Third Bi-monthly Monetary Policy Update, 2019-20

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Outcome of the third bi-monthly monetary policy was in line with market expectation. This move came after witnessing a slowdown in economic growth over a last few quarters along with a benign inflation scenario. Based on an assessment of current and evolving macroeconomic situations, the Monetary Policy Committee (MPC) voted to cut key rate by 35bps and maintained the accommodative stance, allowing it to adjust rates in both the directions, if needed.

Key Outcome

- The policy repo rate under the liquidity adjustment facility (LAF) was reduced by 35bps to 5.40% from 5.75% with immediate effect.
- Consequently, the reverse repo rate under the liquidity adjustment facility (LAF) revised to 5.15%.
- Marginal standing facility (MSF) rate and the Bank rate reduced to 5.65%.

The MPC decided to maintain the accommodative monetary policy stance. 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.

Economic Outlook

- Retail inflation, measured by y-o-y change in the CPI, rose to 3.2% in June from 3% in Q1FY20 mostly due to food inflation. CPI inflation for food rose to 2.4% in June from 2% in May. However CPI inflation excluding food and fuel was 4.1% in June, same as in May. Housing inflation remained unchanged over the last three months. RBI moderated CPI by 20 bps for the one year ahead horizon, although inflation expectations of households remained unchanged in July 2019.
- The manufacturing PMI rose to 52.5 in July from 52.1 in June with a pickup in new orders inflow. Capacity utilisation measured by the order books, inventory and capacity utilisation survey (OBICUS) of the RBI rose marginally to 76.1% in Q4FY19 from 75.9% in Q3FY19. The services PMI expanded to 53.8 in July from 49.6 in June with increase in new business activity, new export orders and employment.
- Liquidity was in large surplus during June-July 2019 due to factors like return of currency to the banking system, open market operation purchase auctions and RBI's foreign exchange market operations. Banks reduced their WALR (weighted average lending rates) on fresh rupee loans by 29 bps during February-June 2019. It is expected that banks will further pass on the rate cut benefits to lenders.

Key Projections

- ❖ H1FY20 GDP growth seen at 5.8%-6.6%, for H2FY20 it is seen at 7.3%-7.5%
- ❖ FY20 GDP forecast cut to 6.9% from 7%
- ❖ Q1FY21 CPI projected at 3.6%
- ❖ Q2FY20 CPI projected at 3.1%
- ❖ H2FY20 CPI projected at 3.5-3.7%.

Monetary policy easing to support economic activities going forward

- ❖ Measures taken to enhance credit flow to NBFCs
- ❖ Banks' exposure to each NBFC raised to 20% of bank Tier-I capital from 15%
- ❖ Risk weight for consumer credit including personal loans but excluding credit card receivables reduced to 100% from 125%
- ❖ Lending to NBFCs for agriculture loan borrowers up to Rs 10 lakh classified as priority sector lending (PSL)
- ❖ Lending to MSMEs for agri loan borrowers up to Rs 20 lakh classified as PSL
- ❖ Lending to housing for agri loan borrowers up to Rs 20 lakh classified as PSL
- ❖ RBI will set up central payment fraud registry for tracking payment system frauds
- ❖ National Electronic Funds Transfer (NEFT) services to be active 24x7 from December from the current timings of 8.00 am to 7.00 pm on all working days (including 1st, 3rd and 5th Saturdays in a month).

Conclusion

The MPC's decision to cut key rates comes against the backdrop of benign headline inflation and subdued economic growth. Domestic economic activities remains 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. With assumption of good monsoon in 2019, RBI believes that these would keep inflation under expected range, providing more room for a future rate cut. We believe domestic facing companies will benefit from the falling interest rate scenario. This would augur well for sectors such as financial services, real estate, auto, infrastructure, and consumer durables. The minutes of MPC's meeting will be published by around August 21, 2019. The next meeting of the MPC is scheduled for October 1, 3 and 4, 2019.

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