First Bi-Monthly Monetary Policy Update, 2017-18

Key policy rate was kept unchanged by Dr. Urjit Patel and the Monetary Policy Committee (MPC). The first policy announcement of the new fiscal had no surprises. However, Headline CPI inflation is set to undershoot the target of 5% for Q4 of 2016-17.

Key points:

Policy repo rate under the liquidity adjustment facility (LAF) remained unchanged at 6.25%. However, reverse repo rate under the LAF was increased by 25bps to 6.0%.

Marginal standing facility (MSF) was cut by 25bps to 6.5%. The cash reserve ratio (CRR) remained unchanged at 4%.

Inflation Outlook

RBI projects inflation to average 4.5% during the first half and 5% during the second half of 2017-2018. Moreover, CPI Inflation is set to undershoot the target of 5% for Q4 of 2016-17 in view of the sub-4% readings for January and February. However, there are upside risks to the baseline inflation projection. This is largely due to rising probability of El-Nino event from July-August and implementation of allowances recommended under the 7th CPC. Further, increasing house rent allowances may push up the baseline trajectory by almost 100-150bps over the next 12-18 months. Moreover, upside risks could arise due to the one-off effect of GST. On the downside, recent easing of international crude prices and their pass through to local prices of petroleum products would reduce pressure on headline inflation. Further, stepped-up procurement operations in the wake of the record production of food grains would rebuild buffer stocks and mitigate food price stress, if it materializes properly.

Growth Outlook

GVA growth is projected to strengthen to 7.4% in 2017-18 from 6.7% in 2016-17, with risks evenly balanced. RBI believes several favorable local factors are expected to drive this acceleration, these include:

- Pace of re-monetization.
- Pro-growth Budget for 2017-2018 to stimulate local economy through capital expenditure, rural demand, social, and physical infrastructure.
- Transmission of policy rate reduction by banks to boost investment and consumption demand.
- Implementation of GST and Insolvency & Bankruptcy Code coupled with the abolition of FIPB would boost investor confidence.
- Upsurge in the IPO market augurs well for investment and growth.

Conclusion

The first bi-monthly monetary policy announcements of 2017-2018 is largely in line with market expectation. However, RBI proposed to allow banks to invest in real estate investment trusts (REITS) and infrastructure investment trust (InvITs) within the umbrella limit (20% of their net owned funds). However, detailed guidelines will be issued in May 2017. Currently, banks can invest in equity-linked mutual funds, venture capital funds(VCF), and equities to the extent of 20% of their net owned funds. We believe this is a long term positive for real estate and infrastructure sectors. Further, Minutes of the MPC's meeting are going to be published by Apr 20, 2017. The next meeting of the MPC is scheduled on Jun 5 and 6, 2017.

Note: This report is only for informative purpose and does not involve any recommendation on any stock mentioned in this report for investment in short term or long term.

Retail Research Desk:

Akhil Rathi	D: 91 22 2858 3210
Hrishikesh Yedve	D: 91 22 2858 3207
Vrinda Aditya	D: 91 22 2858 3209
Neeraj Sharma	D: 91 22 2858 3208
Rohan Gawale	D: 91 22 2858 3213
Dhiral Shah	D: 91 22 2858 3211

Email: retailresearch@acm.co.in

Research Analyst Registration Number: INH000002483

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