

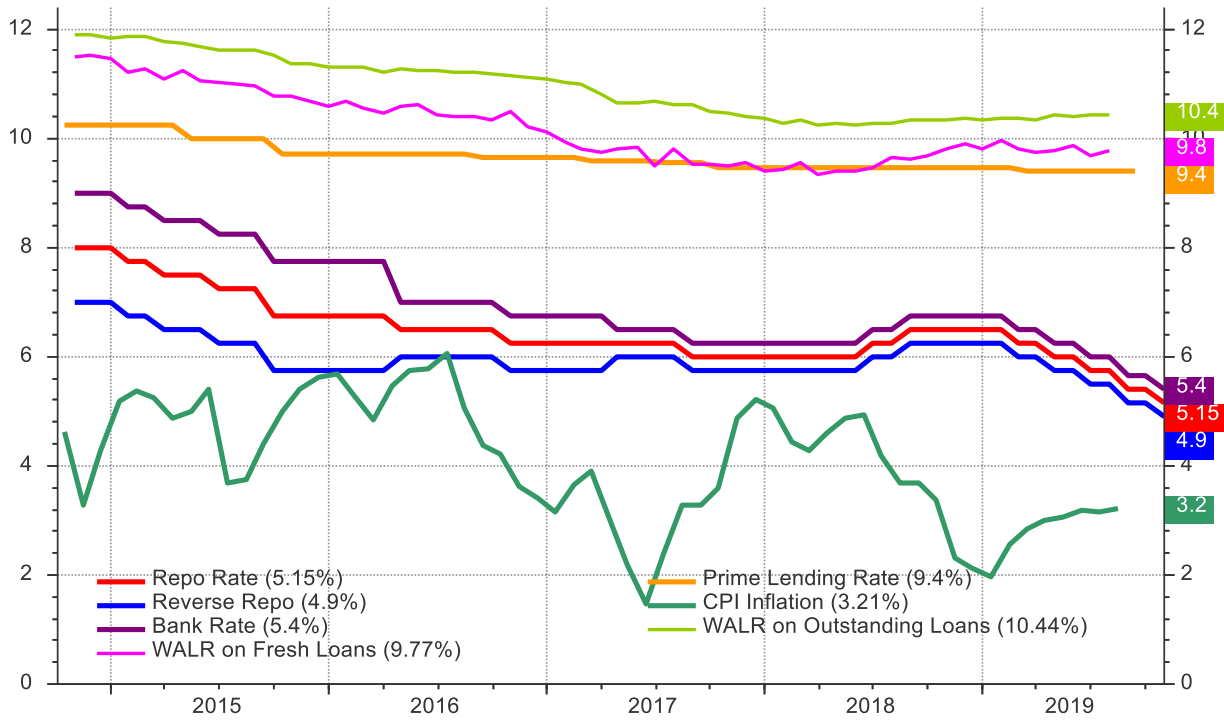
Fifth rate cut this year, more in the offing; FY20 GDP est. cut sharply

Policy rates were eased by 25bps—the fifth consecutive cut in 2019 thus far, accompanied by retention of an ‘accommodative’ stance for as long as required to revive growth. This translates into cumulative easing of 135bps in the year thus far, taking the repo rate to 5.15%—the lowest since April 2010 (reverse repo: 4.90%). The MPC’s decision acknowledged further deterioration of domestic as well as global economic conditions since the last policy in August, leading to further widening of the negative output gap. Following a much weaker-than-expected GDP growth in Q1FY20, the MPC has significantly lowered its GDP growth estimate for FY20 from 6.9% to 6.1%. The statement also included several developmental/regulatory policies measures for strengthening regulation and supervision, broadening and deepening financial markets and improving the payment and settlement systems.

The MPC has noted that continued economic slowdown calls for intensified efforts to revive growth momentum. With inflation expected to remain below the 4% target over the next 12 months, room for further monetary easing remains open, even as transmission of previous cuts is extremely crucial (WALR: -29bps during Feb-Aug 2019). We expect 25-50bps cut in the rest of the financial year, *ceteris paribus*. Key downside risks include volatile crude oil prices amid persisting geo-political uncertainties and financial market volatility.

