

Sliced again

Monetary Policy Review

April 04, 2019

The development

- The Reserve Bank of India (RBI)'s Monetary Policy Committee (MPC) cut the policy rate by 25 basis points (bps) in its first bi-monthly policy statement for fiscal 2020. Four of the six MPC members voted in favour of a rate cut, while the other two suggested a pause. Consequently, the repo rate now stands at 6.00%, and the reverse repo and marginal standing facility (MSF) rates, at 5.75% and 6.25%, respectively. The MPC maintained its neutral policy stance, in a 5-1 vote.
- Today's policy decision was based on the following factors:
 - i) Continuous subdued inflation and reduction in inflation expectations; ii) Slower-than-expected domestic growth. In the second half of fiscal 2019, gross domestic product (GDP) is forecast to log a growth of ~6.5%. Additionally, some of the high frequency indicators such as growth in manufacturing and capital goods, IIP, auto sales, etc, point to significant moderation in activity, amid a slowing global economy.
 - Since August 2018, consumer price index (CPI)-based inflation has remained below the RBI's medium-term target of 4%, reaching a 19-month low of 1.9% in January. It picked up marginally in February to 2.6%, albeit supported by a weak base and uptick in prices of some food categories. The MPC projects headline inflation to remain soft in the near term. It has revised its projections downward as follows: 2.4% in the fourth quarter of fiscal 2019, 2.9-3.0% in the first half and 3.5-3.8% in the second half of fiscal 2020. At the same time, it did acknowledge the monsoon risk from El Nino conditions and highlighted ambiguity in oil price movement.
 - The Central Statistics Office (CSO) recently revised its GDP growth estimate for fiscal 2019 downwards by 20 bps to 7.0%, indicating a slowdown from 7.2% in fiscal 2018. The MPC acknowledged that there are some signs of domestic investment activity weakening as reflected in a slowdown in production and imports of capital goods. The MPC also noted that moderation of growth in the global economy might impact India's exports. Accordingly, it revised its GDP growth forecast for fiscal 2020 downwards to 7.2% from 7.4% earlier. CRISIL expects GDP to grow at 7.3% in fiscal 2020 with a possible downside risk from the monsoons. Private weather agency Skymet has forecast the possibility of a below normal monsoon, citing risks from El Nino.

Our view

As was widely expected, the MPC today decided to cut the repo rate by 25 bps. This is the second consecutive rate cut by the MPC, bringing the total reduction in policy rates to 50 bps in this ongoing rate easing cycle.

Since the last monetary policy announcement, conditions had become more favourable for an easy monetary stance as:

- GDP growth projection has been revised downwards
- Central banks in advanced countries have hit the pause button
- Rupee has appreciated

Along the way, the RBI has also acted swiftly to support liquidity in the system - by conducting adequate open market operations (OMOs) and more recently, the Indian rupee-US dollar swap. Total durable liquidity injected by the RBI through OMOs aggregated Rs 2.985 trillion for fiscal 2019 and the swap of \$5 billion for a tenure of 3 years on March 26, 2019, added further durable liquidity of Rs 346 billion into the system.

It was an opportune time for the MPC to act now rather than later because we believe inflation is slated to start rising as a favourable base effect has begun to wane and prices of some of the key food categories have started going up. Since food has been the main driver of low inflation so far, uptick in food prices can start exerting upside pressure on headline inflation. It is important to note that the wholesale price index (WPI) or wholesale price-based food inflation has been rising over the last two months. We believe this will feed into the CPI food inflation in the coming months. The possibility of El Nino and its impact on the monsoon also poses a risk to food prices. At the same time, the budgetary and political announcements (income support for the poor), if implemented properly, would add an upside to inflation.

The RBI does not see the risks to inflation as material at this point as reflected in the downward revision of inflation trajectory for fiscal 2020.

Also, the recent rise in crude prices, if sustained, and the rising probability of a sub-normal monsoon could pose a challenge to both growth and inflation outlook. Hereon, we expect the monetary policy to be data-driven.

