

Third 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) was reduced by 25bps from 6.25% to 6.00% with immediate effect
- Consequently, reverse repo rate under the liquidity adjustment facility (LAF) and marginal standing facility (MSF) was adjusted to 5.75% and 6.25% respectively
- Cash Reserve Ratio (CRR) of schedules banks remained unchanged at 4% of net demand and time liability (NDTL).

Inflation Outlook:

RBI believes that the inflation trajectory in the baseline projection is expected to rise from the current low. Thus, the MPC decided to keep the policy stance neutral while watching incoming data closely. However, going ahead, as base effects fade, the RBI expects momentum in inflation to be determined by the following key events

- a. Implementation of house rent allowances (HRA) under the 7th Pay Commission
- b. Impact of price revisions ahead of the GST
- c. Disentangling of the structural and transitory factors shaping food inflation .

Further, implementation of farm loan waivers may result in possible fiscal slippages, which may hamper quality of public spending, resulting in inflation spillovers. The RBI believes that headline inflation could rise by an additional 100bps above the baseline over 18-24 months, if states choose to implement salary and allowances hike like the centre in the current fiscal year.

Growth Outlook:

RBI has retained the projection of real GVA growth for 2017-18 at 7.3%, with risks evenly balanced. On the local front, RBI believes that normal and well distributed south west monsoon for the second consecutive year has brightened the prospects of agriculture and allied activities along with rural demand. Moreover, smooth roll-out of GST implementation has further supported MPC members to reduce the policy repo rate by 25 bps. On the state of the economy, MPC believes that there is an urgent need to reinvigorate private investment to remove infrastructure bottlenecks and provide major thrust to Pradhan Mantri Awas Yojana. Moreover, the government and the RBI are working in close coordination to resolve large stressed corporate borrowers.

Further, attempts are being made to recapitalize public sector banks within the fiscal deficit target. The RBI believes that this effort should restart credit flows to the productive sectors as demand revives.

Conclusion

Outcome of the third bi-monthly monetary policy announcement of 2017-2018 is largely in line with market expectation with a neutral stance. However, repo rate cut by 25bps would propel economic growth in the coming years. We believe lower interest rate scenario would boost credit growth in the coming quarters, which would help revive the demand growth scenario. Further, rate sensitive sectors such as auto, real estate, and infrastructure along with high-leverage companies would benefit from the lower interest rate scenario. The minutes of MPC's meeting will be published by Aug 16, 2017. The next meeting of the MPC is scheduled on Oct 3 and 4, 2017.

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