

Focus shifts to growth

Monetary Policy Review

February 7, 2019

The development

- Stumping status quo-ists and clearly plumping for growth, the Reserve Bank of India (RBI)'s Monetary Policy Committee (MPC) slashed policy rate by 25 basis points in a 4-2 vote in its sixth bi-monthly policy statement for fiscal 2019.
- The repo rate now stands at 6.25%, and the reverse repo and marginal standing facility (MSF) rates, at 6.00% and 6.50%, respectively. The MPC also eased its policy stance to *neutral* from *calibrated tightening*, in a unanimous decision.
- Today's policy decisions were based on the following factors:
 - i) Undershooting of inflation in the last few months and a benign trajectory predicted in the coming year ii) Supporting domestic growth, which could be under stress, as suggested by some recent high frequency indicators, amid a slowing global economy. With this move, the monetary policy now complements the fiscal policy in supporting growth.
 - In the last five months, consumer price index (CPI)-based inflation has remained below the RBI's medium-term target of 4%, reaching an 18-month low of 2.2% in December 2018, largely attributed to significantly low food inflation. The MPC projects headline inflation to remain soft in the near term. It has revised its projections downward as follows: 2.8% in fourth quarter of fiscal 2019, 3.2-3.4% in first half and 3.9% in third quarter of fiscal 2020.
 - The MPC noted that, with consumption demand slowing, the Central Statistics Office (CSO) has estimated fiscal 2019 GDP growth at 7.2%, same as that in fiscal 2018. It further noted that some indicators of investment demand such as production and imports of capital goods contracted in November-December and credit flows to industry remain muted. While citing risks from slowdown in global demand amid ongoing trade tensions, the MPC still forecasts a reasonably strong GDP growth of 7.4% for fiscal 2020. CRISIL expects GDP to grow a tad lower at 7.3% in fiscal 2020.

Our view

Today's monetary policy announcement was significant for three reasons. Not only it was the first policy review of this year, it was also the first one with the new RBI governor at the helm. And it followed the interim budget announced earlier this month.

With headline inflation remaining well below RBI's medium-term target of 4%, on account of significant undershooting in food inflation, and the benign outlook in the near term, we believe the softening of stance is in the right direction.

That said, there seemed to have been opposing views on domestic growth conditions. Opening up of the output gap, i.e., actual growth falling below the potential (in last two policy meets, this gap was almost closed) and improvement in capacity utilisation at the same time appears to be somewhat at odds. RBI also continued to maintain its earlier growth forecast of 7.4% for fiscal 2020.

Some risks to inflation can emerge from consumption focussed expansionary fiscal policy, sticky core inflation, and normalisation of food inflation (currently negative) which could gain speed if monsoons are sub-normal. Moderate upturn in global food prices and efforts to raise farm incomes can put upward pressure on inflation. The MPC itself suggested that several proposals in the interim budget are likely to boost aggregate demand by raising disposable incomes, which can push core inflation up further. RBI's inflation assessment does not see these risks as material as it forecasts CPI inflation at 3.8-4.2% for the first half of fiscal 2020 and 3.9% in the third quarter.

Given that the risks to both inflation and growth are evenly distributed, future decision on policy rates would be data driven. CRISIL forecasts CPI inflation at 3.7% in fiscal 2019 and 4.5% in fiscal 2020.

