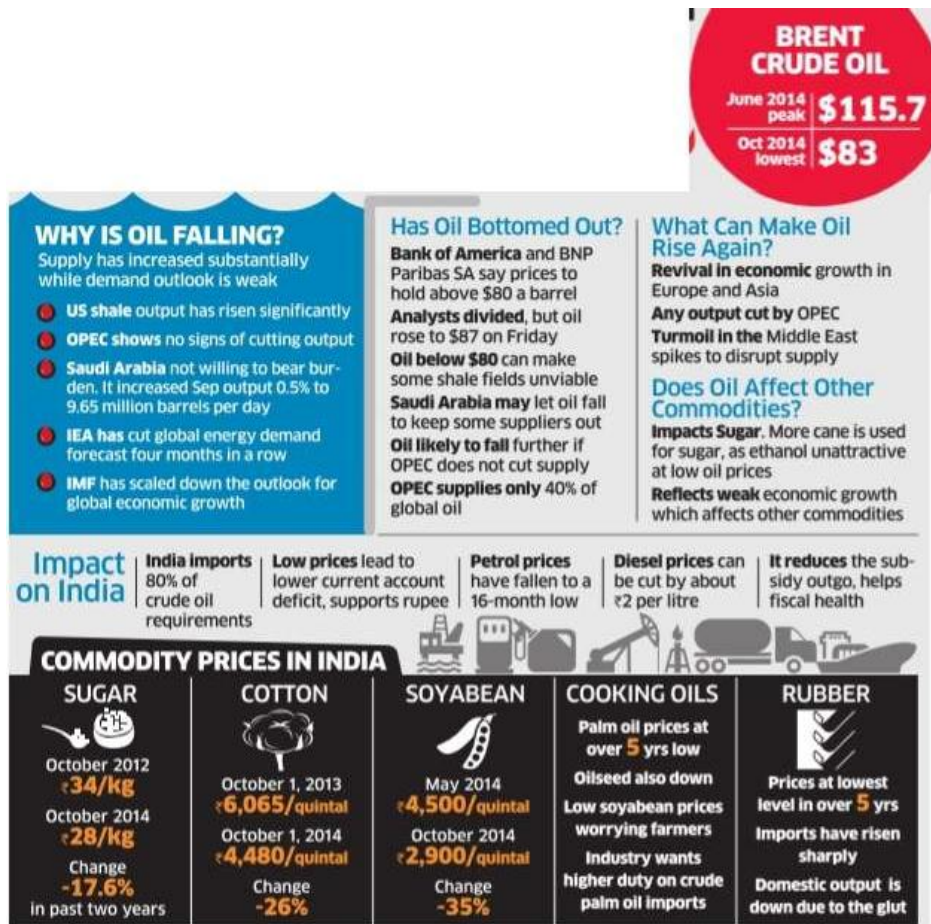


Achhe Din Globally Could Make it Easier for Modi Sarkar

Global commodities have tumbled in recent months, ending an extended bull run that had hurt India by widening the current account and fiscal deficits, besides raising subsidies and weakening the rupee. All this is now reversing. Petrol prices are at a 16-month low, cooking oil and rubber are at a five-year low. Sugar and cotton are also down. This augurs well for a lower rate of inflation...

Low Prices Won't Lead to Rate Cut

India Inc is seeking lower interest rates to boost demand, thanks to both consumer and wholesale price readings dropping to record lows in September due to lower commodity prices. But there's little sign that falling commodity rates are prompting firms to lower prices, who are choosing to cut output instead. So even as the pressure grows on RBI Governor Raghuram Rajan to cut rates, he is unlikely to budge at the next policy announcement on December 2, reports MC Govardhana Rangan.



At one of the customary premonetary policy meetings with industry, former Reserve Bank of India governor Duvvuri Subbarao wanted to know how many of those present would benefit from an interest rate cut.

Almost all hands went up. The next question was how many would pass on the lower cost to customers. Almost no one raised their hands. Subbarao kept interest rates unchanged.

The voice of industry, which is always seeking a cut in the cost of funds, is getting louder again, thanks to both consumer and wholesale price readings dropping to record lows in September.

It's natural that governor Raghuram Rajan, who has made it his mission to bring inflation as measured by the consumer price index permanently under 6%, will be under greater pressure to

cut rates. But will he budge at the next monetary policy announcement, scheduled to be made on December 2? It seems unlikely.

Easing price pressures may be a lot more sustainable than in the past given that most commodity prices are in the grip of a bear market. Crude oil is down nearly a fourth, while iron ore and coal have nearly halved from recent peaks.

Apart from bringing down inflation, this is boosting the profitability of companies. But the central bank believes companies are not doing enough to alleviate price pressure.

“Beyond a point, once the bottom line gets hit, the corporates also price their product in such a way that they prefer cutting down on their production rather than compromising on price,” RBI executive director Deepak Mohanty told analysts recently. “So that kind of oligopolistic behaviour also we have seen in the market.” Retail inflation dropped to a low of 6.46% in September, below the 8% target for January 2015, and closer to January 2016’s target of 6%. But the catch is that once the base effect fades, the measure is expected to rise again by early next year. In fact, the RBI model forecasts 7% retail inflation by March 2016, which may be revised lower if commodity prices keep falling.

“The case for an RBI cut is building up, but will be stronger not just when input prices are falling, but when that is passed on to customers through final product prices,” said Hitendra Dave, managing director and head of global markets for HSBC in India. “It is not that demand can be revived just with lower rates, but also with lower prices for final products.” Rate cuts could become a reality in March if fiscal numbers turn better and commodity prices keep sliding.

But predicting lower interest rates based on just the current inflation numbers is akin to forecasting the outcome of the footballing derby between Manchester United and Chelsea by looking at past data. Statistics may show that Manchester United would be the likely winner, but the problem with that is it doesn’t factor in the absence of Alex Ferguson and the presence of Jose Mourinho at Chelsea.

Similarly, Rajan is in charge at the RBI, and he’s shown himself to be resolute about pursuing the goal of permanently low inflation. Meanwhile, Arun Jaitley is finance minister, not P Chidambaram, who was keen to push for lower interest rates as a means of getting growth back up to speed.

Low readings for one or two months won’t be enough for Rajan to begin the long-awaited lowering cycle.

Commodity prices may turn quickly if the US postpones raising interest rates due to sputtering economic growth and threats to the financial markets.

So external risks remain.

“The medicine (higher rates) seems to be working,” the central bank governor has said, elaborating on the need for long-term remedies. “The problem is before the patient has run the

full course of the medicine, you want to take the patient off the medicine and say let's take a chance. That is always the danger in Indian policy. We have to have the discipline to stay the course." Companies are seeking lower interest rates to boost demand. But there's little sign that falling commodity rates are prompting them to lower product prices, choosing to cut output instead.

Mahindra & Mahindra Ltd. recently declared "no production days" for tractors at its Rudrapur and Jaipur plants "as part of aligning its production with sales requirements". Many other companies have taken similar action.

Industry may eventually have to pass on price cuts given that the RBI is only likely to change course when it sees a sustained downtrend.

The central bank is not just looking at 8% and 6% inflation at two points over the next 15 months, but ultimately wants 4% as recommended by the Urjit Patel panel.