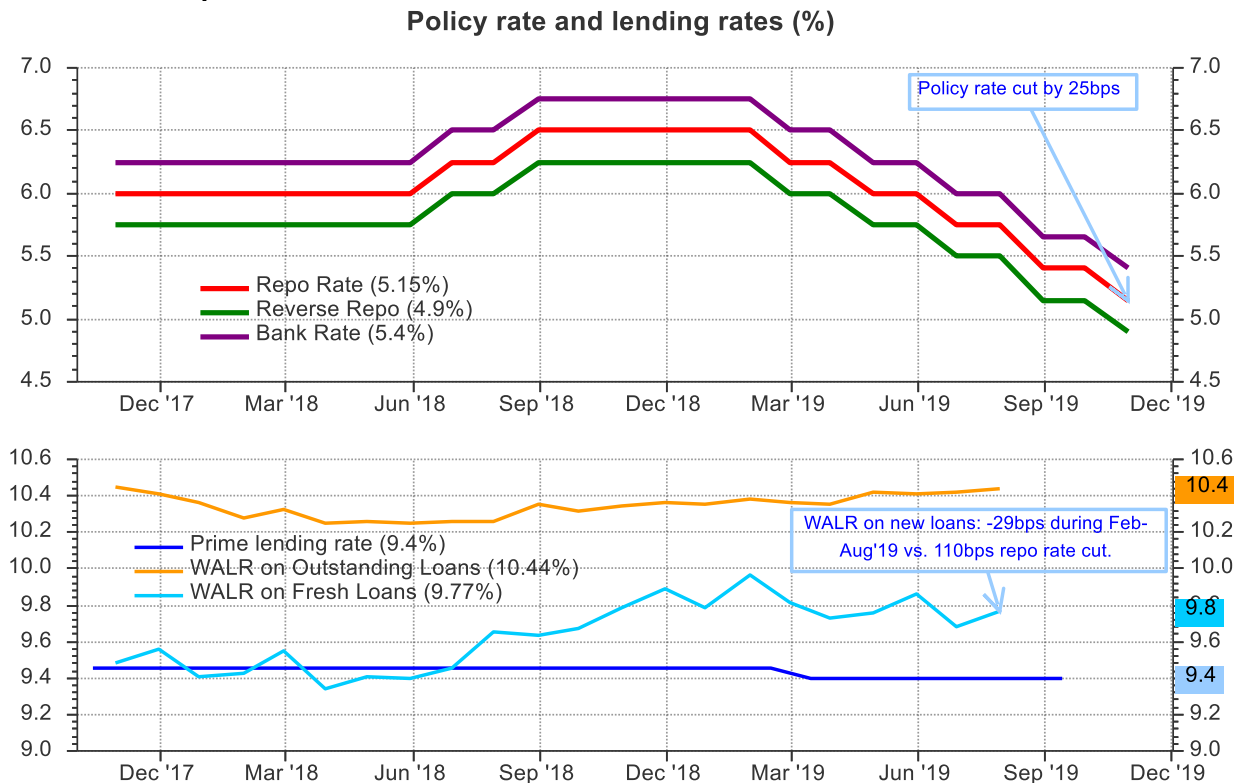
- **MPC cuts repo rate by 25bps; decides to remain accommodative for as long as necessary:** The RBI’s Monetary Policy Committee (MPC) has reduced the policy repo rate by 25bps to 5.15% (the lowest since April 2010), citing further widening of negative output gap since last policy. This translates into cumulative cuts of 135bps in 2019 thus far. In line, the reverse repo rate now stands at 4.9%, while the bank rate/Marginal Standing Facility (MSF) rate are at 5.4%. The MPC has also continued with the ‘accommodative’ stance for as long as necessary to revive growth, while ensuring inflation remains within the target.
- **Inflation outlook remains benign:** The inflation trajectory in the fiscal thus far has broadly been in-line with RBI’s projections. The MPC remains fairly comfortable on the inflation trajectory and expects it to be within the 4% target over next 12 months. The CPI inflation forecast has been slightly revised upwards for Q2FY20 from 3.1% to 3.4%, while the H2FY20 forecast has been retained at 3.5-3.7%. A significant improvement in Southwest monsoon has improved food inflation outlook, even as vegetable prices may remain elevated in the near-term. Importantly, core inflation is expected to remain soft amid weak demand conditions. On the negative side, volatile crude oil prices due to persisting geo-political tensions as well as financial market volatility and consequent pressures on the INR are cited as key downside risks.
- **GDP growth projection sees sharp downward revision:** The MPC has reduced its GDP growth forecast for FY20 for the fourth time in a row, this time at a very steep pace, expecting it at 6.1% vs. 6.9% earlier (7.0%/7.2% in the June/April policy)—5.3% in Q2 FY20 (5.8-6.6% in H1FY20 earlier) and in the range of 6.6-7.2% in H2FY20 (7.3-7.5% earlier). Various high frequency indicators such as auto sales, monthly trade performance, and industrial growth suggest continued weakening of domestic demand conditions, with escalating trade tensions and global growth slowdown adding to the woes. Several global multilateral agencies such as IMF, ADB (Asian Development Bank), UNCTAD (United Nations Conference on Trade and Development) and OECD (Organisation for Economic Co-operation and Development) have also recently slashed India’s growth projections for FY20, with forecasts ranging from 5.9% to 6.6%.
- **Growth to remain at the forefront for now; expect further monetary easing ahead:** The MPC remains committed to addressing growth slowdown within the flexible inflation targeting mandate, even as the recent measures taken by the government over last couple of months are expected to spur domestic demand, especially private consumption. This keeps the room open for further monetary easing, particularly in the wake of a comfortable inflation trajectory ahead. However, a pick-up in monetary policy transmission to the real economy remains crucial—the weighted average lending rate (WALR) on fresh rupee loans has come down by 29bps during Feb-Aug’19 vs. 110bps cut in the policy rate while WALR on outstanding loans has increased by 7bps during the same period. We expect another 25-50bps cut in the rest of the fiscal, *ceteris paribus*.

