RBI reduces repo rate in Sixth Bi-monthly Monetary Policy Statement 2018-19

Policy repo rate reduced to 6.25% from 6.5% (25 basis points cut)

On the basis of an assessment of the current and evolving macroeconomic situation, the Monetary Policy Committee (MPC) decided to reduce the policy repo rate under the liquidity adjustment facility (LAF) by 25 basis points from 6.5% to 6.25% with immediate effect. Consequently, the reverse repo rate under the LAF stands adjusted to 6% and the marginal standing facility (MSF) rate and the Bank Rate to 6.5%. The MPC also decided to change the monetary policy stance from calibrated tightening to neutral. These decisions are in consonance with the objective of achieving the medium-term target for consumer price index (CPI) inflation of 4 per cent within a band of +/- 2 per cent, while supporting growth.

The RBI policy rates so far

Components	6th April 2017	07th June 2017	02nd August 2017	4th Oct 2017	6th Dec 2017	7th Feb 2018	05th April 2018	06th June 2018	01st Aug 2018	05th Oct 2018	5th Dec 2018	07th Feb 2019
CRR	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%
Repo Rate	6.25%	6.25%	6.00%	6.00%	6.00%	6.00%	6.00%	6.25%	6.50%	6.50%	6.50%	6.25%
Reverse Repo Rate	6.0%	6.0%	5.75%	5.75%	5.75%	5.75%	5.75%	6.0%	6.25%	6.25%	6.25%	6.0%
WPI Inflation	6.55% (Feb-17)	3.85% (Apr-	0.9% (Jun-	3.24% (Aug-	3.59% (Oct-	3.6% (Dec-	2.5% (Feb-	3.2% (Apr-	5.77% (Jun-18)	4.53% (Aug-	5.28% (Oct-	3.8% (Dec-18)

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CPI inflation\@	3.65% (Feb-17)	2.99% (Apr-17)	1.5% (Jun-17)	3.36% (Aug-17)	3.6% (Oct-17)	5.2% (Dec-17)	4.44% (Feb-18)	4.6% (Apr-18)	5.00% (Jun-18)	3.69% (Aug-18)	3.31% (Oct-18)	2.2% (Dec-18)
IIP growth	2.7% (Jan-17)	2.5% (Mar-17)	1.7% (May-17)	1.2% (July-17)	3.8% (Sep-17)	8.4% (Nov-17)	7.5% (Jan-18)	4.4% (Mar-18)	3.2% (May-18)	6.60% (Jul-18)	4.5% (Sep-18)	0.5% (Nov-18)
Real GDP growth	7.4%^&*	7.3% ^&**	7.3% ^&***	6.7% ^&^	6.7% ^&^^	6.6% ^&^*	7.4% (2018-19)$#	7.4% 2018-19)$##	7.4% 2018-19)$###	7.4% 2018-19 $####	7.4% 2018-19 $####^	7.4% 2019-20 $####^*

Source: PHD Research Bureau, compiled from various sources, Note:, , #Data for Gross domestic product for Q2 of 2014-15, ^Data for Oct 2014, ^^ Data for November 2014 , ^^^December 2014," Data for Jan 2015, "" Data for Feb 2015, *Data for Sep 2014, ** Data for Oct 2014 and *** Data for Nov 2014.@ Data for Dec 2014. Note: The Ministry of Statistics & Programme Implementation has released the new series of national accounts, revising the base year from 2004-05 to 2011-12. With this backdrop, real GDP growth for 2012-13 is estimated at 5.1% and 6.9% for 2013-14, $Advance estimates of national income 2014-15 MOSPI, @*** Data for August 2015 @#* Feb 2016 @#** January 2016 @^^^^Data for Sep 2015; RBI projection of GVA growth for 2015-16, \@CPI inflation for the respective month of the year. ^&* GVA growth for 2017-18 as per First Bi-monthly Monetary Policy Statement, 2017-18, ^&** GVA growth for 2017-18 as per Second Bi-monthly Monetary Policy Statement, 2017-18, ^&*** GVA growth for 2017-18 as per Third Bi-monthly Monetary Policy Statement, 2017-18. ^&^ GVA growth for 2017-18 as per Fourth Bi-monthly Monetary Policy Statement, 2017-18. ^&^^ GVA growth for 2017-18 as per Fifth Bi-monthly Monetary Policy Statement, 2017-18. ^&^* GVA growth for 2017-18 as per Sixth Bi-monthly Monetary Policy Statement, 2017-18. $# Projections by RBI in First Bi-monthly Monetary Policy Statement, 2018-19, $## Projections by RBI in Second Bi-monthly Monetary Policy Statement, 2018-19, $### Projections by RBI in Third Bi-monthly Monetary Policy Statement, 2018-19, $#### Projections by RBI in Fourth Bi-monthly Monetary Policy Statement, 2018-19, $####^ Projections by RBI in Fifth Bi-monthly Monetary Policy Statement, 2018-19, $####^* Projections by RBI in Sixth Bi-monthly Monetary Policy Statement, 2018-19

Snapshot of the Sixth Bi-monthly Monetary Policy Statement, 2018-19

Since the last MPC meeting in December 2018, there has been a slowdown in global economic activity. Among key advanced economies (AEs), economic activity in the US lost some steam in Q4:2018. The outlook for Q1:2019 is clouded by the partial government shutdown, though the labour market conditions remain strong. In the Euro area, economic activity lost momentum on weak industrial activity. The Japanese economy is gradually recovering and an accommodative monetary policy stance is expected to buttress domestic spending. Economic activity also slowed in some major emerging market economies (EMEs). In China, growth decelerated in Q4:2018.

