

Key Market Theme

- **Aggressive loosening policy by RBI will stoke inflation in India in the next few years**
- **RBI may reverse accommodative stance by the end of this year**
- **Rupee likely to fall sharply by the end of this year**

Macro Analysis

With global easing hitting at every door step of central banks, India's loosening policy may stoke inflation in the next few years. The much-debated domestic GDP data show that growth slipped to a five-year low in Q1. This probably overstates the extent of the slowdown, but there are areas of weakness.

Export growth has slowed, and a sharp rebound seems unlikely given the softness of global demand. Investment growth has also weakened amid a rise in funding costs for India's non-bank financial companies following a large debt default last year. However, investment should recover a little as cuts to policy rates so far this year bring down funding costs.

Consumption should hold up reasonably well, underpinned by the introduction of a (partial) basic income scheme and subdued oil prices. In all, the acute weakness of Q1 is unlikely to persist, but a sharp rebound also seems doubtful. We are forecasting growth of 6.0% this year, from 7.4% in 2018.

The external position looks secure. In the near term, relatively subdued domestic demand will keep a lid on imports. Barring a surge in oil prices - which we don't expect- this should keep the current account deficit in check.

Headline inflation also remains comfortable and below the RBI's 4.0% target, due to low food and fuel inflation as well as weak underlying price pressures. But with food inflation now accelerating, the headline rate is set to rise back above target.

Nevertheless, policymakers are providing stimulus to support the economy. Despite aiming to consolidate fiscal policy this year, the finance ministry unveiled several expansionary measures in the union budget.

We think its budget deficit targets will eventually need relaxing. Meanwhile, the surprise resignation in June of one of the MPC's most hawkish members, and the adoption of an explicitly more dovish policy stance, suggests that further monetary loosening is likely.

Our concern is that policy is being loosened too aggressively. The repo rate is already at its lowest since 2010 and, despite the recent slowdown, firms are reporting that capacity remains tight. Hanging over all of this is the fear that the independence of the RBI is being eroded. We've made relatively sanguine assumptions but the risk is that inflation and interest rates will increase by more than we expect beyond the next 12 to 18 months.

This is a blot on an otherwise fairly upbeat long-run outlook. With larger mandate than first term received by present NDA government should lay the platform for continued gradual reform, and ensure that long-term growth in India remains above that of its emerging market peers against other "majors" in rest of 2019.

Year end forecasts

Categories	Latest	2019	2020	2021
GDP	5.80	6.00	6.80	7.00
Consumer Prices	3.18	3.20	4.00	4.50
Current Account	-2.40	-1.30	-2.00	-2.50
Repo Rate	5.75	5.50	5.75	6.00
USDINR	68.75	72.5	75.0	76.0

Economic Data

	IST	Previous	Median	SMC's Forecast
G7 Meetings	ALL DAY	-	-	-
GBP UK Retail Sales m/m	14:00	-0.50%	-0.30%	-0.30%
USD US Philly Fed Manufacturing Index	18:00	0.3	5.0	5.0

Pivots

Currency	Previous Close	S1	S2	S3	R1	R2	R3
USD/INR (JULY)	68.87	68.77	68.61	68.51	69.02	69.12	69.28
EUR/INR (JULY)	77.38	77.27	77.09	76.98	77.56	77.67	77.85
JPY/INR (JULY)	63.71	63.63	63.54	63.46	63.80	63.88	63.98
GBP/INR (JULY)	85.53	85.39	85.17	85.03	85.75	85.89	86.10

FX Cross INR	CMP	1W	1M
USDINR	68.75	0.46%	-1.11%
EURINR	77.27	0.31%	-1.57%
GBPINR	85.51	-0.24%	-3.15%
JPYINR	63.81	1.16%	-1.51%

Global Yields	10Y-Yield	1W(bps)	1M (bps)
India	6.35	-27.20	-61.20
US	2.05	0.95	-3.35
Germany	-0.29	7.38	-3.72
UK	0.76	2.22	-8.84

FX Majors	CMP	1W	1M
EURUSD	1.1237	-0.16%	-0.50%
GBPUSD	1.2437	-0.69%	-2.09%
USDJPY	107.74	-0.69%	0.41%

Flows	DTD	WTD	MTD
FII's (INR Crs)	-16.97	-1845.37	-4120.54

Note: 1W refers to 1 week change from CMP | 1M refers to 1 month change from CMP



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