# Second Bi-monthly Monetary Policy Update, 2019-20

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Outcome of the second bi-monthly monetary policy was largely in line with the market expectation. However, change in stance from neutral to accommodative policy was a pleasant surprise. We believe this move came after economic growth faltered to a 5-year low of 5.8% during Q4FY19 although inflation continued to remain softer. Based on an assessment of current and evolving macroeconomic situations, the Monetary Policy Committee (MPC) voted to cut key rate by 25bps with change in policy stance from neutral to accommodative.

### Key Outcome

- The policy repo rate under the liquidity adjustment facility (LAF) was reduced by 25bps to 5.75% from 6.00% with immediate effect.
- Consequently, the reverse repo rate under the liquidity adjustment facility (LAF) and marginal standing facility (MSF) was also reduced by 25bps to 5.50% and 6.00% respectively.
- Cash Reserve Ratio (CRR) of schedules banks remained unchanged at 4% of net demand and time liability (NDTL).

The MPC also decided to change the stance of monetary policy from neutral to accommodative. These decisions are in consonance with the objective of achieving the medium-term target for consumer price index (CPI) inflation of 4% within a band of +/- 2%, while supporting growth.

### Inflation Outlook

The May round of the RBI's survey of households reported a softening of inflation by 20 bps each for the three-month and twelve-month ahead horizon. Retail inflation, measured by y-o-y change in the CPI, remain unchanged in April, at its March level of 2.9%. However, CPI inflation excluding food and fuel fell sharply to 4.5% in April 2019, from 5.1% in March 2019, the largest monthly decline since April 2017. The moderation in April inflation was broad-based, with household goods and services and personal care whereas housing inflation was the lowest since June 2017. Further, actual CPI inflation outcomes for Q4FY19 were broadly in line with the April policy projection of 2.5%. With expectation of normal monsoon, RBI slightly revised H1FY20 CPI inflation to 3.0-3.1% from earlier projection of 2.9-3.0% whereas it lowered the H2FY20 CPI inflation to 3.4-3.7% from earlier projection of 3.5-3.8%, with risks broadly balanced. However, beyond the near term, RBI believes that several uncertainties cloud the inflation outlook, which includes the following:

- Probability of El Nino's impact on 2019 monsoon.
- Volatile crude oil prices
- Unseasonal spikes in vegetables prices
- Volatile financial markets and trade uncertainty.
- Geo-political tensions
- Uncertain fiscal situation at the domestic level

Nevertheless, RBI believes that recent slowdown in the domestic economic activity may have a bearing on the inflation outlook. Moreover, MPC reiterates its commitment to achieve the medium-term target for headline inflation of 4% on a durable basis.

### Growth Outlook

The MPC notes Q4FY19 GDP growth data indicate that domestic investment activity has weakened and overall demand has been weighed down partly by slowing exports. A sharp slowdown in investment activity along with a continuing moderation in private consumption growth is a matter of concern. Further, private consumption, especially in rural areas, has weakened in recent months. However, on positive side, political stability, improving capacity utilization to 77% in Q4FY19 from 75.9% in Q3FY19, the uptick in business expectations, buoyant stock market conditions and higher financial flows to the commercial sector augur well for investment activity. On the global side, weak global demand due to escalation in trade war may impact India's exports and investment activity. Financial markets have been driven by uncertainties surrounding the US-China trade negotiations and Brexit. However, recent demand slowdown in the domestic economy along with lack of private investment is compelling the RBI to further lower its FY20 GDP forecast projection from 7% from earlier projection of 7.2%. Moreover, the RBI expects GDP growth of 6.4-6.7% in H1FY20 from earlier projection of 6.8-7.1% and 7.2-7.5% in H2FY20 from earlier projection of 7.3-7.4%, with risks evenly balanced.

### Conclusion

The MPC's decision to cut key rates comes against the backdrop of benign headline inflation and subdued economic growth. Moreover, consecutive three interest rate cut would act as key kicker to drive economy with cheap money. Further, RBI notes that transmission of the cumulative reduction of 50 bps in the policy repo rate in February and April 2019 was 21 bps to the weighted average lending rate (WALR) on fresh rupee loans. With stability in centre, benign inflation scenario along with hope of normal monsoon in 2019 & change in policy stance, we believe market has entered into a rate cut cycle leaving behind rate hike scenario at least on medium-term basis. This would augur well for sectors such as financial services, real estate, auto, infrastructure, and consumer durables. RBI will push banks to further transmit rates into the system to spur consumption economy. The Reserve Bank of India (RBI) has set the minimum leverage ratio at 3.5% for all Indian banks and 4% for systemically-important banks, to maintain financial stability in the country. However, no measures were taken by RBI to revive NBFC sector from liquidity crisis. The minutes of MPC's meeting will be published by June 20, 2019. The next meeting of the MPC is scheduled for August 5 to 7, 2019.

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