Asian Economic Monthly

India cuts policy rate again as inflation rate calms down and Fed rate hike expectations recede

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25 APRIL 2016
(ORIGINAL JAPANESE VERSION RELEASED ON 20 APRIL 2016)

The Bank of Tokyo-Mitsubishi UFJ, Ltd.
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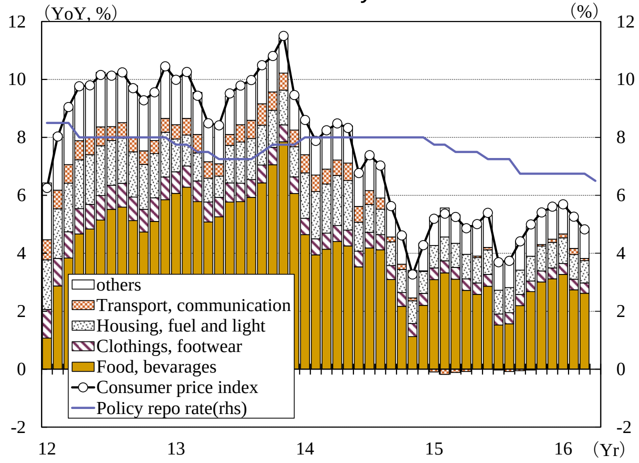
Asian economy has kept lackluster situation, due to sluggish exports. In Vietnam which maintained a relatively high growth last year, the real GDP growth rate decelerated to 5.5% yoy in Jan-Mar, mainly due to weaker growth in manufacturing sector reflecting slowing exports. Meanwhile, Asian central banks are trying to support the economy by monetary policies. *Bank Indonesia (BI)* cut the policy rates three times in a row since this year started, while the *Monetary Authority of Singapore (MAS)* also took a turn of its monetary stance from tightening to neutral this month. India, which keeps on growing on the 7% level, is no exception to this movement and *Reserve Bank of India (RBI)* cut its policy repo rate this month for the first time since last September (Chart 1).

Indian economy has maintained a high growth led by private consumption, but supply side indicators (ex. production, investment) are showing lack in their strength. In that context, thanks to the effect of lower oil price the rise in consumer price stayed at 4.8% yoy in March, falling again below the inflation target of 5%, and the FRB decided to keep the present policy stance at the March FOMC with downward revision of the forecast for the interest rate rise among the members, thrusting back the prospect of additional rate rise in financial markets. Helped by these factors the RBI seems to have decided to cut its policy rate. In addition, Union Budget for 2016-2017 that was published in February may have supported the cut by maintaining the fiscal discipline to narrow the budget deficit to 3.5% of nominal GDP in FY2016 (3.9% in the previous fiscal year) and further to 3% in the following 2 fiscal years (Chart 2). In India, the governments have tended to prioritize household-oriented policies from consciousness of elections and the infrastructure investments have not been implemented sufficiently. As a result, India has a basic structure to be subject to higher inflation from scarce supply capacity. That is why it is urged for the government to continue to make reforms to enhance the supply capacity while observing the fiscal discipline. In this respect, the budget contains increase in infrastructure investments like increased irrigation facilities and local road improvement and the RBI has noted in a statement that the fiscal policies that included improved infrastructures would support the control of future inflation through the improvement of supply conditions.

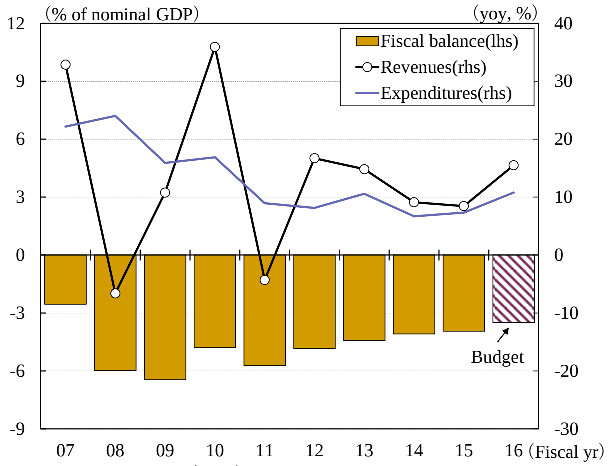
RBI is expected to make policy decisions while carefully monitoring the developments both of inflation and financial market. But it is more likely that RBI will be more cautious to the additional rate cut since it becomes more difficult to forecast the inflation trend as the amount of rainfall by monsoon will affect the food prices, and also it is the time to assess the impact of the past rate cuts.

Chart1：CPI and Policy Rate in India



Source: Central Statistics Office（India）, BTMU

Chart 2：Fiscal Balance of India



Source: Ministry of Finance（India）, BTMU

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