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For better or worse, India's central bank cuts rates to a 7-year low

Proponents forecast a growth boost as skeptics warn of runaway inflation

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Reserve Bank of India Gov. Urjit Patel © AP

NEW DELHI Amid persistently low inflation and widespread calls for growth-boosting measures, the Reserve Bank of India has cut its benchmark lending rate to a seven-year low of 6%.

Urjit Patel, the RBI governor, finally fell in with the 80% of market players who had been expecting a cut on Aug. 2. The possibility of inflation speeding up in the latter half of the year, however, remains a concern.

"This was the opportune time to cut 25 basis points," Patel told reporters on the same day. The consumer price index in June rose 1.54% -- the smallest increase since 2012 and well below the central bank's target of 4% inflation, plus or minus two percentage points.

The RBI stuck to its overall growth forecast of 7.3% for the year ending March 2018, up from 6.6% for the previous fiscal year.

This is the second repo rate cut announced by the six members of the monetary policy committee, or MPC, since its formation in October. The RBI largely maintained its policy rate over the past 10 months, disappointing the market and giving the impression that Patel, who succeeded Raghuram Rajan as governor in September, is hawkish.

The Aug. 2 decision was endorsed by four members of the MPC, while one member voted for a 50-basis-point cut and another wanted no change. In announcing its decision, the committee put the ball in the government's court, calling for urgent action to reinvigorate private investment, remove infrastructure bottlenecks and tackle widespread housing needs.

Some experts argue that while the rate cut may benefit the economy by stimulating demand, it is unlikely to spur investment.

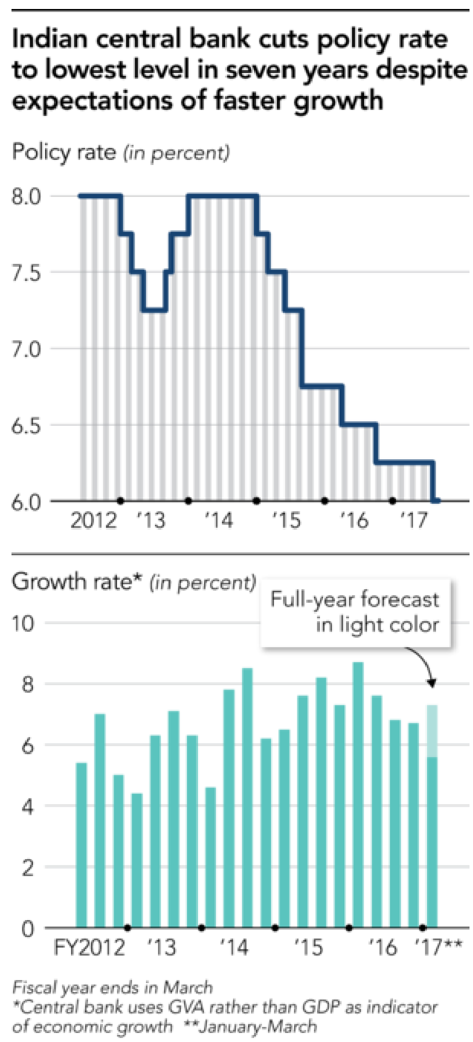
"This rate cut will provide some support to the demand for consumer durables," Devendra Kumar Pant, chief economist of India Ratings and Research, told the Nikkei Asian Review. Demand for home appliances such as refrigerators and televisions has been subdued since December. This is partly due to the government scrapping high-denomination bank notes last November, which slashed the amount of cash in circulation.

GDP growth in recent quarters had mostly been led by private consumption, as large amounts of overcapacity held down capital investment.

According to Hong Kong-based Gavekal Research, India offers some of the world's best growth potential, but investors are deterred by the cost of Indian assets, and this in turn has dampened economic momentum in recent quarters.

"Right now, investment is impeded by the big overhang of bad loans in the banking system and uncertainty over short-term demand," the company said.

This is fueling hopes that the rate cut will spur consumption further.



A ROSY TAKE As for the new goods and services tax, the central bank sounded optimistic about the biggest tax reform since India gained independence from Britain in 1947. On July 1, the GST replaced more than a dozen confusing levies with a unified nationwide system. The RBI said on Aug. 2 that the rollout of the GST "has been smooth" and predicted "growth-enhancing" effects.

Many businesses remain unconvinced of this as they struggle to adapt to the new tax regime. The size of the problem was evident in the Nikkei Manufacturing Purchasing Managers' Index for India, which on Aug. 1 recorded its lowest level since 2009. CARE Ratings said the rate cut may lead to higher inflation. Contributing factors will be increases in rent allowances, large farm loan waivers and global financial and political risks. Although CARE expects another round of rate cuts toward the end of this year, the MPC has hinted that this will not happen until the next financial year, which starts in April.