Figure 1: Policy rates reduced by 135bps since start of 2019
 India policy rate, inflation, lending rate (%)



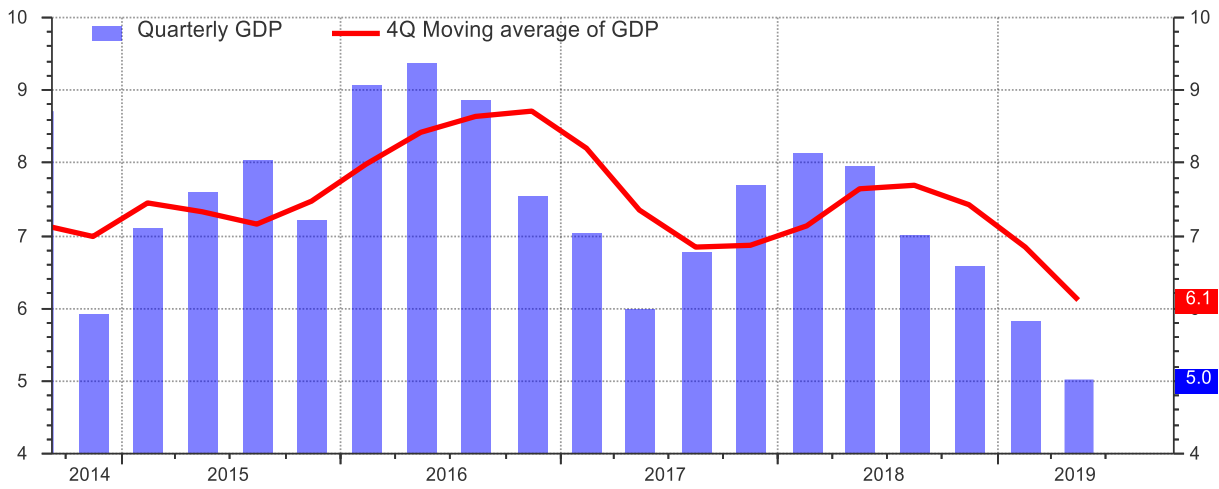
Source: RBI, Refinitiv Datastream, NSE. WALR: Weighted Average Lending Rate

