

India to Cut Rates in 2009, No Increase This Year, Goldman Says

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India's central bank may cut benchmark interest rates in the first quarter of 2009 for the first time in more than five years as inflation and growth slow, according to Goldman Sachs Group Inc.

The Reserve Bank of India will leave the overnight lending rate unchanged at a seven-year high for the rest of 2008 as it shifts focus to reviving growth from curbing inflation, Tushar Poddar, a Mumbai-based economist at the U.S. securities firm, wrote in a research note today. Declining commodity prices will help cool India's inflation from near a 16-year high, he said. The central bank has raised the rate by 3 percentage points since October 2004.

"We think the interest-rate cycle has peaked," Poddar wrote. "With commodity prices coming off, demand slowing and expectations that inflation will fall, the case for raising rates has weakened."

India's benchmark 10-year bond yields, which reached a seven-year high of 9.55 percent in July, have fallen by more than a percentage point since then, suggesting investors are paring bets for rate increases. The five-year interest-rate swap rate has dropped almost 2 percentage points from a July peak of 10.46 percent.

The rate of inflation in Asia's third-largest economy tripled this year to 12.14 percent in the first week of this month. The rate touched 12.63 percent, the highest since 1992, in August.

Inflation to Slow

India's "inflation will fall significantly in early 2009," after remaining "in double digits through 2008," Poddar wrote, without giving a forecast.

The central bank predicted in July the nation's \$1.2- trillion economy to grow 8 percent this year, the slowest pace since 2004, revising downward its earlier forecast of as much as 8.5 percent.

India is also unlikely to add to this year's increases in the so-called cash-reserve ratio, the proportion of deposits banks must hold in reserves, because there's less spare cash in the financial system, according to Goldman.

The Reserve Bank raised the reserve ratio to an eight-year high of 9 percent in July to prevent excess money in the banking system from stoking inflation. Rising money-market rates and lenders' increasing dependence on borrowings from the central bank indicate cash at banks has declined.

The monetary authority started holding additional daily money auctions and eased norms for lending to banks last week to boost the availability of funds as capital flows to emerging markets shrank amid a global credit crunch.

Tight Liquidity

“Given the current global environment of tight liquidity and the central bank's move last week to ease liquidity conditions, any further cash-reserve ratio hike is firmly ruled out,” Poddar wrote.

Indian banks borrowed money from the central bank on every trading day in the past three weeks. The rate at which banks lend to each other overnight has averaged 10.1 percent this month, up from 8.8 percent in August, data compiled by Bloomberg show. It rose to 15.63 percent on Sept. 19, the highest since March 2007.

Overseas investors have sold Indian stocks worth a record \$8.8 billion this year, according to the capital markets regulator.

Source: Bloomberg