Analyst: Avinash Tanawade (022) 6714 1449

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RBI Event Note @ Dalal & Broacha

RBI POLICY UPDATE:

- Reserve Bank of India's (RBI) monetary policy committee (MPC) has decided to keep key policy rates unchanged at 5.15%, amid rising consumer inflation.
- Consequently, the reverse repo rate under the LAF remains unchanged at 4.90%, and the MSF rate and the Bank Rate at 5.40%.
- These decisions are in consonance with the objective of achieving the medium-term target for CPI inflation of 4% within a band of +/- 2%.
- The committee decided to continue with an accommodative stance, given its outlook for moderation in inflation below 4% by H1 FY21.
- MPC unanimously votes for status quo on repo rate

Key Policy rates:

Policy Tools	Policy rates	Status
Repo	**5.15%**	Unchanged
Reverse Repo	**4.90%**	Unchanged
Marginal Standing Facility (MSF)	**5.40%**	Unchanged
Bank Rate	**5.40%**	Unchanged
CRR	**4.00%**	Unchanged
SLR	**18.50%**	Unchanged

Growth Outlook

- **At 4.5% real GDP growth and 6.1% nominal GDP growth, India's economic growth has slowed to its weakest pace since 2013. The major factors in the GDP fall were weak manufacturing, falling consumer demand, weak private investment, and a drop in exports due to a global slowdown.**
- On the positive side, the business expectations index of the RBI's industrial outlook survey indicates a marginal pickup in business sentiments in Q4. According to the central bank, monetary policy easing since February 2019 and the measures initiated by the Government over the last few months are expected to revive sentiment and spur domestic demand
- **The six-member committee has lowered the GDP growth forecast for FY20 to 5.0% (from 6.1% in the October policy); expected to be in the range of 4.9-5.5% in H2FY20 and 5.9-6.3% for H1 FY21- with risks somewhat tilted to the downside.**

Inflation Outlook

- **Consumer price inflation has increased to 4.62% in October 2019, climbing above 4% for the first time in 15 months and up from 3.99% in September 2019.**
- Food inflation was the biggest culprit, which spiked to 6.9% in October – a 39- month high – pushed up by a sharp increase in prices of vegetables due to heavy unseasonal rains. However, with a pick-up in arrivals from the late kharif season along with measures taken by the Government to augment supply through imports, vegetables prices is likely to soften by early February 2020
- Core inflation (excludes food and fuel prices) softened further from 4.2% in Sep to 3.4% in Oct 2019, as price increases moderated across several services, which reflected in transportation fares, telephone charges, tuition fees and house rentals.
- **The committee expects inflation to pick up in the near term but will moderate below target by Q2FY21. MPC has revised its CPI inflation projection upwards to 5.1-4.7% for H2:2019-20 and 4.0-3.8% for H1:2020-21, with risks broadly balanced.**
- While improved monetary transmission and a quick resolution of global trade tensions are possible upsides to growth projections, a delay in revival of domestic demand, a further slowdown in global economic activity and geo-political tensions are downside risks.

Other key takeaways

- After the introduction of the external benchmark system, most banks have linked their lending rates to the policy repo rate.
- MPC expects transmission to improve in credit market as share of base rate loans declines and floating rate loans come up for renewal. The transmission is picking up, with 1-year MCLR declined by 49 bps.
- Net foreign direct investment rose to US$ 20.9 billion in H1 FY20 from US$ 17.0 billion a year ago.
- Net foreign portfolio investment was of the order of US$ 8.8 billion in April-November 2019 as against net outflows of US$ 14.9 billion in the same period of last year.
- Net disbursals of external commercial borrowings rose to US$ 11.5 billion during April-October 2019 as against US$ 1.2 billion during the same period a year ago.
- India's foreign exchange reserves were at $ 451.7 billion on December 3, 2019 – an increase of US$ 38.8 billion over end-March 2019.
- The next meeting of the MPC is scheduled during February 4-6, 2020.
- MPC recognises that there is monetary policy space for future action. However, given the evolving growth-inflation dynamics, the MPC felt it appropriate to take a pause at this juncture.

