
<b>Cons; Invst, Savings ** (%GDP)</b>														
Consumption	79.4	78.5	78.9	77.2	75.0	70.2	69.2	67.8	66.8	69.4	69.7	68.7	67.0	66.0
Capital Formation	25.3	23.8	22.3	24.6	26.9	32.8	34.7	35.7	38.2	35.4	35.8	34.8	37.5	38.0
Gross Domestic Savings	24.2	23.2	22.9	25.7	29.1	32.4	33.5	34.6	36.9	32.2	33.7	35.0	36.0	37.0
<b>Real Indicators (%YoY)</b>														
Cement despatches (domestic)	15.2	-1.9	9.8	8.7	5.8	8.1	10.1	10.2	9.8	8.5	11.2	4.8	12.0	12.0
Commercial vehicle sales	22.0	-11.9	-4.5	28.0	36.2	22.4	10.1	33.3	4.2	-21.4	39.2	27.0	7.0	10.0
Car sales	45.3	-5.3	3.2	7.8	27.2	17.8	7.7	20.7	12.1	0.3	25.7	29.3	10.0	16.0
Two-wheelers	9.4	0.7	15.3	17.0	11.3	15.7	13.6	11.5	-7.8	2.7	25.9	25.8	15.0	10.0
Diesel consumption	5.6	-3.4	-3.7	0.3	1.2	6.9	1.4	6.7	11.1	8.5	8.9	6.5	6.0	6.0
Mobile Tele density	0.2	0.3	0.6	1.3	3.1	4.8	8.2	14.1	22.0	33.0	48.9	67.9	80.5	86.1
<b>Monetary Indicators (% YoY)</b>														
Money supply	14.6	16.8	14.1	14.7	16.8	12.0	21.4	21.3	21.1	19.3	16.7	16.0	17.0	17.0
Inflation – WPI (Avg)	3.3	7.1	3.6	3.4	5.5	6.5	4.4	6.5	4.8	8.0	3.6	8.6	9.0-9.5	7.5
CPI (Avg)	3.4	3.7	4.3	4.1	3.8	3.9	4.2	6.8	6.2	9.1	13.0	9.5	8.0	7.0
Bank credit growth	18.2	17.3	15.3	23.7	15.3	30.9	37.0	28.1	22.3	17.5	16.7	21.4	18.0	18.0
Deposit growth	13.9	18.4	14.6	16.1	17.5	13.0	24.0	23.8	22.4	18.0	17.0	15.8	17.0	17.0
<b>Fiscal Indicators (% GDP)</b>														
Centre's fiscal deficit)	-5.2	-5.4	-6.0	-5.7	-4.3	-3.9	-4.0	-3.3	-2.5	-6.0	-6.4	-5.1	-5.8***	-4.6
State fiscal deficit	-4.5	-4.0	-4.1	-3.9	-4.2	-3.3	-2.4	-1.8	-1.5	-2.6	-3.0	-3.0	-2.5	-2.5
Combined deficit (Centre+State)	-9.0	-9.1	-9.5	-9.1	-8.1	-7.2	-6.5	-5.4	-4.1	-8.5	-9.1	-8.1	-8.3	-7.1
Off Balance Sheet Items	-	-	-	-	-	-	-0.5	-0.9	-0.6	-1.7	-0.2	NA	NA	NA
Combined liabilities ( dom+ext)	73.6	76.9	81.5	84.3	84.4	84.3	82.3	78.1	76.2	75.5	72.4	67.4	65.8	64.5
<b>External Sector (% YoY)</b>														
Exports (US\$bn)	37.5	45.5	44.7	53.8	66.3	85.2	105.2	128.9	166.2	189.0	182.2	250.5	298.1	357.7
% YoY	9.5	21.1	-1.6	20.3	23.3	28.5	23.4	22.6	28.9	13.7	-3.6	37.4	19.0	20.0
Imports (US\$bn)	55.4	57.9	56.3	64.5	80.0	118.9	157.1	190.7	257.6	308.5	300.6	380.9	457.1	525.7
%YoY	16.5	4.6	-2.8	14.5	24.1	48.6	32.1	21.4	35.1	19.8	-2.6	26.7	20.0	15.0
Trade deficit (US\$bn)	-17.8	-12.5	-11.6	-10.7	-13.7	-33.7	-51.9	-61.8	-91.5	-119.5	-118.4	-130.5	-159.1	-168.0
Invisibles (US\$bn)	13.7	9.8	15.0	17.0	27.8	31.2	42.0	52.2	75.7	91.6	80.0	86.2	101.6	117.2
Current Account Deficit (US\$bn)	-4.1	-2.7	3.4	6.3	14.1	-2.5	-9.9	-9.6	-15.7	-27.9	-38.4	-44.3	-57.5	-50.8
% to GDP	-0.9	-0.6	0.7	1.2	2.3	-0.3	-1.2	-1.0	-1.3	-2.3	-2.8	-2.6	-2.8	-2.2
Capital Account (US\$bn)	9.5	8.8	8.6	10.8	16.7	28.0	25.5	45.2	106.6	6.8	53.4	59.7	68.0	63.5
% GDP	2.0	1.9	1.7	2.1	2.7	3.9	3.1	4.8	8.6	0.6	3.9	3.5	3.4	2.7
Forex Assets (excl gold) (US\$bn)	35.1	39.6	51.0	71.9	106.1	135.1	145.1	191.9	299.1	241.6	252.8	273.7	284.2	296.8
Months of imports	7.6	8.2	10.9	13.4	15.9	13.6	11.1	12.1	13.9	9.4	10.1	8.6	7.5	6.8
External Debt (US\$bn)	98.3	101.3	98.8	104.9	112.7	134.0	139.1	172.4	224.4	224.5	261.2	305.9	330.9	355.9
Short Term Debt	3.9	3.6	2.7	4.7	4.4	17.7	19.5	28.1	45.7	43.3	52.3	65.0	NA	NA
<b>Exchange Rate</b>														
US\$/INR - annual avg	43.4	45.7	48.0	48.3	45.9	45.0	44.3	45.2	40.2	46.0	47.4	45.6	45.2	44.4
% depreciation	2.8	5.3	5.0	0.6	-5.0	-2.0	-1.6	2.0	-11.1	14.4	3.0	-3.8	-0.8	-1.8
US\$/INR - year end	43.6	46.5	48.9	47.5	43.6	43.8	44.6	43.6	40.1	50.7	44.9	44.6	45.5	44.0
% depreciation	2.8	6.7	5.2	-2.9	-8.2	0.3	2.0	-2.3	-8.0	26.4	-11.4	-0.7	2.0	-3.3

\*Using spliced data \*\* At current prices. \*\*\*Assuming oil at US\$105/bbl and full payment of under-recoveries to oil companies

Source: CSO, RBI, Ministry of Finance and CIRA Estimates

## Appendix A-1

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