ET NOW Q&A

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A 50-bps+ Rate Cut Possible if Inflation is Under Control

In a chat with ET NOW, Sukumar Rajah, CIO-Equity, Franklin Templeton Asset Management India, says without looking at the fine print of the Budget, it is very difficult to feel 100% confident about the government's fiscal targets. Edited excerpts:

What is your initial assessment of the Budget?

There are no negative surprises. The market was afraid about some (long term) capital gains tax or some other form of tax being imposed. We did not see any of those negatives. They kept to the promise of the 3.5% deficit target.

Was that a surprise?

No. It looks like they were going to keep to that because it is important to get rates down and to get the rates down, the inflation has to be under control. There is a lot of thrust on rural India, which is key as it provides a feel-good factor without which it is very difficult for the consumption demand to improve. Also, we can spend more on irrigation and there can be some insulation from monsoon deficit. A greater spending on infrastructure is very good. The only grey area is we do not know the fine print. They have assumed certain increase in revenues, but we do not know where the excess revenue is coming from.

Do you think the revenue growth projection of 14% for FY17 is a bit ambitious?

The key is what is the nominal GDP growth going to be.

They are projecting 11%...

But if you look at last year, the nominal GDP growth was very similar to the real GDP growth. So, while the CPI inflation was 5% and the GDP deflator was near zero, we do not know what is going to be there. If the GDP deflator is going to be lower, then it is possible that even after achieving about 7% real GDP growth, they could undershoot on nominal GDP growth. If they undershoot on a nominal GDP growth, then the revenue growth for the corporate sector would be lower. So indirect taxes and direct taxes might be affected.

FURTHER RATE CUTS

Raghuram Rajan wants to see inflation come to much lower levels. If he sees that happening, there can be substantial rate cuts

So, you are questioning the government's commitment towards 3.5% fiscal deficit target...

All I am saying is we do not know the fine print. So, there is a risk that if the external conditions are not good, they can be short of some of the revenue targets. I am not saying that they would not achieve that but we have to see the fine print to understand what the risks are. Without looking at the fine print, it is very difficult to feel 100% confident.

What are you expecting in terms of rate cuts in addition to the 125 bps we have seen thus far?

It is a function of how soon the inflation comes under control. I think (RBI Governor Raghuram) Rajan has made it very clear that he is going to be data dependent. He wants to see inflation come to much lower levels. If he sees that happening, there can be substantial rate cuts.

GREY AREA IN BUDGET

I am not saying that they won't achieve that (fiscal deficit target) but we have to see the fine print to understand what the risks are

What is your expectation on the rate cycle when you are saying substantial rate cuts? More than 50 bps?

Yes, a more than 50 bps (rate cut) is a possibility if inflation comes under control very fast and Rajan has confidence that the government is going to stick to the fiscal deficit target.

If you are saying more than 50 bps, do you mean 75 bps or even 100 bps over the next 12 months?

It is not ruled out. I would not say it is a base case that we will have a 100 bps cut. If the global situation continues to be deflationary, commodity prices continue to be pretty low, the government sticks to the deficit targets and we do not see any big spike in food inflation, then it is a positive.