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Regulation and Supervision

RBI to amend tighter norms for Urban Cooperative Banks:

- In order to reduce concentration risk in the exposures of primary (urban) co-operative banks (UCBs) and to further strengthen the role of UCBs in promoting financial inclusion, it is proposed to amend certain regulatory guidelines relating to UCBs.
- The guidelines would primarily relate to exposure norms for single and group/interconnected borrowers, promotion of financial inclusion, priority sector lending, etc.
- These measures are expected to strengthen the resilience and sustainability of UCBs and protect the interest of depositors. An appropriate timeframe will be provided for compliance with the revised norms.
- With a view of building a similar database of large credits extended by primary (urban) co-operative banks (UCBs), it has been decided to bring UCBs with assets of Rs 500 crore and above under the CRILC reporting framework.
- RBI also plans to prescribe a comprehensive cyber security framework for the UCBs, as a graded approach, based on their digital depth and interconnectedness with the payment systems landscape, digital products offered by them and assessment of cyber security risk.
- The framework would mandate implementation of progressively stronger security measures based on the nature, variety and scale of digital product offerings of banks.
- A draft circular proposing the above changes for eliciting stakeholder comments will be issued shortly.

Changes in IBUs

- In order to facilitating ease of operations, the regulator has allowed the International Financial Service Centre Banking Units (IBUs) to open foreign currency current accounts of their corporate borrowers.
- With regard to the liquidity coverage ratio, it has also allowed the IBUs to accept fixed deposits in foreign currency of less-than-one-year tenor from non-bank entities and consequently removed the current restriction on premature withdrawal of deposits.

Central Bank increases P2P lending cap to Rs 50 lakh:

- In order to give a boost to the P2P lending sector, RBI has increased the lending cap for each individual lender from the current Rs 10 lakh to Rs 50 lakh.
- Further, it is also proposed to do away with the current requirement of escrow accounts to be operated by bank promoted trustee for transfer of funds having to be necessarily opened with the concerned bank. This will help provide more flexibility in operations. Necessary instructions in this regard will be issued shortly.

RBI to introduce new prepaid payment instrument

- In a bid to facilitate its usage and promote digital payments, the regulator has proposed to introduce a new type of prepaid payment instrument (PPI) with a limit of up to Rs 10,000.
- The loading / reloading of such PPI will be only from a bank account and used for making only digital payments such as bill payments, merchant payments, etc. Such PPIs can be issued on the basis of essential minimum details sourced from the customer.
- Instructions in this regard will be issued by December 31, 2019.

RBI issues final norms for 'on-tap' licensing of Small Finance Banks

- The central bank has released final guidelines and opened the window for applicants to approach the regulator at any point of time for 'on-tap' licensing of Small Finance Banks (SFBs).
- The minimum paid-up voting equity capital or net worth requirement has been set at Rs 200 Cr, up from Rs 100 Cr as set earlier.
- For primary urban cooperative banks that intend to convert into SFB, should have net worth of Rs 100 Cr, which will have to be increased to Rs 200 Cr within five years from the date of commencement of business.
- Payments Banks have also been allowed to apply for conversion into SFB after five years of operations, if they are meet other eligibility norms.
- SFBs will be given scheduled bank status immediately and will be allowed to open banking outlets from the date of commencement of operations
- The listing of SFB will be mandatory within three years after it reaches the net worth of Rs 500 crore for the first time.

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Contact	Email ID	Contact No.	Sector
Mr. Kunal Bhatia	kunal.bhatia@dalal-broacha.com	022 67141442	Auto, Auto Ancillary, FMCG
Ms.Charulata Gaidhani	charulata.gaidhani@dalal-broacha.com	022 67141446	Pharma /Healthcare
Ms. Abhilasha Satale	abhilasha.satale@dalal-broacha.com	022 67141439	Midcaps
Mr. Mayank Babla	Mayank.babla@dalal-broacha.com	022 67141412	I.T.
Mr. Avinash Tanawade	avinash.tanawade@dalal-broacha.com	022 67141449	BFSI
Mr. Suraj Nandu	suraj.nandu@dalal-broacha.com	022 67141438	Associate
Ms. Nidhi Babaria	Nidhi.babaria@dalal-broacha.com	022 67141450	Associate
Mr. Tanush Mehta	tanush.mehta@dalal-broacha.com	022 67141432	Associate

Address: - 508, Maker Chambers V, 221 Nariman Point, Mumbai 400 021
Tel: 91-22- 2282 2992, 2287 6173, (D) 6630 8667 Fax: 91-22-2287 0092
E-mail: research@dalalbroachaindia.com, equity.research@dalal-broacha.com