# RBI Policy Update

*April 04, 2019*

## An assessment of RBI's 1st Bi-monthly Monetary Policy Statement, FY 2019-20

**RBI's Policy Stance:**
In line with the market expectations, the MPC decided to cut the benchmark interest rate by 25 bps and continued to maintain its stance as "Neutral". This is the second successive rate cut announced by the MPC on back of increasing concerns over economic growth. **The MPC reiterated its commitment to achieve the medium-term target for headline inflation of 4% within a band of +/- 2% while supporting growth and decided to**:

- **reduce** the policy repo rate under the liquidity adjustment facility (LAF) by **25 basis points** from **6.25% to 6.00%** with immediate effect;
- maintain the monetary policy stance as **neutral**

| Variable | Stands at |
|---|---|
| **Repo** | 6.00% |
| **Reverse Repo** | 5.75% |
| **CRR** | 4.00% |
| **MSF** | 6.25% |
| **SLR** | 19.25% |

Source: www.rbi.org.in

**Policy Stance & Rationale:**

- The 1st bi-monthly policy meeting of FY20, chaired by the Reserve Bank of India governor Shaktikanta Das and members voted 4-2 to cut its benchmark interest rate for a second consecutive meeting, amidst rising concerns over economic growth. The committee voted 5-1 for keeping the stance at "neutral"

- The MPC reduced the policy repo rate under the liquidity adjustment facility (LAF) by 25bps to 6.0% Consequently, the reverse repo rate under the LAF stands adjusted to 5.75%, and the marginal standing facility (MSF) rate and the Bank Rate to 6.25%. The committee further decided to keep the stance to 'neutral'.

- The MPC noted that global economic activity has slowed down. In the US, the subdued performance in the final quarter of 2018 appears to have continued into Q1:2019. The Euro area slowed down in Q4:2018 on soft domestic demand and contracting manufacturing activity and the Italian economy contracted for two consecutive quarters in Q3 and Q4. Growth in UK slowed down on Brexit uncertainty, with industrial production contracting during September-January. There was a rebound in Japanese economy in Q4 on increased domestic consumption expenditure and recovering investment spending. The monetary policy stances of the US Fed and central banks in other major advanced economies (AEs) have turned dovish.

- Some of the major emerging market economies (EMEs) also experienced a slowdown. The Chinese economy decelerated in Q4:2018 on subdued domestic and global demand impacting industrial activity. On the domestic front, there has been a downward revision in GDP data to 7% from 7.2%, this marks deceleration in the economic activities due to a slowdown in public and private consumption. However, indicators suggest moderation in growth, primarily driven by the government's push on the sectors like road and housing further demand from net exports and a deceleration in imports due to a decline in crude oil prices. While the PMI continues to be in expansion zone, the numbers have come down from recent highs. While inflation has been soft on back of lower food prices, CPI ex-food and fuel remains over 5%.

- Retail inflation (CPI) increased to 2.6% in Feb'19 from 2.2% in Dec'18, primarily increase in prices of items excluding food and fuel. Inflation ticked up in all food sub-groups even egg except for vegetables, sugar, pulses and fruits. Inflation in the fuel and light sub-group shrunk by the lagged impact of the softening of international energy prices

- The MPC noted that there are some signs of domestic investment activity weakening as reflected in a slowdown in production and imports of capital goods. The moderation of growth in the global economy might impact India's exports. On the positive side, however, higher financial flows to the commercial sector augur well for economic activity. Private consumption, which has remained resilient, is also expected to get a fillip from public spending in rural areas and an increase in disposable incomes of households due to tax benefits. Business expectations continue to be optimistic. Taking into consideration the above factors, GDP growth for 2019-20 is projected at 7.2 %- in the range of 6.8-7.1 % in H1:2019-20 and 7.3-7.4 %in H2 - with risks evenly balanced.

**Outlook:**

- The MPC noted the global economic activity has slowed down and the monetary policy stance of key central banks in advanced economies (AE) have turned dovish. Crude oil prices though have risen on back of OPEC production cuts and disruption in supplies on back of US sanctions on oil exports from Venezuala. Financial markets continue to be driven by monetary stance of key central banks and crude oil prices. Inflation continues to remain in subdued in AE leading to softening of yields globally.

- Domestically also there has been downward revision in GDP data and high frequency indicators suggest moderation in the activity across various sections. While the PMI continues to be expansion zone, the numbers have come down from recent highs. While inflation has been soft on back of lower food prices, CPI ex-food and fuel remains over 5%.

- The MPC further reduced inflation forecast for FY2019-20 to 2.9-3% in H12019-20 (from 3.2-3.4%) and 3.5-3.8% in H2FY2019-20 (from 3.9%) indicating that CPI will continue to remain below 4% medium term target of the MPC.

- Growth projections were reduced marginally to 6.8-7.1% (H1FY2019-20) and 7.3-7.4% (H2FY2019-20). However, the MPC highlighted uncertainties on inflation trajectory due to possible reversal in food prices, uncertainty on crude prices (which is closer to USD70/bbl), sticky core inflation and developing fiscal situation. However the output gap remains negative, which gave the MPC room to cut rates to spur investment growth.

- US, El Niño conditions strengthened during February 2019, which may affect the prospects of a normal south west monsoon. While the rate cut was as per market expectations, the continuation of the "neutral" stance dented sentiments and market sold off with 10Y sovereign yield rising by 10bps from the lows. The lack of unanimity among members for rate cut (2 members voted for a pause) further weighed on the markets

- Going forward the demand in upcoming auctions is likely to determine the direction of rates, as the supply is heavy in 1HFY2020 with Rs.17000cr scehduled auction per week. Over medium term, the outcome of the elections will likely play key role in determining rate direction. In the short term we expect 10YG-Sec to trade between 7.20-7.40% range. We continue to favour short term corporate bonds over government bonds as (1) supply of government bonds is front loaded and hence long term rates may remain under pressure (2) RBI's effort to inject liquidity should favour short term bonds (3) uncertainty on election outcome will likely keep markets volatile