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RBI Event Note @ Dalal & Broacha

RBI POLICY UPDATE:

- RBI's Monetary Policy Committee on Friday decided to cut its benchmark repo rate by 25 bps to 5.15%, citing benign inflation and to support economic growth. The latest rate cut would take cumulative cuts so far this year to 135 bps.
- Consequently, the reverse repo rate under the LAF stands reduced to 4.90%, and the marginal standing facility (MSF) rate and the Bank Rate to 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%, while supporting growth.
- While all members of the MPC unanimously voted to reduce the policy repo rate and to maintain the accommodative stance of monetary policy, one MPC member (Dr R. H. Dholakia) voted to reduce the policy repo rate by 40 bps instead of 25 bps.
- CPI inflation inched up to 3.21% in August (10-month high) but remained within the central bank's comfort zone. Going forward, we see limited room for further rate cuts in the current fiscal, possibly another 15 bps, with another 25-35 bps in early FY21.

Key Policy rates:

Policy Tools	Post policy	Pre policy	Status
Repo	5.15%	5.40%	Changed by 25 bps
Reverse Repo	4.90%	5.15%	Changed by 25 bps
Marginal Standing Facility (MSF)	5.40%	5.65%	Changed by 25 bps
Bank Rate	5.40%	6.00%	Changed by 25 bps
CRR	4.00%	4.00%	Unchanged

Growth & Inflation Outlook:

- MPC has lowered the GDP growth forecast for FY20 from 6.9% in the August policy to 6.1% (5.3% in Q2FY20 and in the range of 6.6-7.2% for H2FY20), mainly due to weak domestic demand. For the last few months, the central bank has been reducing its growth projections at each successive policy meeting. GDP growth for Q1 FY21 is also revised downwards to 7.2%.
- With inflation expected to remain below target in the remaining period of FY20 and Q1FY21, MPC has noted that there is policy space to address these growth concerns by reinvigorating domestic demand within the flexible inflation targeting mandate. It is in this context that the MPC decided to continue with an accommodative stance as long as it is necessary to revive growth, while ensuring that inflation remains within the target.
- MPC has also revised the path of CPI inflation slightly upwards to 3.4% for Q2 FY20, while projections are retained at 3.5-3.7% for H2 FY20 and 3.6% for Q1 FY21, with risks evenly balanced.
- Overall liquidity remained surplus in August and September 2019 despite expansion of currency in circulation and forex operations by the RBI draining liquidity from the system. Net daily average absorption under the LAF amounted to Rs 140,497 Cr in August and Rs 122,392 Cr in September 2019. Reflecting easy liquidity conditions, the weighted average call rate (WACR) traded below the policy repo rate (on an average) by 8 bps in August and by 6 bps in September.

Other major announcements

- In order to boost credit flow to the bottom of the economic pyramid, RBI has increased the household income limit for borrowers of NBFC-MFIs from the current level of Rs 1 lakh for rural areas and Rs 1.60 lakh for urban/semi urban areas to Rs 1.25 lakh and Rs 2.00 lakh, respectively. Also, the lending limit has been increased to Rs 1.25 lakh from Rs 1 lakh per eligible borrower.
- For development of offshore rupee markets, the central bank has allowed domestic banks to freely offer foreign exchange prices to non-residents at all times, out of their Indian books, either by a domestic sales team or through their overseas branches; and permitting rupee derivatives (with settlement in foreign currency) to be traded in International Financial Services Centres (IFSCs).
- In order to popularise the cross-border transactions in Indian rupee, RBI has been decided, in consultation with the GoI, to enhance the scope of non-interest bearing Special Non-resident Rupee (SNRR) Account by permitting persons resident outside India to open such accounts to facilitate rupee denominated ECB, trade credit and trade invoicing. Further, restriction on the tenure of SNRR account, which is currently 7 years, is also proposed to be removed for the aforesaid purposes. Guidelines in this regard would be issued within a month.

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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.babladalal-broacha.com	022 67141412	I.T/Telecom/Media
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