Figure 2: Whither Transmission? Repo -110bps during Feb-Aug 2019; 'New loan' WALR -29bps, 'Old loan' WALR +7bps



Source: RBI, Refinitiv Datastream, NSE. WALR: Weighted Average Lending Rate

Figure 3: Q1FY20 GDP growth came in at a six-year low



Source: RBI, Refinitiv Datastream, NSE

Figure 4: A snapshot of monetary policy statements in FY20 thus far

	April 2019	June 2019	August 2019	October 2019
Global growth	Global activity remains soft. Bond yields softened further and slipped further into negative zone in Germany/ Japan as central banks signalled softer stances. EM currencies have traded with a depreciating bias on country-specific factors and a weakening economic outlook in China.	Global economic activity has been losing pace after a marginal improvement in Q12019, reflecting further slowdown in trade and mfg. activity. Most EM currencies have depreciated against the USD.	Global economic activity has slowed down further, amidst elevated trade tensions and geo-political uncertainty. Bond yields have declined sharply on more accommodative stance by central banks.	Trade and geo-political tensions continue to cloud global economic outlook. Central banks became more accommodative with inflation remaining below targets across major advances/emerging economies
Domestic growth	Growth decelerated for the 3rd quarter in a row in Q3FY19. Output gap remains negative, with the economy facing headwinds, especially on the global front. FY20 GDP forecast cut from 7.4% to 7.2%.	Growth impulses have weakened significantly, with a sharp slowdown in investment activity and continued moderation in private consumption growth being a matter of concern. FY20 GDP forecast cut from 7.2% to 7.0%.	Economic outlook remains weak, with private consumption and investment activity remaining sluggish, even as a decline in input costs augurs well for growth. FY20 GDP forecast cut from 7.0% to 6.9%.	High-frequency indicators point to continued weakening of manufacturing and services sector activity. FY20 GDP growth forecast slashed from 6.9% to 6.1%.
Inflation	Lower-than-expected core inflation has imparted downward bias to headline inflation. A 10% increase in crude oil prices since the last policy is a risk. CPI inflation est. revised downwards to 2.4% in Q4FY19, 2.9-3.0% in H1FY20 and 3.5-3.8% in H2.	Inflation remains below the target even after accounting for the expected transmission of the past two rate cuts. CPI inflation estimate revised to 3.0-3.1% in H1FY20 (2.9-3.0% earlier) and 3.4-3.7% in H2 (3.5-3.8% earlier).	Inflation has evolved in-line with RBI's projected trajectory and is expected to remain within the target over a 12-month ahead horizon. Headline inflation estimated at 3.1% for Q2FY20 and 3.5-3.7% for H2FY20.	Inflation trajectory remains benign; to remain within 4% target over next 12 months. Q2FY20 forecast raised from 3.1% to 3.4% amid near-term pressures from crude and vegetable prices. H2FY20 forecast retained at 3.5-3.7%.
Liquidity	Liquidity turned into deficit in Feb-Mar'19, reflecting the build-up of govt. cash balances. Liquidity needs were met through OMO purchases. WACR remained broadly aligned with the policy repo rate.	Liquidity turned into surplus in early June after remaining in deficit during April and May due to restrained govt. spending. WACR traded 6bps above the repo in April and 6bps lower in May.	Liquidity was in large surplus in Jun/July'19 due to return of currency to banking system, drawdown of excess CRR by banks, OMO purchases/forex operations by RBI. WACR traded in line with repo in June, but -14bps in July.	Liquidity remained surplus in Aug/Sep 2019 despite expansion of CIC and forex operations by RBI. The weighted average call rate (WACR) traded below repo rate by an avg. of 8bps in August and 6bps in Sep.
Transmission		Transmission of cumulative cuts of 50bps in Feb/April 2019 was 21 bps to the weighted average lending rate (WALR) on fresh rupee loans.	Transmission has improved marginally with WALR on fresh rupee loans falling by 29 bps during the current easing phase so far (February-June 2019)	Monetary transmission has remained staggered and incomplete. WALR on new loans has come down 29bps during Feb-Aug 2019 vs. policy cut of 110bps.
Rate action	-25bps. Repo: 6.0%; Reverse Repo: 5.75%	-25bps. Repo: 5.75%; Reverse Repo: 5.5%	-35bps. Repo: 5.4%; Reverse Repo: 5.15%	-25bps. Repo: 5.15%; Reverse Repo: 4.9%
Stance	Neutral	Accommodative	Accommodative	Accommodative

