

Experts see inflation, CAD relief after Fed rate hikes

MPC will be guided more by domestic inflation-growth dynamics, they say

INDIVJAL DHASMANA
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India may get some relief on the retail price inflation and current account deficit (CAD) fronts in the current financial year following the Federal Reserve's move to hike its key benchmark interest rate by 75 basis points (bps) and expected further monetary tightening by the US central bank.

"If aggressive US Fed tightening brings down commodity prices, it may transmit to lowering domestic inflation within the MPC's (monetary policy committee's) comfort zone," ICRA chief economist Aditi Nayar said.

Retail inflation remained above the Reserve Bank of India's target of four per cent, plus or minus two per cent, for the sixth consecutive month in June, though it moderated to 7.01 per cent from 7.04 per cent in May.

Lower commodity prices should ease the pressure on the monthly trade deficit numbers, Nayar added.

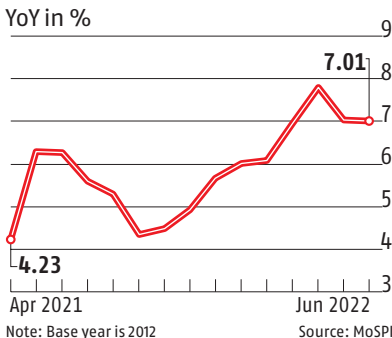
The country's trade deficit stood at an all-time high of \$26.18 billion in June, compared with \$24.29 billion the previous month. The deficit widened to \$70.8 billion in the first quarter of the current financial year, more than double the \$31.42 billion seen a year ago. This is likely to widen the CAD to at least three per cent of gross domestic product (GDP) in the current financial year, compared with 1.2 per cent a year ago.

Madan Sabnavis, chief economist of the Bank of Baroda, said indications are that this is not the last rate hike by the US Fed and, hence, one should be prepared for more aggressive moves.

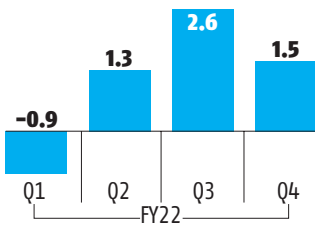
"This will mean that the reversal of FPI (foreign portfolio investors) flows will continue for the rest of the year too, putting pressure on the balance of payments," he said.

He added that as long as the rates are being increased it would mean that the Fed sees the US economy overheating. "Gradually, we can see growth slowing

RETAIL INFLATION



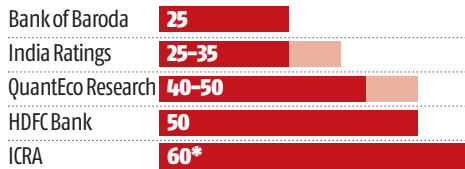
CAD AS % OF GDP



Minus means current account surplus
Source: RBI

VARIOUS PROJECTIONS OF MPC REPO RATE HIKE IN AUGUST

(in basis points)



* in next two policy meetings

Source: Respective entities

down, which will lower commodity prices. That can be beneficial for trade to an extent," Sabnavis said.

Sakshi Gupta, principal economist at HDFC Bank Treasury, said the US Fed delivered a "goldilocks" policy — being sufficiently hawkish but not too aggressive, reducing some fears of a deep recession in the US.

"This could help stabilise the rupee in the near term as both US yields and the dollar have softened in response to the policy announcement," she said.

RBL Bank chief economist Rajni Thakur said for India, both CAD and inflation are likely to have a follow through impact via currency volatility.

MPC

The MPC, which is scheduled to meet next week, is likely to be guided more by

the domestic inflation-growth dynamics than the US Fed's move, even though the measure has narrowed the interest rate differential between the US and India, the analysts said.

"In our view, the MPC is more likely to be guided by the outlook for domestic inflation-growth dynamics than the size of the US Fed's rate hike," Nayar said.

Gupta concurred. "Domestic inflation is likely to fall below seven per cent for July, providing some comfort to the RBI. (We) expect a 35-50 bps rate hike by RBI next week," she said.

Sabnavis does not expect the MPC to deliver any nasty shocks, given the current situation. "It will look at Fed moves but will be driven more by domestic inflation, which looks stable at seven per cent," he said.