Monetary Policy Review-April 2019

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The Reserve Bank of India, on expected lines, reduced the repo rate by 25 bps from 6.25% to 6% in its monetary policy meeting. This is the second such rate cut by the Central Bank in 2019. The RBI, however, continued maintaining the neutral stance.

This is in accordance with the CARE Ratings' forecast of no change in stance and 25 bps cut in interest rates.

The major criterion driving the decision appears to be held in the timing of this policy. This was the most opportune time for a rate cut given that inflation is well within the RBI's target and there was a need to stimulate the economic growth.

RBI has maintained its neutral stance to await future clarity on data to assert the decision on rate cuts in the coming months.

The RBI has indicated that it would remain watchful of the evolving inflationary trajectory which although currently has been along the targeted paths faces upward pressure owing to

- Uncertainties regarding the Sustainability of softening of inflation in fuel items.
- Uncertainties regarding the movement in the oil prices.
- Likelihood of reversal in vegetable prices during the summer.
- Elevated levels of Inflation excluding food and fuel.
- Volatility in financial markets viz subdued global growth and trade uncertainties.
- Deviation in the fiscal situation of the government, if any.

Key Highlights

Table 1: Monetary policy rates

%	Feb'19	April'19	Change
Repo rate	6.25	6	⬇
Reverse repo	6	5.75	⬇
Marginal standing facility	6.5	6.25	⬇
Bank rate	6.5	6.25	⬇
Cash reserve ratio	4	4	−

- In the December'18 policy meet, SLR was proposed to decline gradually by 25 bps in each calendar quarter till it reaches 18% commencing January, 2019. SLR now stands at 19.25%.

RBI's assessment on global and domestic economy

The RBI while deciding on the interest rate trajectory has considered the following aspects:

Global economy

- Weak global economic growth owing to slowdown in US, Eurozone, UK and Japan.
- Dovish stance adopted by the US Federal Reserve.
- Subdued economic performance of major emerging market economies including China, Russia, Brazil and South Africa.
- Rise in crude oil prices on account of production cuts by OPEC and Russia coupled with supply disruptions owing to US sanctions on Venezuela.

Indian Economy

Positives

- Narrowing of current account deficit as a result of declining trade deficit coupled with increase in services exports.
- High FDI inflows during Apr'18-Jan'19.
- Higher foreign portfolio investments during the last quarter of 2018-19.
- Decline in fuel inflation from 4.5% in December to 1.2% in February.
- Improvement in disbursement of credit to large industries.

Negatives

- Deceleration in Indian economic growth in Q3 2018-19 on the back of subdued private and public consumption.
- Moderation in manufacturing component of Industrial production with slackening of automobiles, pharmaceuticals, machinery and equipment.
- Muted credit flow to small and medium enterprises by the banks.
- Contraction in sales of commercial vehicles, indicative of slowing demand situation in the economy.
- Marginal uptick in the retail inflation driven by rise in prices of personal care and effects, and recreation and amusement.
- Subdued growth in the exports with reduction in the exports of petroleum products in line with the decline in international crude oil prices.

RBI's outlook on inflation and economic growth

Inflation

The RBI has lowered its inflation projections for Q4FY19, H1FY20 and Q3FY20 assuming a normal monsoon in 2019. The lower projections for inflation is premised on low food inflation, moderation in core inflation (inflation excluding food and fuel), and lower households' inflation expectations.

	Dec'18	Feb'19	Apr'19
Q4FY19	NA	2.8%	2.4%
H1FY20	3.8-4.2%	3.2-3.4%	**2.9-3%**
Q3FY20	NA	3.9%	**3.5-3.8%**

Economic growth

In terms of economic prospects for the Indian Economy, the RBI feels that private consumption is expected to hasten with an increase in public spending in rural areas and increase in disposable incomes of the households on account of tax exemptions provided in this year's interim budget. The RBI also believes that higher financial flows to the commercial sector will help revive economic activity. However, it has also detailed concerns about uncertainties surrounding growth in the form of subdued investment activity, slowdown in production and imports of capital goods along with lower exports due to slowdown in global economic growth.

As a result, the RBI has marginally lowered its growth projections from 7.4% to 7.2% for FY20

	Feb'19	Apr'19
H1FY20	7.2-7.4%	6.8-7.1%
H2FY20	NA	7.3-7.4%
FY20	7.4%	7.2%

*As per Dec'18 policy

Developmental and regulatory policies

- **LCR disclosures :**
  The RBI has permitted banks to reckon an additional 2% of government securities within the mandatory SLR requirements, as Facility to avail liquidity for Liquidity coverage ratio (FALLCR) in a phased manner, taking it to a total of 15% of the bank's NDTL. This has been done to ensure that banks have sufficient high quality liquid assets. This will be beneficial for banks and release funds for lending purposes.

- **Permitting GSec trading through International Central Securities Depositories (ICSDs)**
  The RBI along with the government has initiated discussions with ICSDs to allow their non-residents to transact in government securities. The operational details is to be discussed with ICSDs , SEBI and the government.

- **Licensing of Non-Banking Financial Companies as authorized dealers**
  With an aim to improve the ease of undertaking forex transactions, non-deposit systematically important NBFCs have been allowed to apply for a grant of Authorized Dealer license

- **Committee to study the growth of Housing Finance Securitization Market**
  In view of the benefits brought in by the standardisation of asset securitisation practices as also their role in enabling superior management of credit and liquidity risks as alluded to before, RBI has decided to constitute a Committee that will assess the state of housing finance securitisation markets in India; study the best international practices as well as lessons learnt from the global financial crisis; and propose measures to further develop these markets in India by identifying critical steps required such as, inter alia, definition of conforming mortgages, mortgage documentation

standards, digital registry for ease of due diligence and verification by investors, avenues for trading in securitised assets, etc.

CARE Ratings' View

CARE Ratings expect 25-50 bps rate cut during the year given the RBI has lowered its projections for inflation and economic growth but will be data driven. *We are expecting the retail inflation to move towards 4% in FY20 and GDP growth to be around 7.1% for FY20.*

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