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RBI Event Note @ Dalal & Broacha

RBI POLICY UPDATE:

- With retail inflation well within the median four percent mark and the economy growing at its slowest pace in nearly five years, Reserve Bank of India's (RBI) Monetary Policy Committee on Wednesday decided to cut its benchmark repo rate by 35 bps to 5.40%. This is the fourth straight rate cut from the central bank, taking the total tally to 110 bps in the calendar year 2019.
- While all members of the MPC unanimously voted to reduce the policy repo rate and to maintain the accommodative stance of monetary policy, two MPC members (Chetan Ghate and Pami Dua) voted to reduce the policy repo rate by 25 bps instead of 35 bps.

Key Policy rates:

Policy Tools	Post policy	Pre policy	Status
Repo	**5.40%**	**5.75%**	Changed by 35 bps
Reverse Repo	**5.15%**	**5.50%**	Changed by 35 bps
Marginal Standing Facility (MSF)	**5.65%**	**6.00%**	Changed by 35 bps
Bank Rate	**5.65%**	**6.00%**	Changed by 35 bps
CRR	**4.00%**	**4.00%**	Unchanged

Growth Outlook

- The six-member committee has lowered the GDP growth forecast for FY20 to 6.9 % (from 7% in the June policy); expected to be in the range of 5.8-6.6% for H1FY20 and 7.3-7.5% for H2FY20 - with risks somewhat tilted to the downside. GDP growth for Q1FY21 is projected at 7.4%.
- Growth worries persist; given various high frequency indicators suggesting weakness in both domestic and external demand conditions. Business Expectations Index of RBI's industrial outlook survey shows muted expansion in demand conditions in Q2, although a decline in input costs augurs well for growth.
- Capacity utilisation (CU) in the manufacturing sector, measured by the order books, inventory and capacity utilisation survey (OBICUS) of RBI rose marginally to 76.1% in Q4FY19 from 75.9% in Q3; seasonally adjusted CU, however, fell to 74.5% in Q4 from 75.6% in Q3.
- Industrial growth, measured by the index of IIP, moderated to 3.1% in May 2019, pulled down by manufacturing and mining sectors. In terms of the use-based classification, the production of capital goods and consumer durables decelerated. Growth in the index of eight core industries decelerated to 0.02% in June, dragged down by a contraction in petroleum refinery products, crude oil, natural gas and cement.

Inflation Outlook

- MPC expects retail inflation to remain well within the RBI's 4% mandate for next 12-month; CPI inflation is projected at 3.1% for Q2FY20 and 3.5-3.7% for H2FY20, with risks evenly balanced. CPI-based inflation for H1FY21 has been projected at 3.6%.
- Inflation expectations of households remained unchanged in the July 2019 round of RBI's survey for the three months ahead horizon as compared with the previous round, but they moderated by 20 bps for the one year ahead horizon. Input cost pressures from prices of agricultural and industrial raw materials continued to ease in May and June. Nominal growth in rural wages was muted, while growth in staff costs in the manufacturing sector eased in Q1. Manufacturing firms participating in the RBI's industrial outlook survey expect input cost pressures to soften on account of lower raw material costs in Q2.

System Liquidity

- Liquidity in the system was in large surplus in June-July 2019 due to (a) return of currency to the banking system; (b) drawdown of excess cash reserve ratio (CRR) balances by banks; (c) open market operation (OMO) purchase auctions; and (d) RBI's foreign exchange market operations.
- The central Bank absorbed liquidity of Rs 51,710 Cr in June, Rs 1,30,931 Cr in July and Rs 2,04,921 Cr in August (up to August 6, 2019) on a daily net average basis under the LAF.
- Two OMO purchase auctions amounting to Rs 27,500 Cr were conducted in June, thereby injecting durable liquidity into the system.
- The weighted average call money rate (WACR) – the operating target of monetary policy – was aligned with the policy repo rate in June, but it traded below the policy repo rate on a daily average basis by 14 bps in July and 17 bps in August (up to August 6, 2019).

Other major announcements

- In order to improve the flow of credit to consumers and small businesses, the central bank has decided to reduce the risk weight for consumer credit, including personal loans, but excluding credit card receivables, to 100% from the current 125%.
- RBI has raised bank's exposure limit to a single NBFC to 20% of the Tier-I capital of the bank against the current 15%.
- The central bank has given priority sector tag to bank loans extended to registered NBFCs (other than MFIs) for Agriculture (investment credit up to Rs 10 lakh); Micro & Small Enterprises (up to Rs 20 lakh) and housing (up to Rs 20 lakh per borrower from Rs 10 lakh at present).
- In order to promote digital transactions, the central bank has decided to make available the National Electronic Funds Transfer (NEFT) system for transfer of money on a 24x7 basis from December 2019. Currently, the NEFT payment system operated by RBI as a retail payment system is available for customers from 8.00 am to 7.00 pm on all working days of the week (except 2nd and 4th Saturdays of the month).

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