

Fourth Bi-monthly Monetary Policy Update, 2019-20

October, 2019

Outcome of the fourth 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) voted to cut key rate by 25bps and maintained the accommodative stance, allowing it to adjust rates in both the directions, if needed. This move came after witnessing a slowdown in economic growth over a last few quarters along with a benign inflation scenario.

Key Outcome

- The policy repo rate under the liquidity adjustment facility (LAF) was reduced by 25bps to 5.15% from 5.40% with immediate effect.
- Consequently, the reverse repo rate under the liquidity adjustment facility (LAF) revised to 4.90%.
- Marginal standing facility (MSF) rate and the Bank rate reduced to 5.40%.

The MPC decided to maintain the accommodative monetary policy stance as long as it is necessary to revive growth, ensuring inflation remains within the target. These decisions are in consonance with the objective of achieving the medium-term target for CPI inflation of 4% within a band of +/- 2%, while supporting growth.

Economic Outlook

- GDP slumped for the fifth consecutive quarter to 5% in Q1FY20. Private final consumption expenditure (PFCE) was at 18 quarter low whereas gross fixed capital formation remained muted in line with previous quarter.
- Gross Value Added (GVA) declined to 4.9% in Q1FY20 due to lower manufacturing growth of 0.6%. By September end, rainfall surpassed the long period average (LPA) by 10%, which led to 121% growth in live storage of water in major reservoirs compared to average level over the last ten years. Rabi season seems brightened increasing rural domestic demand. Kharif production is estimated to close at last year's level.
- Capacity utilisation (CU) in the manufacturing sector, measured by the OBICUS (order books, inventory and capacity utilisation survey) of the Reserve Bank, declined to 73.6% in Q1FY20 from 76.1% in Q4FY19.
- CPI was in a narrow range of 3.1%- 3.2% between June and August. While food inflation picked up, fuel prices moved into deflation due to volatility in global crude prices and sharp decline in international price of LPG. Inflation excluding food and fuel softened in August.
- RBI's consumer confidence survey shows weak consumer sentiment and tepid consumption demand, especially relating to non-essential items. Manufacturing firms see weakening of demand conditions in Q2-Q3FY20 and expect their output prices to be soft as the cost of finance and salary outgoes remain muted.
- Liquidity remained surplus in August-September 2019 despite expansion of currency in circulation and FOREX operations by the RBI draining liquidity from the system. Net daily average absorption under the LAF amounted to Rs.1,40,497Cr in August and Rs.1,22,392Cr in September. The weighted average call rate (WACR) traded below the policy repo rate (on an average) by 8bps in August and by 6 bps in September, reflecting easy liquidity conditions in economy.
- India's foreign exchange reserves were at US\$ 434.6bn on October 1, 2019, up by \$21.7bn over end March 2019

Key Projections

- ❖ Q2FY20 GDP growth to be 5.3%, H2FY20 GDP would be in range of 6.6% - 7.2%
- ❖ FY20 GDP forecast cut to 6.1% from 6.9%
- ❖ Q1FY21 GDP projected at 7.2%
- ❖ Q2FY20 CPI projected at 3.4%
- ❖ H2FY20 CPI projected at 3.5-3.7%
- ❖ Q1FY21 CPI projected at 3.6%

Conclusion

The MPC's decision to cut key rates comes against the backdrop of benign headline inflation and subdued economic growth. Domestic economic activities remain weak as private consumption remains sluggish backed by global slowdown, trade tensions, and volatility in crude prices. However, lowering interest rate would act as key growth driver to lift the economy with the help of higher consumption. We believe domestic companies will benefit from the falling interest rate scenario. This would augur well for sectors such as financial services, real estate, auto, infrastructure, FMCG, and consumer durables. The minutes of MPC's meeting will be published by October 18, 2019. The next meeting of the MPC is scheduled for December 3, 4, and 5, 2019.

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