

The growth pitch

Monetary Policy Review

June 06, 2019

Repo sliced, stance changes to accommodative

- The Reserve Bank of India (RBI)'s Monetary Policy Committee (MPC), in its second bi-monthly Monetary Policy Review for fiscal 2020 today, cut the policy rate by 25 basis points (bps), following two similar cuts in the previous two policies. Consequently, the repo rate now stands at 5.75% (lowest since September 2010), and the reverse repo and marginal standing facility (MSF) rates at 5.50% and 6.00%, respectively. The MPC also changed its policy stance to *accommodative* from *neutral*. The moves were unanimous, with all six MPC members voting for the rate cut and the change in policy stance.
- Today's policy decision was based on the following factors:
 - i) Benign inflation scenario, especially the core; ii) Sharp slowdown in domestic growth, amid global headwinds stemming from subdued global growth and escalating trade tensions
 - Inflation based on the consumer price index (CPI) remains well below the RBI's medium term target of 4%, with the latest print, for April, at 2.92%. The MPC believes headline inflation will remain under 4% this fiscal and has projected CPI inflation at 3.0-3.1% for H1 and 3.4-3.7% for H2, with risks broadly balanced. Not only has core inflation (taking out food and fuel) moderated sharply, but also inflation expectations of the households have continued to moderate, the committee has noted. While it has acknowledged the volatility in crude oil prices, the MPC believes its impact on headline inflation is muted. CRISIL forecasts CPI inflation for fiscal 2020 at 4%.
 - The Central Statistics Office (CSO) recently revised its GDP growth estimate for fiscal 2019 downwards by 20 bps to 6.8%, the slowest pace of growth since fiscal 2014. The MPC has noted that "weak global demand due to escalation in trade wars may further impact India's exports and investment activity. Further, private consumption, especially in rural areas, has weakened in recent months." It has accordingly revised down its GDP growth projection for fiscal 2020 to 7.0% from 7.2% earlier. Given the Indian Metrological Department's prediction of well-distributed and near normal monsoon (96% of long period average) last week and expectation of lagged impact of rate cuts filtering in going ahead, we believe GDP growth will cross 7.0% in fiscal 2020. Our current growth forecast of 7.3% is under revision.

Our view

The third consecutive rate cut of 25 bps by the MPC takes the cumulative reduction in the ongoing rate easing cycle to 75 bps. The MPC has been vocal with its concerns on the growth front. The rate cut, therefore, was largely anticipated and was adequately reflected in the sharp fall in bond yields of late. That, along with the change in stance to accommodative, suggests the MPC's optimism in containing inflation below the target for the rest of the year and the need for the monetary policy to support growth at a time when fiscal policy remains constrained.

The economy has seen growth slow down further since the last monetary policy announcement. GDP growth dropped to 5.8% on-year in Q4 fiscal 2019 from 6.6% in the previous quarter, marking the slowest quarterly rise since Q4 fiscal 2014. A sharp slowdown in fixed investment, followed by private consumption and exports, dragged down growth. Industrial sector output, measured by the Index of Industrial Production (IIP) recorded a negative 0.1% growth in March, the latest available data, with manufacturing activity contracting. Other high frequency indicators, including that for the services sector, also paint a dull picture. The broad-based slowdown in growth suggests it may be more entrenched than transitory.

Inflation, at the same time, remains under control. While food inflation – which has been the prime mover of headline inflation so far – has started picking up marginally, core inflation has started softening. This keeps at bay the possibility of headline inflation breaching the medium term target in the near term.

Systemic liquidity in the banking system has improved and become surplus. Early June saw average daily surplus of Rs. 660 billion, as opposed to deficit during April and most of May. The tightness in liquidity was due to leakage of cash into the system (currency in circulation had gone up), which is expected to continue to correct with elections

being over. The RBI has continued to announce open market operations, signalling its intent to keep liquidity adequate. The problems in the NBFC space, though, may warrant larger liquidity support from the central bank.

The rate reductions and changing of stance to accommodative should also help improve transmission of the monetary policy further. The past repo rate cuts have transmitted to new lending but rates on existing loans have, in fact, gone up. RBI's guidance on a relook at the liquidity framework from the point of view of simplification and communication provides comfort on the liquidity and rate transmission in future.

CRISIL believes another rate cut can be expected if the monsoon progresses favourably and the government remains committed to its fiscal consolidation path.

