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# RBI Monetary Policy

'Weakening economic activity'

Jun 6, 2019

## RBI reduces policy repo rate by 25 bps to 5.75%

- Policy repo rate under the liquidity adjustment facility (LAF) reduced by 25 bps to 5.75%
- Consequently, the reverse repo rate under the LAF adjusted to 5.50%. Marginal standing facility (MSF) rate and Bank Rate adjusted to 6.00%.
- Policy stance changed to 'accommodative' from 'neutral'.
- The RBI revised CPI inflation forecast to 3.0-3.1% in H1FY20 (2.9-3.0% earlier) and 3.4-3.7% in H2FY20 (3.5-3.8% earlier projected).
- MPC expressed concern over weakening demand. GDP growth revised downward to 7.0% for FY20 from previous forecast of 7.2%.
- RBI to set up working group to review liquidity management framework.
- Allowing on-tap licencing of small finance banks.
- RBI sets minimum leverage ratio at 4% for systemically important banks; 3.5% for all other banks.
- RBI is closely monitoring the situations of banks, HFCs and NBFCs.
- RBI will create a foreign exchange trading platform for SME exporters and importers.

The Reserve Bank of India (RBI), in its second bi-monthly monetary policy statement' 2018-19, cut the policy repo rate by 25 bps to 5.75% in order to boost the aggregate demand in the economy. Citing considerable weakness in private consumption and investment activity, the MPC also changed its stance from 'neutral' to 'accommodative' indicating no possibility of rate hike in near future but stands ready for rate cut to boost economic activity. India' GDP growth slipped to five year low of 5.8% in Q4FY19 v/s 6.6% in Q3FY19. Private consumption slowed down to 7.2% in Q4FY19 (8.1% in Q3FY19) impacted by subdued activity of consumption finance due to NBFCs crises. Investment in economy also witnessed sharp slowdown to 3.6% in Q4FY19 v/s 11.7% in Q3FY19 due to govt's fiscal concern & lack of private investments.

## Decision of 25 bps rate cut was unanimous with all six MPC members voting for a cut in rates and a change in stance.

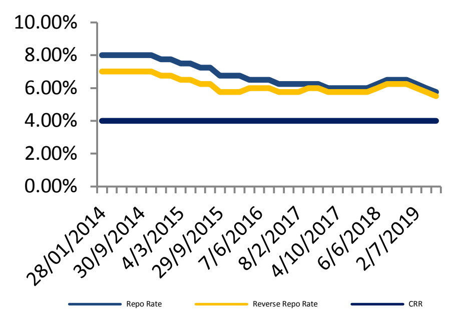
## MPC's view on inflation

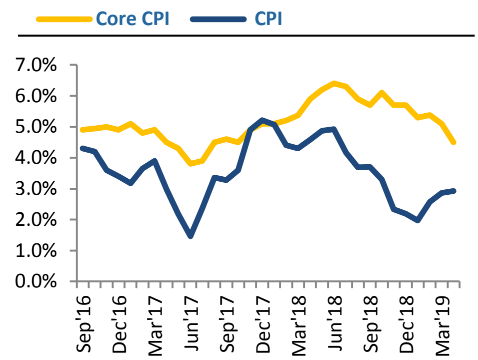
As per the MPC, the summer pick up in vegetables prices has been sharper than expected and latest update also suggests a broad based pick-up in prices of several food items which is likely to impart upward pressure to the near term trajectory of food inflation. However the impact is likely to offset by the lower core inflation. Core inflation or inflation excluding food and oil reduced to 18-month low of 4.5% in Apr (5.1% in Mar) due to significant decline in domestic and external demand conditions. While the crude oil price is appeared to be volatile, its impact on CPI inflation has been muted so far due to incomplete pass-through. RBI's household survey in May'19 indicated that inflation expectation of household has reduced by 20 bps for 3 months ahead horizon compared with previous survey. Considering all these factors, the MPC revised CPI inflation forecast to 3.0-3.1% in H1FY20 (2.9-3.0% earlier) and 3.4-3.7% in H2FY20 (3.5-3.8% earlier projected). Key upside risks to inflation are unseasonal pick up in vegetables' prices, volatility in crude oil prices and govt's fiscal position.

## GDP growth revises downward to 7.0% for FY20

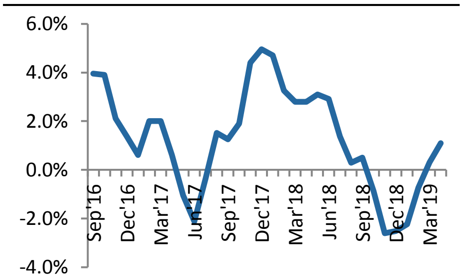
The MPC noted that sharp slowdown in investment activity along with a continuing moderation in private consumption growth is a matter of concern. Widening output gap indicates that growth impulses have weakened significantly. Weak exports growth due to global concerns and decline in private consumption especially in rural areas were weighed on economic growth. Meanwhile, RBI latest survey shows that capacity utilization (CU) in manufacturing sector improved to 77% in Q4 v/s 75.9% in Q3 and business assessment index (BAI) of the industrial outlook survey (IOS) in Q1FY20 remained unchanged at its level in the previous quarter. Manufacturing PMI also edged up to 52.7 in May (51.8 in Apr) with strengthening of output, new orders and employment. GDP growth for FY20 is revised downward from 7.2% in the April policy to 7.0% in the range of 6.4-6.7% for H1FY20 and 7.2-7.5% for H2FY20 with risks evenly balanced.

RBI's Monetary Policy Stance

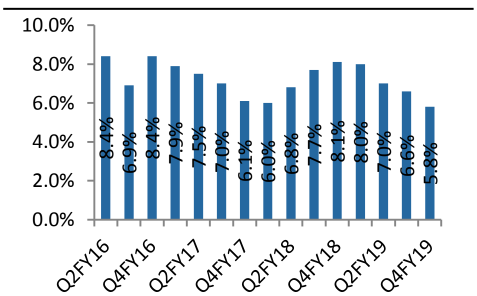



Food inflation




Indian GDP Gr. (%)

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### Choice's Rating Rationale

The price target for a large cap stock represents the value the analyst expects the stock to reach over next 12 months. For a stock to be classified as Outperform, the expected return must exceed the local risk free return by at least 5% over the next 12 months. For a stock to be classified as Underperform, the stock return must be below the local risk free return by at least 5% over the next 12 months. Stocks between these bands are classified as Neutral.

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