

Will RBI's rate-cut pause get longer?

As expected by many quarters, the Reserve Bank of India (RBI) adopted a wait and watch approach in its Sixth Bi-monthly Monetary Policy announced on Tuesday, and kept key policy rates unchanged. The governor justified the status-quo on higher consumer inflation that was up for a fifth month during December.

Experts say the policy statement is mildly hawkish and hints at a pause on further rate cuts. "RBI seems to be worried about the inflationary impact of seventh Pay Commission awards and the recent prescription of higher public spending to boost demand and growth. It moved in anticipation and pushed a pause button on further interest rate cuts, at least in the near term," says Dhananjay Sinha, head-institutional equity, Emkay Global Financial Services.

domestic research house sees an impact of 60-70 basis points (bps) to its own inflation estimate for March 2017, due to Pay Commission and higher service tax (latter expected in Budget). By the laying down the conditions required for further monetary accommodation, RBI has put the onus on the government. This lowers the probability of a further rate cut, given the rising chorus for fiscal expansion to push-up growth, feels Sinha.

Economists are not surprised. "The policy was on the expected lines, considering recent economic developments. Next move by RBI will now be decided by the forthcoming Union Budget, which is expected to be inflationary," says Madan Sabnavis, head economist, CARE Ratings. RBI has observed services inflation has been sticky since September; attributable to housing, transport & communication and medical services. Core inflation as a result has inched up in the past four months and household inflation expectations remain elevated.

Odds for a rate cut have also been diminished by the recent developments in the bond market where rising supply has put an upward pressure on bond yield.

"Yields are firming up due to rising supply of bonds, especially from the state governments and more is coming, thanks to the UDAY scheme," adds Sabnavis.

Under UDAY, bank loans to state electricity boards worth Rs 3 lakh crore are to be converted into state government bonds and transferred to respective bank investment portfolio from their loan books.

A likely fiscal expansion by the Union government could further increase bond supply in FY17, keeping bond yields high. "In this environment even if RBI cuts rate, it won't be transmitted into the economy," says Sinha.

There are other pressure points also, even as clarity over monsoons (after two below par seasons) is awaited. Meanwhile, rate cuts seem to be losing their sting on Dalal Street. The benchmark and key sectoral indices have continued their downward march despite a cumulative 125 bps cut in policy rates in past one year. It's time investors looked beyond RBI for market cues.

(Source : www.business-standard.com)