New RBI Guv Brings Rate Cut Expectations

The slower pace of consumer price rises has triggered expectations of a rate cut, with market participants shortening the odds on the central bank changing its stance to neutral early next year before resuming the cycle of reduction in financing costs. “A cut in funding costs will help New Delhi to retain growth, fuelling investments. The policy stance may be changed first to neutral soon,” said Soumya Kanti Ghosh, chief economist at SBI. “Crude oil prices are unlikely to shoot up next year as the world economy is facing growth headwinds. Back home, growth is showing signs of declining momentum.”

The Reserve Bank of India has changed its stance to “calibrated tightening” in its October bimonthly monetary policy. The central bank normally changes its stance before going for any rate action. “India’s growth will likely slow, consistent with global growth slowing,” said Suyash Choudhary, head fixed income at IDFC MF. “Alongside, consumer prices continue to undershoot forecasts. Thus, directionally one should look for incrementally easier monetary policy, either via rates or liquidity.” The six-month Overnight Indexed Swap, where traders exchange their fixed rates against variable, dropped 68 basis points to 6.67%, show data from Bloomberg. The overseas gauge of the same derivative instrument too fell 50 basis points in past three months.

India’s retail inflation plunged to a 17-month low to 2.33% in November, much lower than average market expectations. Lower prices of vegetables, eggs and pulses contributed to the drop. “The likelihood of a rate cut seems to be rising with each inflation reading,” said Abheek Barua, chief economist at HDFC Bank. “It is important to watch the growth inflation mix carefully. It is essential to gauge if the subdued trend in food inflation is sustainable or short-lived.”

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