

Sixth Bi-monthly Monetary Policy Update, 2019-20

February, 2020

Outcome of the sixth bi-monthly monetary policy was in line with market expectation. The Monetary Policy Committee (MPC) decided to keep the policy repo rate unchanged at 5.15% extending a pause in its rate-easing cycle. The MPC continue to recognize that there is room for further rate cut as the committee to continue with 'accommodative' stance as long as it is necessary to revive growth, while ensuring that inflation remains within target.

Key Outcome

- The policy repo rate under the liquidity adjustment facility (LAF) was unchanged at 5.15%.
- Consequently, the reverse repo rate under the LAF remains unchanged at 4.90%, and the marginal standing facility (MSF) rate and the Bank Rate at 5.40%.

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.

Inflation Outlook

Retail inflation, measured by year-on-year changes in the CPI, surged from 4.6 per cent in October to 5.5 per cent in November and further to 7.4 per cent in December 2019, the highest reading since July 2014. While food group inflation rose to double digits, the fuel group moved out of deflation. Inflation in CPI excluding food and fuel continued to edge up from its October trough. CPI food inflation increased from 6.9 per cent in October to 12.2 per cent in December, primarily caused by a spike in onion prices due to unseasonal rains in October-November. **Excluding onions, food inflation would have been lower by 4.7 percentage points and headline inflation by 2.1 percentage points in December.** The January round of the RBI's survey of households reported an eased in inflation expectations by 60 bps for the three-month ahead horizon and 70 basis points over the 1-year ahead horizon.

The projection for headline CPI has been revised upwards to 6.5 per cent for Q4:2019-20; 5.4-5.0 per cent for H1:2020-21; and 3.2 per cent for Q3:2020-21.

Growth Outlook

- April-September 2020 GDP growth seen in the range of 5.5-6 percent; October-December growth seen at 6.2 percent.
- FY21 GDP growth seen at 6%.

Key Announcements

RBI provides incentive to spur credit flow for auto, residential housing, MSME loans:

- Banks will not need to set aside CRR against incremental lending to these segments
- Restructuring scheme for MSME loans extended by a year
- Bank loans to MSMEs will have to be linked to an external benchmark starting April 1
- No asset classification downgrade for one year for certain delayed commercial real estate project
- The daily rate repo and four 14-day term repos every fortnight being conducted, at present, are being withdrawn.

Conclusion

India's Monetary Policy Committee decided to keep interest rates unchanged, extending a pause in its monetary easing cycle. The committee reiterated that its monetary policy stance remains 'accommodative' for as long as it is necessary to revive growth, but decided to maintain a status quo on policy rates amid elevated inflation. Moreover, RBI announced some key incentives to spur credit flow for auto, residential housing, MSME loans. We believe the accommodative stance of the policy along with multiple supportive measures for MSMEs, NBFCs and banks are stepping in the right direction which will help ease credit flow, help banks manage stress and soften loan pricing. We believe this would benefit banks, housing finance companies and real estate companies, going ahead. The minutes of MPC's meeting will be published by February 20, 2020. The next meeting of the MPC is scheduled during March 31st to April 3rd, 2020.

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Asit C. Mehta INVESTMENT INTERMEDIATES LTD.

Retail Research Desk:

Akhil Rathi D: 91 22 2858 3210
 Hrishikesh Yedve D: 91 22 2858 3207
 Neeraj Sharma D: 91 22 2858 3208
 Rohan Gawale D: 91 22 2858 3213
 Karan Desai D: 91 22 2858 3221
 Email: retailresearch@acm.co.in

Research Analyst Registration Number:
 INH000002483

CIN: U65990MH1993PLC075388

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