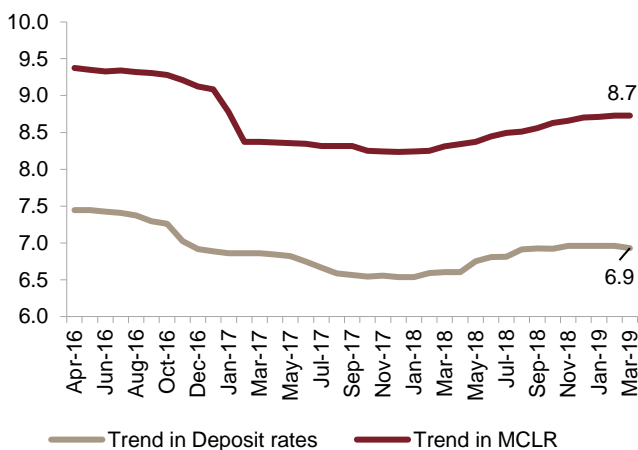
Banking sector view

Credit growth continues to accelerate

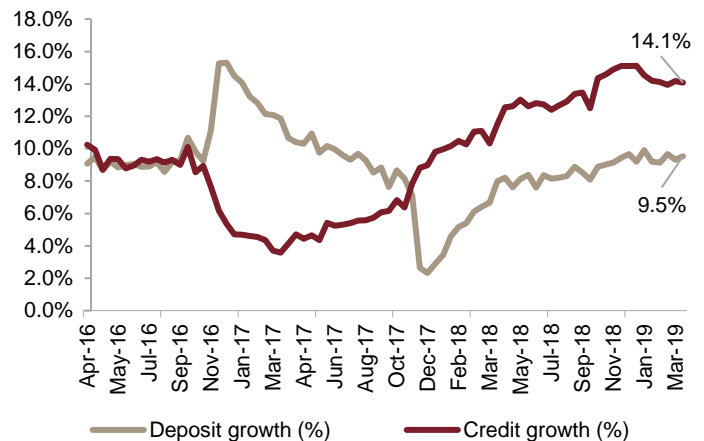
Banking credit continued to post double-digit growth, registering 14.1% increase on-year as of March 15, 2019. However, growth was still not broad-based as industrial credit growth continued to remain anaemic. As of February 2018, industrial credit (which accounts for ~33% of gross bank credit) grew at ~5.6% on-year, while the services sector (which accounts for ~27% of gross bank credit) and retail segment (which accounts for ~26% of gross credit) registered strong growth of ~23% and ~17%, on-year, respectively, driven by strong consumption demand and higher credit requirement by non-banks. Deposit growth, too, improved, up ~9.5% on-year as of March 15, 2019.

CRISIL Research expects banking credit to grow upwards of ~13% on-year in fiscal 2019 and improve to 13-14% on-year in fiscal 2020, compared with 7.4% in fiscal 2018, driven by strong retail credit growth, higher disbursement to non-banks, exemption of six banks from prompt corrective action (PCA) framework and resolution of big ticket-sized stressed assets. Deposits are expected to clock a growth of ~10% on-year in fiscal 2019, partly supported by higher deposit rates offered by the banking sector.

MCLR and deposit rates of banks



Credit and deposit growth of banks (on-year)



Note: Average of one-year MCLR of 10 banks considered. Deposit rate is the average of 1-2 years of maturity, considered for 10 banks.

Source: RBI, CRISIL Research

Repo rate under the Liquidity Adjustment Facility (LAF) cut by 25 bps; to aid banking profitability in near term

In order to achieve the medium-term target of 4.0% CPI inflation (within a +/-2% band), the RBI cut the key rate at which the central banks lends to other commercial banks to 6.0%. Global economic growth has slowed down, especially with respect to the US, the UK, and the euro region, where industrial activity has lost momentum. In India, domestic production has decelerated, affected by slowdown in consumption demand, despite strong growth in gross fixed capital formation (GFCF), supported by robust growth in roads, and affordable housing segments. Along with these, downward revision of GDP, advance estimates by the CSO, and declining IIP have led to downward revision of the key lending rate.

Transmission of rate cuts to end-consumers is expected to be gradual and relatively lower than the repo rate revisions. This is expected to aid banking sector profitability in the near term.

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