Third rate cut since Jan'19, and more to come; FY20 GDP est. at 7.0%

Policy rates were further eased by 25bps in the second monetary policy statement of the fiscal, accompanied by a unanimous view for a change in monetary policy stance from 'Neutral' to 'Accommodative'. The decision was in line with deteriorating economic conditions since the last policy in April and with a weak inflation and growth outlook expected for the year. The third rate cut for 2019, with a 25bps cut seen in each of the policy meets in February and April takes the repo rate down to 5.75%. The RBI Governor also highlighted that the 50bps rate cut since February has translated into a 21bps transmission on the WALR (weighted average lending rate) for new loans—somewhat quicker than usual—and with the accommodative policy stance allows room for additional rate cuts through the year. The incrementally muted growth outlook calls for an additional 50bps cut in FY20. The statement also provided guidance on a number of developmental/regulatory policies, which included allowing retail investors to trade SDLs (State Development Loans) on *Specified Stock Exchanges.*

- **Repo cut by 25bps, accommodative stance**: The central bank has reduced the policy repo rate by another 25bps to 5.75%. In line, the reverse repo rate now stands at 5.5%, while the bank rate/Marginal Standing Facility (MSF) rate are at 6.0%. The MPC also changed its monetary policy stance from 'neutral' to 'accommodative', signalling more rate cuts on the way. In the April policy meet, the RBI projected Q4 FY19 inflation at 2.4%, and the actual inflation came largely in-line at 2.5%. Weak growth (GDP growth for FY19 at 6.3% at a five-year low), still-benign inflation necessitated another cut in June.
- **Inflation outlook remains benign**: The path of CPI inflation for FY20 has been slightly revised upwards to 3.0-3.1% in H1FY20 (2.9-3.0% earlier) and downwards to 3.4-3.7% in H2FY20 (3.5-3.8% earlier), with risks evenly balanced. This decision was taken based on several factors such as (1) an upward bias in the near-term trajectory of food inflation, (2) a significant weakening in domestic and external demand that has led to a sharp decline of 60bps in core inflation (ex-food ex-fuel), imparting a downward bias on the inflation trajectory, (3) uncertainty in international crude oil prices, and (4) moderation in inflation expectations of households. Going forward, risks around baseline inflation mainly emanate from uncertainties relating to the monsoon: While the IMD recently projected a normal monsoon season, there has already been a delay in onset of rains amid weak *El-Nino* conditions that could lead to an unseasonal spike in vegetable prices, posing risks to the biggest component (~45%) of the inflation basket, food & beverages.
- **GDP growth projection revised downwards**: After a five-year low GDP print of 6.3% in FY19, the RBI has reduced India's growth forecasts for this fiscal, with GDP in FY20 projected at 7.0% (from 7.2% earlier) – in the range of 6.4-6.7% in HI FY20 (6.8-7.1% earlier) and 7.2-7.5% in H2 (7.3-7.4% earlier) with risks evenly balanced. Growth impulses have weakened, widening the output gap, with concerns arising from both domestic and global factors; domestic investment activity has weakened on lower production, exports have slowed down and private consumption has declined, while uncertainties surrounding the trade war and volatile oil prices continue to pose headwinds on global demand.
- **Way forward**? Amidst the following inflation and growth outlook, we believe there is room for an incremental 50bps easing in this fiscal, *ceteris paribus*. Unfolding of the SW monsoons by June, and the global growth scenario and financial market volatility would be key indicators that would dictate the rate trajectory going forward.

