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No surprises (also see in Jpeg)

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No surprises

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The market seems to have factored in the rate cut.

D. R. Dogra

The latest rate cut by the RBI has been in line with the larger market expectations, but hopes of seeing a significant reduction in rates through the year have been watered down on account of the cautious statements made by the central bank.

It is not surprising that the markets have not quite reacted to the policy as the present reduction of 25 bps in policy rates has already been factored in — both stock and money.

Going by the outlook provided in the annual monetary policy for the current fiscal by the RBI, we could be looking forward to only a slow and limited recovery in the overall economy, that too on assumptions such as a normal monsoon for the country and a stabilisation in global economy, all of which come with a good degree of uncertainty. Overall, the pressures and risks to economic growth remain unabated.

Of particular concern is the outlook of subdued industrial activity, attributed in large part to inhibited investments by risk-averse borrowers and lenders. The need for investments, especially in the infrastructure space, needs no deliberation. Boosting investments is essential for reviving growth.

Herein, policy action would be key — in terms of bridging supply bottlenecks, attracting investments and fiscal consolidation.

BOND MARKETS

The latest RBI move is a positive for the bond markets. Markets could see a further drop in yields of government bonds.

One cannot be too sure about whether this would also translate into lower corporate yields and the level of activity in the corporate bond market.

There is also a high likelihood of an increase in foreign investments in the debt markets, following the Centre's recent reduction in the withholding tax rates, which could, in turn, boost liquidity in these markets, especially for corporate bonds.

The Government has also been easing regulations to stimulate inflows into the Indian bond markets. Going forward, these moves could aid in resource mobilisation and investments in the debt markets.

The RBI has reiterated that the scope for rate cuts remains limited. Thus any further cut, that too a moderate one, is likely only after inflation rate stabilises and is within the central bank's comfort levels.

The reaction of banks in terms of transmitting the same to lower lending rates will be critical here.

Going by the RBI's projections of a decline in headline inflation in this fiscal to an average of 5.5 per cent and its stated endeavour to bring down WPI to 5 per cent by March 2014, we are inclined to expect a 50 bps cut in interest rates by the RBI during the course of the year.

(The author is MD & CEO, CARE Ratings.)