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RBI Event Note @ Dalal & Broacha

RBI POLICY UPDATE:

- RBI's monetary policy committee has decided to keep key policy rates unchanged at 5.15%, owing to a rise in inflation & stress on the economy. Soaring prices of vegetables drove India's retail inflation rate to 7.35% in Dec 2019, which is well above RBI's comfort zone.
- Consequently, the reverse repo rate under the LAF remains unchanged at 4.90%, and the MSF rate and the Bank Rate at 5.40%.
- All members of MPC voted to maintain the policy repo rate and continue with the accommodative stance of monetary policy.
- These decisions are in consonance with objective of achieving the medium-term target for CPI inflation of 4% within a band of +/- 2%

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	18.25%	Unchanged

Growth Outlook:

- MPC has pegged the GDP growth for FY21 at 6% and in the range of 5.5-6.0% in H1FY21 and 6.2% in Q3FY21. According to the central bank, the pick-up in GDP growth is likely to be led by private consumption, which should benefit from higher spending power on account of the reduction in GST rates and income tax rate reductions for middle-income slabs.
- Rural incomes would be supported by the expected bumper rabi production and the recent improvement in terms of trade for farm sector on account of higher food prices. Furthermore, Union Budget envisages that capital outlay excluding defence would expand by 26.2%, which could crowd in private investment. Overall, gross fixed investment could rise & propel domestic demand, income & employment.

Inflation Outlook:

- CPI inflation projection has been revised upwards to 6.5% for Q4FY20 vs. 5.1-4.7% in H2FY20 earlier and for H1FY21 it is 5.4-5.0% vs. 4.0-3.8% earlier, with risks broadly balanced. According to RBI, the recent pick-up in prices of non-vegetable food items, specifically in milk due to a rise in input costs, & in pulses due to a shortfall in kharif production, are all likely to sustain. However, food inflation is likely to soften from the high levels registered in December & the decline is expected to become more pronounced during the Q4FY20 as onion prices ease following arrivals of late kharif & rabi harvests.
- Some factors that could influence inflation are revisions in mobile phone charges, the increase in prices of drugs and volatilely in crude prices due to unabated geopolitical tensions in the Middle East on one hand, and uncertain global economic outlook on the other.

Other major announcements

- **In order to ensure sufficient liquidity in the system and push transmission of already announced interest rate cuts, RBI has decided to conduct Long Term Repo Operations (LTROs) of Rs one trillion of one year and three years tenor.** This will start from February 15, 2020.
- **Also to boost MSME, home and auto sectors, RBI has allowed banks to deduct the equivalent of incremental credit disbursed by them as retail loans from their NDTL for maintenance of CRR.** This exemption will be available for incremental credit extended up to the fortnight ending July 31, 2020. Within banking, we believe **SBI, IndusInd Bank, ICICI Bank, Axis Bank, Federal Bank & RBL will be major beneficiary.**
- In a big relief to the MSME sector, RBI has taken two steps extended restructuring to Dec 2020 (from Mar 2020) & linked medium enterprise rate to external benchmark. These combined steps will allay concerns on near term delinquency & provide credit to these segments at lower rates.
- **In order to support project loans in the commercial real estate sector, the central bank has decided to extend date of commencement for these loans by a year without downgrading asset classification.** The detailed instructions will be issued shortly by the central bank. Prima facie, this move will benefit real estate financiers like Indiabulls Hsg, PNB Hsg, LIC Hsg, L&T Finance and Piramal Enterprises.

Outlook

Although the vegetable prices are set to cool off as new winter crop arrives in the market, we believe in the near term the central bank is likely to wait and watch for more clarity on the inflation & GDP outlook. Transmission of past interest rate cuts also remains an issue. Between Feb to Oct 2019, the MPC has reduced the repo rate by 135 bps. Further, the central bank has announced policies to support the troubled sectors like realty, housing, MSME and NBFC segments. The specific announcements in terms of CRR relief or long term durable liquidity for banks will likely to push the overall credit availability in the financial system.

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