First Bi-monthly Monetary Policy Update, 2018-19

April, 2018

Outcome of the first bi-monthly monetary policy was more dovish. This came after witnessing a gradual recovery in economy and easing inflation. However, the outcome was in line with market expectation. Based on an assessment of current and evolving macroeconomic situations, the Monetary Policy Committee (MPC) voted to keep key interest rates unchanged, but maintained a neutral stance, allowing it to adjust rates in both the directions, if needed.

Key Outcome:

- The policy repo rate under the liquidity adjustment facility (LAF) remains unchanged at 6.0%
- Consequently, the reverse repo rate under the liquidity adjustment facility (LAF) and marginal standing facility (MSF) remain unchanged at 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 sharp moderation in food prices has resulted in lower inflation outcome in first two months of 2018. Thus, it is fair to lower inflation projection for Q4FY18 from earlier 5.1% to now 4.5%. For 2018-19, the MPC has also reduced its inflation forecast. It now expects CPI inflation in the first half of the year at 4.7-5.1% from earlier projection of 5.1-5.6% and maintains inflation target for second half of the year at 4.4%. However, excluding the impact of HRA revisions, CPI inflation is projected at 4.4-4.7% for H1FY19 and 4.4% in H2FY19. Moreover, MPC notes that there are several uncertainties surrounding the baseline inflation, which include:

a. Revised formula for MSP as announced in recent budget
b. Staggered impact of HRA
c. Any further fiscal slippage
d. Uncertain monsoon scenario
e. Volatile crude prices

However, MPC reiterates its commitment to achieve the medium-term target for headline inflation of 4% on a durable basis.

Growth Outlook

The MPC notes that economic growth has been recovering and the output gap is closing. This is also reflected in pick up in credit off-take in recent months. RBI believes that there are clear sign of revival in investment activity followed by improvement in global demand. Further, this should encourage exports and boost fresh investments. RBI believes that all this is expected to accelerate the pace of economic activity in 2018-19. On the whole, real GDP growth is expected to strengthen to 7.4% in FY19 from 6.6% growth expected during FY18. Further, they expect GDP growth of 7.3-7.4% in H1FY19 and 7.3-7.6% in H2FY19, with risks evenly balanced. RBI believes that aggregate demand is expected to improve and this would be led by GST support, recapitalisation of banks, and resolution of distressed assets. Also, pick-up in global trade could help reduce the negative drag from exports.

Conclusion

Outcome of the first bi-monthly monetary policy announcement of 2018-2019 is a status quo but with a positive commentary on inflation and growth. The MPC notes that economy is on a recovery path, including early signs of a revival of investment activity. With expectation of normal monsoon in 2018, RBI believes that these would keep inflation under expected range. We believe RBI's move clearly indicates that the economy is finely balanced between rising GDP growth and control inflation rate. Going ahead, we believe domestic economy will continue to enjoy a lower interest rate scenario for next few quarters. Thus, this would be a positive for the economy facing sectors such as banks, auto, real estate, and infrastructure. Further, RBI defers implementation of Ind-AS for schedule commercial banks by one year, now from April 2019. The minutes of MPC's meeting will be published by April 19, 2018. The next meeting of the MPC is scheduled on June 5 and 6, 2018.

Asit C. Mehta
INVESTMENT INTERRMEDIATES LTD.

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

CIN: U65990MH1993PLC075388

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