Crude oil prices recovered from their December lows in early January on production cuts, but remain below their peak levels in October. Base metals, which witnessed selling pressures in December on persisting uncertainty over US-China trade frictions, recouped losses in January on expectations of thawing of trade disputes and production disruptions. Gold prices have risen, underpinned by safe haven demand in response to geo-political uncertainty and volatility in equity markets. Inflation edged lower in major AEs and many key EMEs.

Global financial markets began the year on a calmer note after a turbulent December. Among AEs, equity markets in the US recovered from a sharp sell-off in December, triggered by monetary policy tightening by the Fed, trade tensions and an impending shutdown. EM stock markets, which declined in December on a slew of soft economic data, registered some gains recently on expectations of accommodative monetary policy stances in major economies. Moving on to the domestic economy, on January 7, 2019 the Central Statistics Office (CSO) released the first advance estimates (FAE) for 2018-19, placing India’s real gross domestic product (GDP) growth at 7.2 per cent – the same level as in 2017-18 (first revised estimates). The FAE for 2018-19 featured an acceleration in gross fixed capital formation (GFCF) and a slowdown in consumption expenditure (both private and government). The drag from net exports is estimated to decline in 2018-19.

After exhibiting an uptick in the festive month of October, industrial activity, measured by the index of industrial production (IIP), slowed down in November. The year-on-year (y-o-y) growth in core industries decelerated to 2.6 per cent (y-o-y) in December, pulled down by a slowdown in the production of electricity and coal; and contraction in petroleum refinery products, crude oil and fertilisers output.

Relaxation of External Commercial Borrowing (ECB) framework for Resolution Applicants: RBI has proposed to relax the end-use restrictions under the approval route of the ECB framework for resolution applicants under the Corporate Insolvency Resolution Process (CIRP) and allow them to utilise the ECB proceeds for repayment of Rupee term loans of the target company.

Review of Instructions on Bulk Deposit: With a view to enhancing the operational freedom of banks in raising deposits, it is proposed to revise the definition of bulk deposits as single rupee deposits of Rs. 2 crore and above; and, that henceforth banks shall maintain their bulk deposit interest rate cards in the core banking system for supervisory review.

Risk Weights for rated exposures to Non-Banking Financial Companies (NBFCs): With a view to facilitating flow of credit to well-rated NBFCs, it has now been decided that rated exposures of banks to all NBFCs, excluding Core Investment Companies (CICs), would be risk-weighted as per the ratings assigned by the accredited rating agencies, in a manner similar to that for corporates. Exposures to CICs will continue to be risk-weighted at 100%.

Harmonisation of NBFC Categories: It has now been decided by RBI to harmonise major categories of NBFCs engaged in credit intermediation, viz., Asset Finance Companies (AFC), Loan Companies, and Investment Companies, into a single category. The proposed merger of existing categories would reduce to a large extent the complexities arising from multiple categories and also provide the NBFCs greater flexibility in their operations.

Task Force on Offshore Rupee Markets: In order to take forward the process of gradual opening up of the foreign exchange market and also to benefit from a wider range of participants and views, it is proposed to set up a Task Force on Offshore Rupee Markets. The Task Force will examine the issues relating to the offshore Rupee markets in depth and recommend appropriate policy measures that also factor in the requirement of ensuring the stability of the external value of the Rupee. Further details about the composition and terms of reference of the Task Force shall be issued separately by the end of February 2019.

Rationalisation of Interest Rate Derivative Directions: It is proposed to rationalise interest rate derivative regulations to achieve consistency and ease of access with the eventual objective of fostering a thriving environment for management of interest rate risk in the Indian economy.

Investment by Foreign Portfolio Investors (FPI) in Corporate Debt: As a part of the review of the FPI investment in Corporate Debt undertaken in April 2018, it was stipulated that no FPI shall have an exposure of more than 20% of its corporate bond portfolio to a single corporate (including exposure to entities related to the corporate). FPIs were given exemption from this requirement on their new investments till end-March 2019 to adjust their portfolios. While the provision was aimed at incentivizing FPIs to maintain a portfolio of assets, further market feedback indicates that FPIs have been constrained by this stipulation. In order to encourage a wider spectrum of investors to access the Indian corporate debt market, it is now proposed to withdraw this provision. A circular to this effect will be issued by mid-February, 2019.

Collateral-free Agriculture Loan –– Enhancement of Limit: Keeping in view the overall inflation and rise in agriculture input costs since then, it has been decided to raise the limit for collateral– free agriculture loans from Rs. 1 lakh to Rs. 1.6 lakh. This will enhance coverage of small and marginal farmers in the formal credit system. The circular to this effect will be issued shortly.

