# RBI Monetary Policy Review

MIRAE ASSET Mutual Fund

**February 7th, 2019**

## Policy Action:

- RBI, in the monetary policy review reduced the policy repo rate under the liquidity adjustment facility by 25bps from 6.5% to 6.25%.
- Consequently, the reverse repo rate under the LAF stands adjusted to 6.0%, and the marginal standing facility (MSF) rate and the Bank Rate to 6.5%.
- Statutory liquidity ratio (SLR) was reduced to 19.25%. As per the proposed plan to align SLR with LCR by 25 bps every calendar quarter until the SLR reaches 18% of NDTL.
- The MPC also decided to change the monetary policy stance from "Calibrated tightening" to "Neutral".
- The committee voted unanimously to change the stance to 'neutral', while four members of the MPC voted for a rate cut two voted to keep the policy rate unchanged.
- This is the first rate cut announced since August 2017

As part of the Developmental and Regulatory Policies following decisions are of note:

(1) RBI to set up panel on offshore Rupee market to look at causes for growth of this market and suggest ways to encourage nonresidents to participate in domestic market
(2) To Form work group to review Agriculture Credit
(3) Bank lending to NBFCs will be permitted to be risk weighted based on their assigned ratings in contrast to the 100% risk weight applied currently, guidelines for it will be issued by end of this month.
(4) Also RBI to harmonize major categories of NBFCs engaged in credit intermediation, including AFCs, loan companies, and investment companies, into a single category
(5) Resolution applicants under Corporate Insolvency Resolution Process will also be allowed to avail of (ECBs) to repay existing lenders
(6) Eases external borrowing norms and remove 20% overseas investment limit in corporate debt.
(7) The committee also noted that the output gap has opened up modestly. Investment activity is recovering but supported mainly by public spending on infrastructure. There is need to strengthen private investment activity and buttress private consumption.

## Economy Assessment:

- GDP growth for FY19 has also been revised down to 7.2% from 7.4% earlier, while the forecast for FY20 is pegged at 7.4%.
- Inflation forecast is reduced to 2.8%, from 2.7%-3.2% for 2HFY19 earlier, the inflation forecast for 1HFY20 has also been lowered to 3.2%-3.4%, from 3.8%-4.2% earlier and estimated at 3.9% for 3QFY20.
- The inflation forecast is subject to following risk factors:
    - vegetable prices have been volatile in the recent period; reversal in vegetable prices could impart upside risk to the food inflation
    - the oil price outlook continues to be hazy

- Heightening trade tensions and geo-political uncertainties weighing on global growth prospects,
- The unusual spike in the prices of health and education needs to be closely watched.
- Financial markets remain volatile
- the monsoon outcome is assumed to be normal;
- Several proposals in the union budget for 2019-20 are likely to boost aggregate demand by raising disposable incomes

## Market Reaction:

While the market expected change in stance the - rate cut came in as surprise, it was seen that right after the announcement, sovereign bonds rallied providing some relief to market concerned about a record government borrowing program. Factoring in this information resulted in the 10Y benchmark yields falling to 7.52% from 7.58% levels while briefly touching low of 7.47%. Consequently INR hit low of 71.27/$ in trading post announcement.

## Outlook:

**With a 25bp rate cut today, the room has opened up for more rate cuts in the course of next few meetings. The overall case has been justified with lower than expected inflation and moderate growth, Moreover the Fed adopting dovish tone in its policy and oil prices stabilizing further supported the case for rate cut. However while the committee is believed to factored in the budget announcements in its projections the actual numbers will be watched closely. For now, in our view this is the balanced policy in light of current situation. We expect the yield curve to steepen in reaction to policy action with short term rates easing and long bond yields remain largely range bound with a downward bias.**