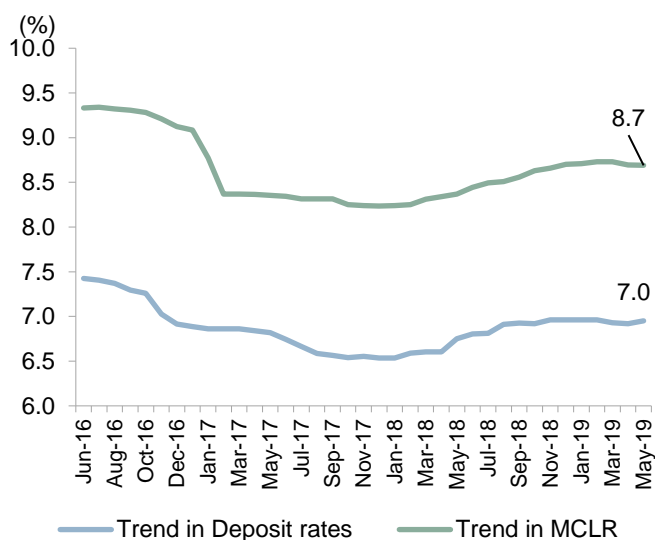
Banking sector view

Credit growth picks up pace

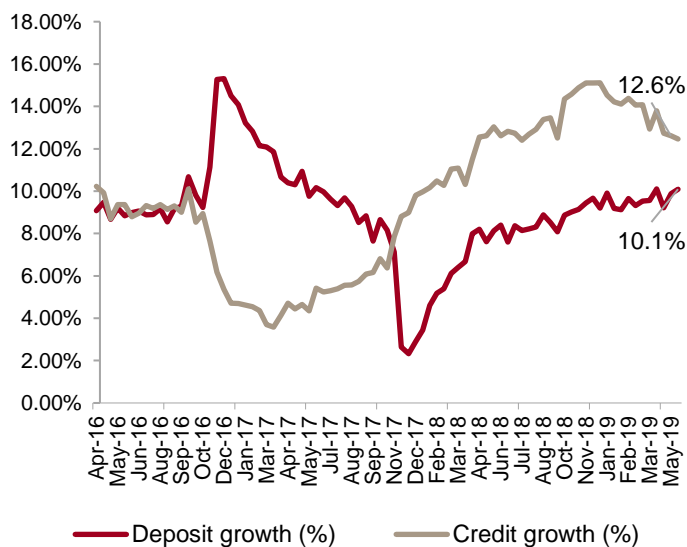
Scheduled commercial banks continued to post double-digit growth (excluding credit extended to NBFCs), registering credit growth of ~11.3% YoY as of May 24, 2019. Industrial credit growth extended its recovery since the past fourth months, after almost two years of subdued growth. As of April 2019, industrial credit (which accounts for ~33% of gross bank credit) grew ~6.9% YoY, while the services sector (~27% of gross bank credit) and retail segment (~26% of gross bank credit) registered healthy growth of ~10% YoY and ~16% YoY, respectively, driven by strong consumption demand and higher credit requirement by NBFCs. Excluding credit given out to NBFCs, overall services credit growth was ~11% as of April 2019. Deposit growth too improved, growing ~10.1% YoY as of May 24, 2019, supporting incremental credit demand.

CRISIL Research expects net banking credit to grow ~13-14% in fiscal 2020, compared with ~12.2% in fiscal 2019 and ~7.4% in fiscal 2018, driven by strong retail credit growth, higher disbursements to NBFCs and resolution of big-ticket stressed assets. Deposit growth is expected to be ~11-12% in fiscal 2020, partly due to higher share in subscriptions to debt issuances versus mutual funds.

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

Repo rate under the Liquidity Adjustment Facility (LAF) lowered by 25 bps; benefits expected to be passed on to customers by banks

To achieve its medium-term target of 4.0% CPI Inflation (within a +/-2% band), the Reserve Bank of India (RBI) reduced repo rate – which is the key policy rate at which the central bank lends to commercial banks – by 25 basis points to 5.75%. Global economic activity has been witnessing a slowdown, especially in the US, the UK, and the European Union, where industrial activity remains muted. On the domestic front, GDP is estimated to have grown ~6.8% (as per NSSO) during the fourth quarter of fiscal 2019, down ~20 bps from the second revised advanced

estimate, released in February. Growth was majorly pulled down by the downward revision in private final consumption expenditure (PFCE), along with a moderation in exports. Growth in gross fixed capital formation (GFCF) declined sharply to single digits (~3.6%), after witnessing double-digit growth in the previous five quarters. These acted as a trigger for the in the rate cut.

Expectation for healthy deposit growth and repo-rate cuts worth ~75 bps over the past five months are likely to result in the transmission of interest-rate benefit from banks to customers. However, the rate of transmission is likely to be relatively lower at ~10-20 bps, as deposit rates will stay relatively firm and credit costs remain high.

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