<u>Outlook</u>

In the fifth bi-monthly monetary policy resolution in December 2018, CPI inflation for 2018-19 was projected in the range of 2.7-3.2 per cent in H2:2018-19 and 3.8-4.2 per cent in H1:2019-20, with risks tilted to the upside. The actual inflation outcome at 2.6 per cent in Q3:2018-19 was marginally lower than the projection. There have been downward revisions in inflation projections during the course of the year, reflecting mainly the unprecedented soft inflation recorded across food sub-groups.

Several factors will shape the inflation path, going forward according to RBI. First, food inflation has continued to surprise on the downside with continuing deflation across several items and a significant moderation in inflation in cereals. Secondly, the moderation in the fuel group was larger than anticipated. Thirdly, while inflation excluding food and fuel remains elevated, the recent unusual pick-up in the prices of health and education could be a one-off phenomenon.

Fourthly, the crude oil price outlook remains broadly the same as in the December policy. Fifthly, the Reserve Bank's surveys show that inflation expectations of households as well as input and output price expectations of producers have moderated significantly. Finally, the effect of the HRA increase for central government employees has dissipated completely along expected lines. Taking into consideration these developments and assuming a normal monsoon in 2019, the path of CPI inflation is revised downwards to 2.8 per cent in Q4:2018-19, 3.2-3.4 per cent in H1:2019-20 and 3.9 per cent in Q3:2019-20, with risks broadly balanced around the central trajectory.

Turning to the growth outlook, GDP growth for 2018-19 in the December policy was projected at 7.4 per cent (7.2-7.3 per cent in H2) and at 7.5 per cent for H1:2019-20, with risks somewhat to the downside. The CSO has estimated GDP growth at 7.2 per cent for 2018-19. Looking beyond the current year, the growth outlook is likely to be influenced by the following factors. First, aggregate bank credit and overall financial flows to the commercial sector continue to be strong, but are yet to be broad-based. Secondly, in spite of soft crude oil prices and the lagged impact of the recent depreciation of the Indian rupee on net exports, slowing global demand could pose headwinds. In particular, trade tensions and associated uncertainties appear to be moderating global growth. Taking into consideration the above factors, GDP growth for 2019-20 is projected at 7.4 per cent – in the range of 7.2-7.4 per cent in H1, and 7.5 per cent in Q3 – with risks evenly balanced.

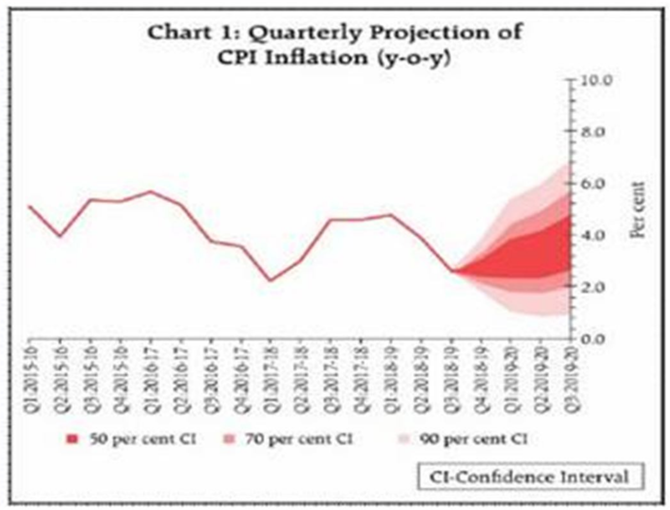

Chart 1: Quarterly Projection of CPI Inflation (y-o-y)

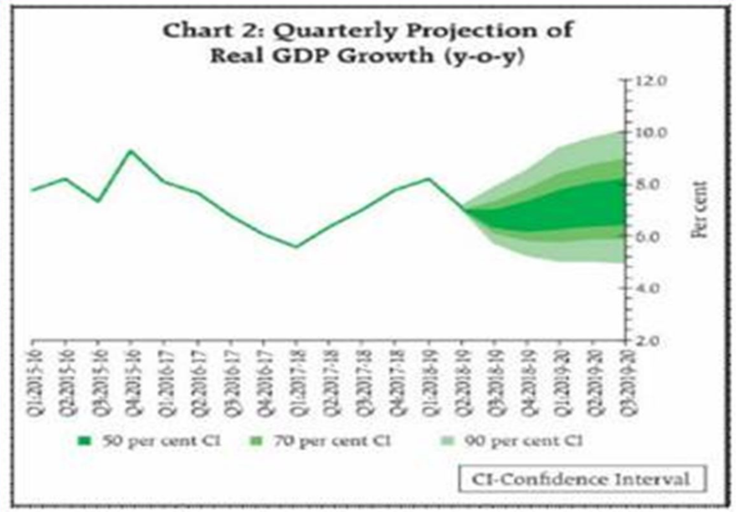

Chart 2: Quarterly Projection of Real GDP Growth (y-o-y)

Source: RBI

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Warm Regards,

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