Fifth Bi-monthly Monetary Policy Update, 2017-18

Outcome of the third bi-monthly monetary policy was in line with market expectation. Based on an assessment of current and evolving macroeconomic situations, the Monetary Policy Committee (MPC) cut the policy repo rate by 25bps. However, the decision of MPC is consistent with a neutral stance of monetary policy.

Key Outcome:

- The policy repo rate under the liquidity adjustment facility (LAF) remains unchanged at 6.0%
- Consequently, reverse repo rate under the liquidity adjustment facility (LAF) and marginal standing facility (MSF) remains unchanged at 5.75% and 6.25% respectively
- Cash Reserve Ratio (CRR) of schedules banks remains unchanged at 4% of net demand and time liability (NDTL)

Inflation Outlook:

RBI believes that there is an upside risk to inflation and increased its inflation projection marginally for the year. It now expects inflation to range between 4.3-4.7% in the third as well as fourth quarters of the current fiscal from the earlier projection of 4.2-4.6% in the second half of this fiscal year. However, the headline inflation outcomes have evolved broadly in line with projections. Going ahead, RBI expects momentum in inflation to be determined by the following key events:

a. Impact of house rent allowances (HRA) in coming months

b. International price movement in crude oil prices

c. Acceleration in fuel & food prices .

Further, RBI believes that implementation of farm loan waivers by select states, partial roll back of excise duty and VAT in the case of petroleum products, and decrease in revenue on account of reduction in GST rates for several goods and services may result in fiscal slippage. This would also have some implications on inflation. However, MPC remains committed to keeping headline inflation close to 4% on a durable basis.

Growth Outlook:

RBI has retained the projection of GVA growth for 2017-18 at 6.7%, with risks evenly balanced. However, it noted that second quarter growth was weaker than it had anticipated. Further, RBI believes that recent increase in oil prices may have a negative impact on margins of firms and on GVA growth. Moreover, shortfall in kharif production and Rabi sowing pose downside risks to growth. On the brighter side, RBI believes that there has been some pick up in credit growth. Recapitalization of public sector banks may help improve credit flows further. According to MPC assessment, capital raising from primary market has increased significantly after several years of sluggishness. As such capital will deploy to set up new projects, RBI believes that this would boost the growth potential of the economy over the medium term. Also, improvement in the ease of doing business ranking should help sustain foreign direct investment in the economy.

Conclusion

Outcome of the fifth bi-monthly monetary policy announcement of 2017-2018 is largely in line with market expectation with a neutral stance. The repo rate has been brought down from a high of 8% since the start of rate reduction cycle, which began in early 2015. With 200bps reduction in cost of domestic borrowings, RBI now expects that such reduction should be passed on to the end users by the banks in order to boost credit growth and thus propels the domestic economy. The minutes of MPC's meeting will be published by Dec 16, 2017. The next meeting of the MPC is scheduled on Feb 6 and 7, 2018.

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