Figure 1: Policy rates reduced by 75bps since start of 2019

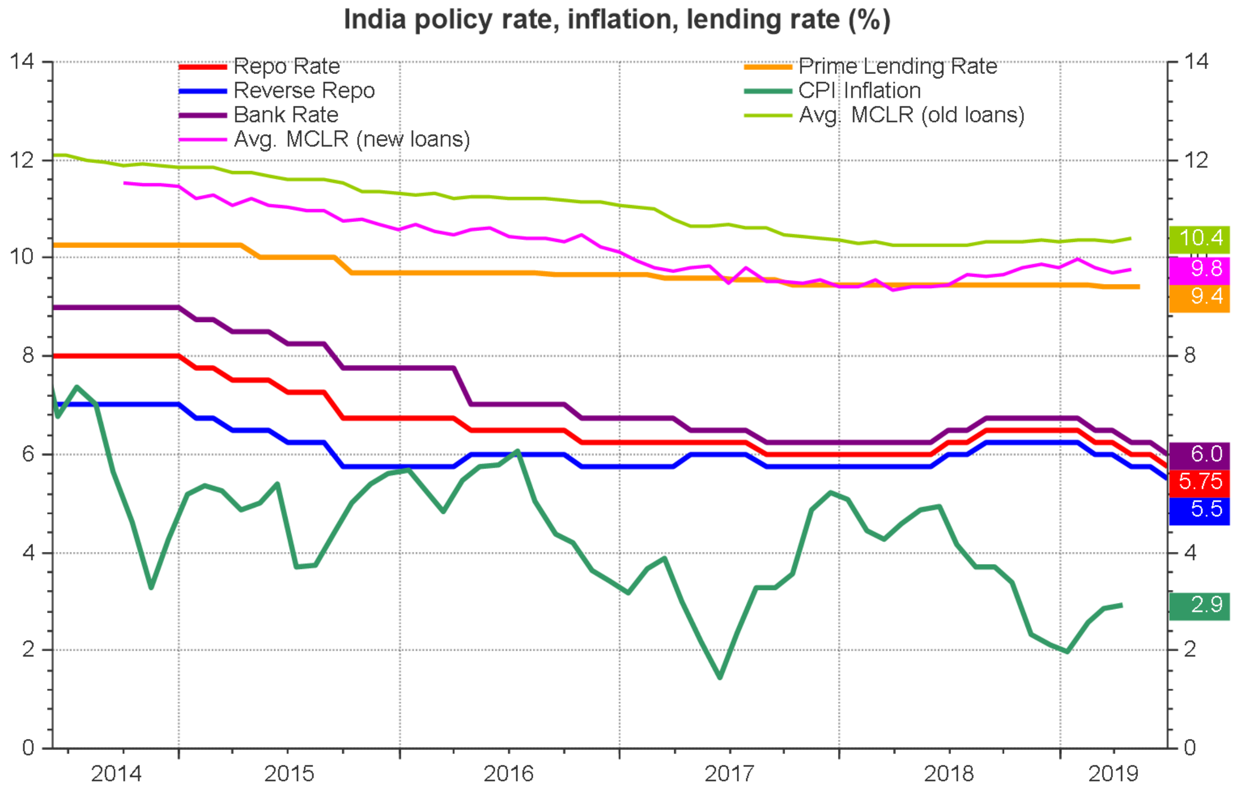


Figure 2: Whither Transmission? Repo -75bps; 'New loan' MCLR -21bps, 'Old loan' MCLR +4bps

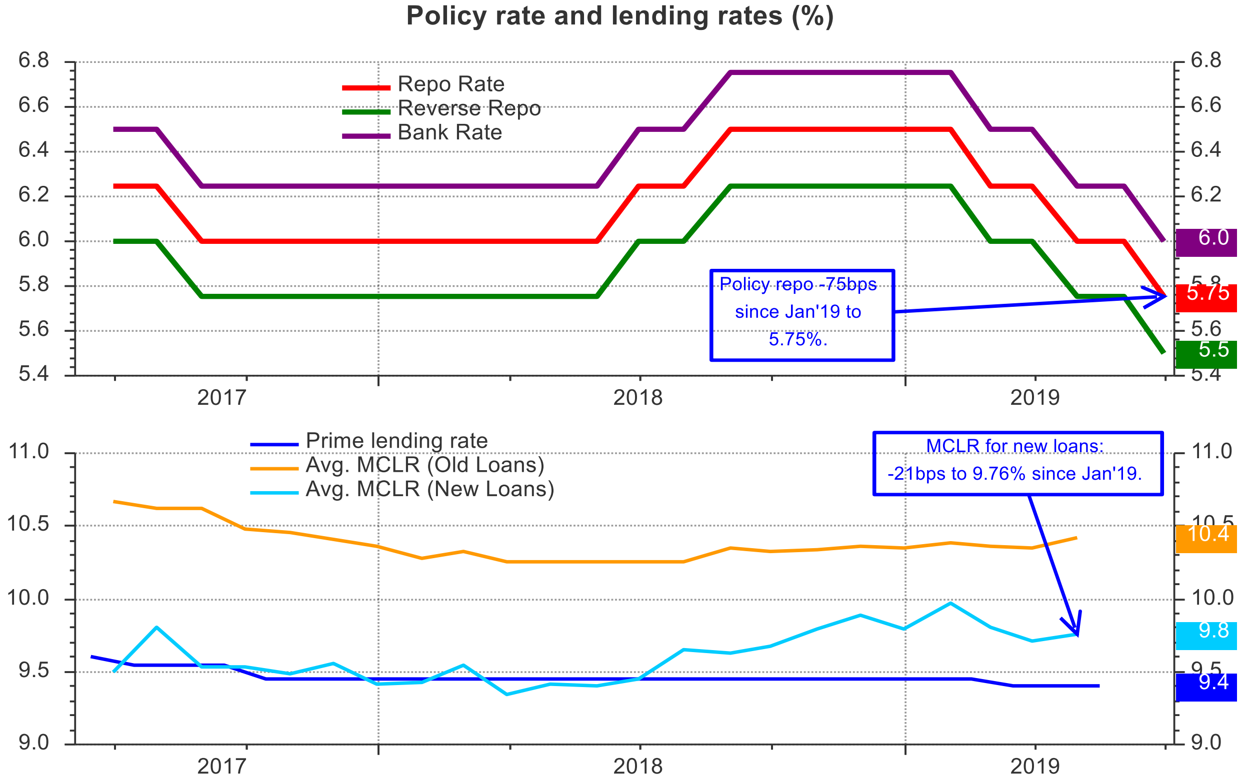
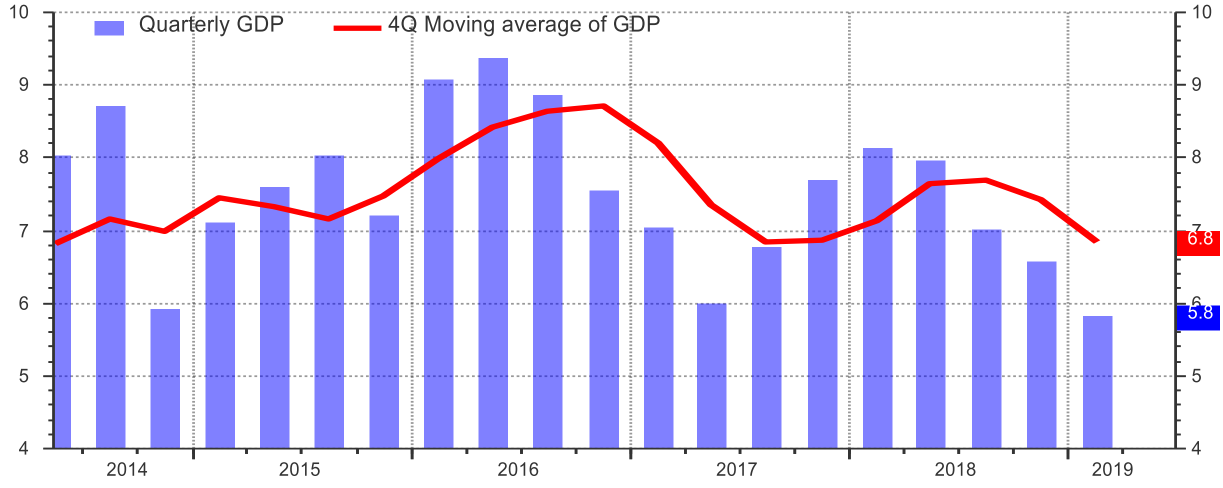


