

Policy rate unlikely to go much lower from hereon, says HDFC Bank's Abheek Barua

'RBI Governor has flagged some concerns on inflation, which are not necessarily linked to a good monsoon'

RADHIKA MERWIN

Given the risks to inflation, there could be just one more rate cut by the RBI, says Abheek Barua, Chief Economist at HDFC Bank. In a telephonic interaction with *Businessline*, Barua said that with the central bank's focus being more on achieving the long-term CPI inflation target of 4 per cent rather than the 5 per cent by March 2017, lowering rates could be a challenge. Excerpts:

Are we at the end of the rate-easing cycle now?

Based on Tuesday's policy statement, the possibility of rates going much lower from hereon is unlikely. RBI Governor Raghuram Rajan has clearly flagged some concerns on inflation, which are not necessarily linked to a good monsoon.

Services inflation, for instance, which has been sticky or moving up, is something that cannot be addressed in a matter of months.

He also spoke of global commodity prices, which may be at the beginning of an upcycle, and that is not going to go away in a hurry.

Given all these risks to inflation, I believe that there could be

just one more rate cut. Also, the focus is more on achieving the long-term CPI inflation target of 4 per cent rather than the 5 per cent by March 2017. So, lowering rates now appear to be a bit of a challenge.

Given all these risks to inflation, do you think the RBI needs to revise its inflation expectations?

I would think so. There are structural problems that cannot be addressed in a short span of time (where there are price pressures). It is perhaps prudent for the RBI to put less emphasis on these factors while setting the policy rate, because these are not going to go away. Otherwise, we might be stuck in a low growth track for some time to come.

There are segments such as education, healthcare, etc., where it doesn't matter if you keep rates high or low and there has to be a mechanism by which such factors are netted out while fixing the inflation target.

While others may argue that these categories are as much a critical part of the consumption basket and need to be accounted for, these are long-term issues that have been neglected for decades. Broad changes in a short period of time cannot be expected.

So, policy rate revisiting 4.75 per cent levels as seen in 2009 is difficult in the near future...

The argument to maintain posi-

tive real interest rates to keep the flow of savings going is a valid one. So, given an expected real interest rate of about 1.5 per cent, there isn't much headroom for the RBI to go below 6.25 per cent if inflation stays in the 4.75-5.25 per cent band.

Have the RBI's measures around liquidity — moving from deficit to neutral or lowering the rate corridor — helped in transmission of policy rates?

We have transitioned into a system where there is more liquidity than in the past. There is also some degree of automaticity in the way lending rates are set under MCLR (marginal cost of funds-based lending rate). While these measures have helped, the full transmission is yet to happen.

Since this is a new phenomenon, transmission will pick up pace going ahead.

HDFC Bank lowering its MCLR rates this week is a case in point. Other banks may follow soon. The important thing is that

We are now getting into a zone of high liquidity and banks lowering deposits rates, which will, in turn, facilitate quicker transmission.

ABHEEK BARUA
Chief Economist
at HDFC Bank

MCLR has taken discretion out of the pricing decision quite considerably. We are now getting into a zone of high liquidity and banks lowering deposits rates, which will, in turn, facilitate quicker transmission.

That said, in pricing loans banks will have to build in risk premium, and this has to be left to banks as it impacts their prof-

its. Given that the MCLR regime is new, there are some teething issues, which the RBI has indicated it would review.

In the coming months, we can see a lot of changes in the MCLR framework which can lead to a more effective transmission of policy rates.

While on the shorter end, rates are likely to move down, on account of these measures, on the longer end — 10-year government bond in particular — yields have been sticky. Why?

If you look at the yield curve, there has been softening of yields at the very long end such as the 15- or 30-year bonds or at the very short end — in bonds with tenure of up to five years.

But in the relevant segment, that is the 7-10-year bonds, yields have been sticky. Global uncertainties around the US Fed rate hike, Brexit referendum, and possible pull out of funds from emerging markets have kept these bond yields sticky.

On the domestic front, concerns on outflows at the time of FCNR (B) redemption and what the RBI would do to counter such volatility have been weighing on bond yields. Following assurance by the RBI on Tuesday, of maintaining rupee liquidity when the need arises, there is limited upward pressure on bond yields.