Source: RBI, NSE

Decoding the Developmental and Regulatory Policies

Sr. No	Policy	What does it mean?	Implications
Regulation and Supervision			
1	Easing income and loan limits for NBFC-MFI	The household income limit for borrowers of NBFC-MFIs has been increased from Rs0.1mn for rural areas and Rs0.16mn for urban/semi-urban areas to Rs0.125mn and Rs0.2mn respectively. The lending limit has been raised from Rs0.1mn to Rs0.125mn per eligible borrower.	Will help in effective credit disbursal to those at the bottom of the economic pyramid.
Financial markets			
2.	Incentivising NRIs to access the onshore foreign exchange market	The RBI has accepted the following recommendations of the Task Force on Offshore Rupee markets: a) Allowing domestic banks to freely offer FX prices to NRIs at all times, out of their Indian books, either by a domestically or through their overseas branches; and b) Allowing rupee derivatives (with settlement in foreign currency) to be traded in International Financial Services Centres (IFSCs).	Will help in improving access of overseas users to onshore foreign exchange market.
3.	Review of the Non-Resident Rupee Account Policy	Non-residents Indians permitted to open non-interest bearing Special Non-resident Rupee (SNRR) Account with no restriction on the tenure (which is currently seven years).	Will further ease cross-border transactions in INR by facilitating rupee-denominated ECB, trade credit and trade invoicing.
Payment and Settlement Systems			
4.	Liquidity Support for the Proposed 24x7 National Electronic Funds Transfer (NEFT) System	In continuation of the announcement regarding 24/7 availability of the NEFT payment system, the RBI has decided to extend the collateralised liquidity support which is currently available till 7.45 pm on NEFT working days, round the clock.	Will facilitate smooth settlement of NEFT transactions in the accounts of the banks maintained with the RBI, thereby helping them in better fund management.
5.	Internal Ombudsman by large non-bank Prepaid Payment Instrument (PPI) Issuers	An internal ombudsman scheme shall be institutionalised at the large non-bank PPI issuers (having >10mn pre-paid payment instruments outstanding), with an aim to facilitate a swift and cost-effective complaint redressal mechanism.	Will strengthen the grievance redressal mechanism by providing an additional tier at the entity level itself.
6	Granular dissemination of Payment System data	More granular information on payment data covering the payment systems authorised by the RBI shall be disseminated. With this, the entire gamut of payment systems data will be available in the RBI Bulletin/Website	Will aid in further development of the digital systems space.
7	Creation of an Acceptance Development Fund (ADF)	An ADF shall be created in consultation with the stakeholders as recommended by the Committee on Deepening of Digital Payments. The framework will be operationalised by December 2019.	Will help in improving digitisation in Tier III to Tier VI centres.
8.	Expanding and deepening of digital payments ecosystem	A district identified by State/UT Level Bankers Committees (SLBCs/ UTLBCs) in their respective States/UTs on a pilot basis shall be allocated to a bank with significant footprint which will endeavour to make the district 100% digitally enabled.	Will deepen digital payment ecosystem in these districts.

Source: RBI, NSE

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