Figure 3: Q4FY19 GDP growth came in at a 20-quarter low



Source: RBI, Thomson Reuters

Decoding the Developmental and Regulatory Policies

Sr. No	Policy	What does it mean?	Notes
1	Leverage ratio (LR) for banks	Minimum LR should be 4% for Domestic Systemically Important Banks (DSIBs) and 3.5% for other banks as decided by the Basel Committee on Banking Supervision (BCBS).	Will ensure financial stability (mitigate risks of excessive leverage) and move towards harmonisation with Basel III standards.
2	On-tap licensing for small finance banks	New players could submit their application to RBI at any point of time throughout the year and licenses will be granted accordingly. More time would be needed to review performance of payment banks.	Would enhance access of banking facilities to small borrowers and encourage competition. Report to be submitted by end Aug'19.
3	Regulatory and supervisory framework for core investment companies (CICs)	The Working Group would review the regulatory guidelines and supervisory framework.	Would strengthen corporate governance framework of CICs.
4	Internal working group to review liquidity management framework	Internal Working Group to review existing liquidity management framework and suggest measures to simplify the current framework and clearly communicate the objectives, quantitative measures and toolkit of liquidity management by the RBI.	Report to be submitted by mid-Jul'19.
5	Foreign exchange trading platform for retail participants	A new forex platform for retail participants has been created by unifying the existing fragmented market microstructure.	This would ensure fair and transparent pricing for users of foreign exchange, regardless of order size.
6	Comprehensive review of money market directions	To ensure consistency across products in terms of issuers, investors and other participants, RBI will rationalize existing regulations covering different money market products.	Improve transparency and safety of money markets.
7	Retail participation in government security market	Retail participants would be allowed to bid for state development loans through *Specified Stock Exchanges*, just like they have been doing for treasury bills and government bonds.	Enhanced participation from buyers is expected to boost demand for government securities and thereby bring down the cost of borrowing.
8	Review of charges for RBI-operated payment systems	No charge to be levied on customers for RTGS and NEFT transactions	To incentivize digital banking
9	Constitution of a committee to review the ATM interchange fee structure	The RBI to constitute a panel to review ATM interchange fee structure. Committee to submit its recommendations within two months of its first meeting.	This would help resolve the persistent demands from the public to change the fee structure.

Source: RBI, NSE

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