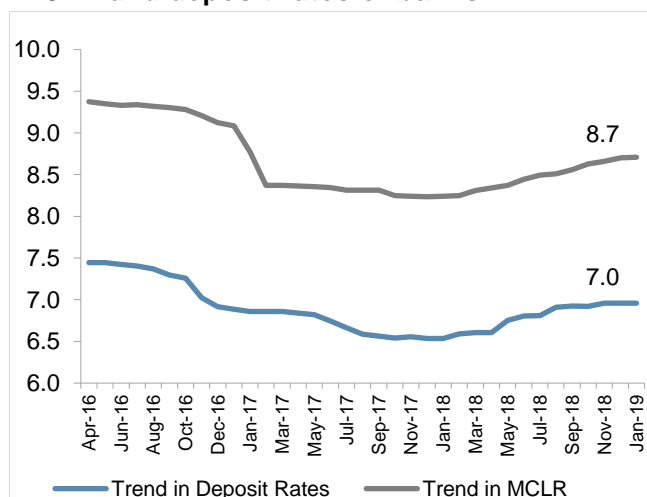
Banking sector view

Credit growth continues to accelerate

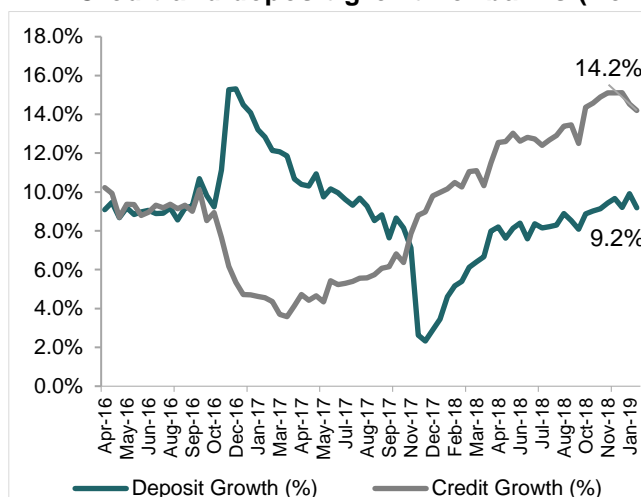
Banking credit continued posting double digit growth, registering 14.2% on-year as of January 18, 2019. However, growth was still not broad-based as industrial credit growth continued to remain anaemic. As of December 2018, industrial credit (which accounts for ~33% of gross bank credit) grew at ~4.4% on-year, while the services sector (which accounts for ~27% of gross bank credit) and retail segment (which accounts for ~25% of gross credit) registered strong growth of ~23% and ~17%, respectively, driven by strong consumption demand and higher credit requirement by non-banks. Deposit growth too improved, growing by ~9.2% on-year as of November 9, 2018.

CRISIL Research expects banking credit to grow at ~13% on-year in fiscal 2019 compared with 7.4% in fiscal 2018, driven by strong retail credit growth, higher disbursement to non-banks, and resolution of big ticket sized stressed assets. Deposit growth is expected to be ~10% on-year in fiscal 2019, partly supported by higher deposit rates offered by banking sector.

MCLR and deposit rates of banks



Credit and deposit growth of banks (YoY)



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

Source : RBI, CRISIL Research

Changes in risk weights for rated exposures to non-banking financial companies (NBFCs)

The RBI has decided that rated exposures of banks to all NBFCs, excluding core investment companies (CICs), would be risk-weighted as per the ratings assigned by the accredited rating agencies, in a manner similar to that for corporates. Exposures to CICs will continue to be risk-weighted at 100%. Earlier the risk weight was rating based only for asset finance companies (AFCs), infrastructure finance companies (NBFC-IFCs), and infrastructure debt funds (NBFC-IDFs). The decision is a positive for higher rated eligible NBFCs towards which risk weights were flat 100% and will aid incremental lending from banks to such well rated corporates. It will also help banks with higher exposure to such entities free up their capital, if these guidelines are retrospective.

Analytical contacts

Dharmakirti Joshi

Chief Economist, CRISIL Ltd.
dharmakirti.joshi@crisil.com

Rahul Prithiani

Director, CRISIL Ltd.
Rahul.prithiani@crisil.com

Adhish Verma

Economist, CRISIL Ltd.
adhish.verma@crisil.com

Media Contacts

Saman Khan

Media Relations
CRISIL Limited
D: +91 22 3342 3895
M: +91 95940 60612
B: +91 22 3342 3000
saman.khan@crisil.com

Hiral Jani Vasani

Media Relations
CRISIL Limited
D: +91 22 3342 5916
M: +91 982003 9681
B: +91 22 3342 3000
hiral.vasani@crisil.com

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