

## ECOWRAP

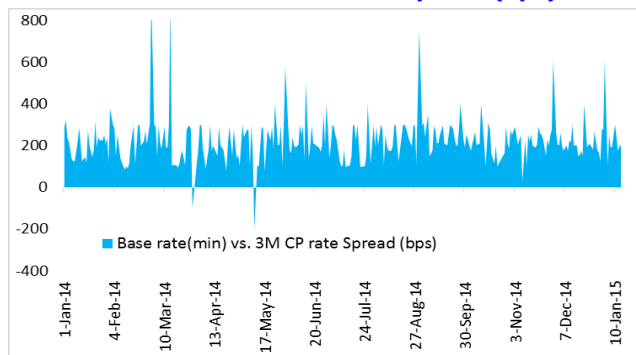
## Beginning of a rate easing cycle



The decision to cut repo rate by 25 basis points was a pleasant surprise to the market. While we can debate on the timing and magnitude of such a rate cut, it was perhaps long overdue. What might have prompted the apex bank to go for the cut is the entrenched disinflationary impetus. Interestingly, SBI Corporate Pricing Power Index is now at a 5 year low, while SBI Pass through Index is at a 5½ year low. With global commodity and oil prices continue to be benign, it is understood that the Pass Through Index could head even lower in the coming days. This will have a positive impact on SBI Corporate Pricing Power Index, and hence the entrenched disinflationary impetus should continue. This means that this could be just the beginning of a rate easing cycle. However, delivering a rate cut monetary policy cycle for the second time may be a tad difficult as this may introduce a uncertainty element in policy formulation. Thus, we believe the next rate cut could happen in Apr'15, and possibly a 50 basis point rate cut. However, we don't rule out completely another 25 basis point cut before the end of FY15. We see a prolonged pause thereafter and the next cut could happen in Q2FY16. Cumulatively, 75-100 basis points is envisaged in FY16. This particular cut may not translate into a lending rate cut for banks immediately, as the current spread between CP and minimum base rate of banks are hovering at 200 basis points, giving corporates the option of continued mobilisation through low cost CP, until and unless there is a material pick up in demand for bank credit. Additionally, the transmission mechanism is more a function of liquidity in the banking system, that is comfortable and adequate. We also expect the 10yr G-sec yield to move down to 7.3% over the next couple of months. The short term yields will move down even sharply and there is a likelihood of the short term and long term rates converging now.

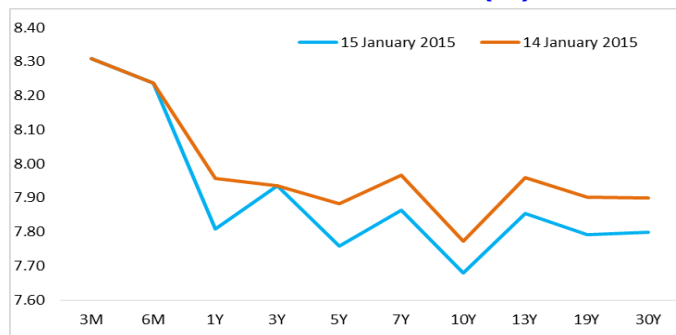
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Chart 1: Base rate-3M CP Spread (bps)



Source: SBI Research

Chart 2: India Yield Curve (%)



Source: SBI Research; 15 January 2015 data is as on 2pm

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