NSE

Macro Review

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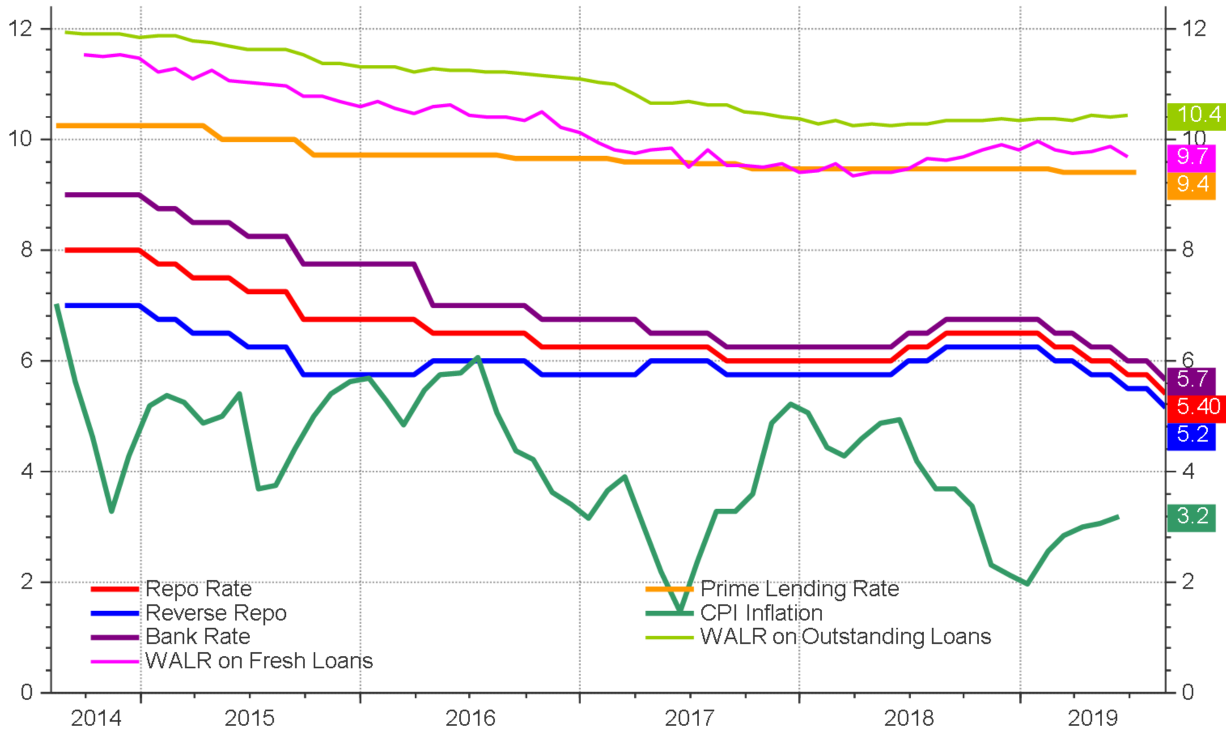
Fourth rate cut this year, room for more; FY20 GDP est. slashed

Policy rates were eased further, but by an unconventional 35bps in the third monetary policy review of the fiscal, accompanied by retention of an 'accommodative' stance. This translates into cumulative easing of 110bps in the year thus far, taking the repo rate to 5.4%—the lowest since 2011 (reverse repo: 5.15%). The MPC's decision acknowledged deteriorating domestic economic conditions since the last policy in June, with a global downturn adding to the woes, even as inflation has remained fairly benign at the CPI level. The tone of the policy statement remained dovish as the MPC now views addressing growth concerns as its utmost priority, with inflation likely to remain well within its target band over the next 12 months. The MPC has marginally revised the FY20 GDP growth forecast from 7% to 6.9%, with risks tilted to the downside. The statement also included several developmental/regulatory policies in the areas of financial markets, payment and settlement systems, banking regulation, financial inclusion and credit flow to NBFCs.

With growth impulses remaining weak, and global backdrop remaining unsupportive, there is room for another 25bps rate cut, *ceteris paribus*, even as transmission of previous rates cuts is extremely crucial (MCLR: -29bps since Jan 2019). Key downside risks include below-normal rainfall in the second half of the season, leading to a spike in food prices, and volatile crude oil prices amid geopolitical tensions.

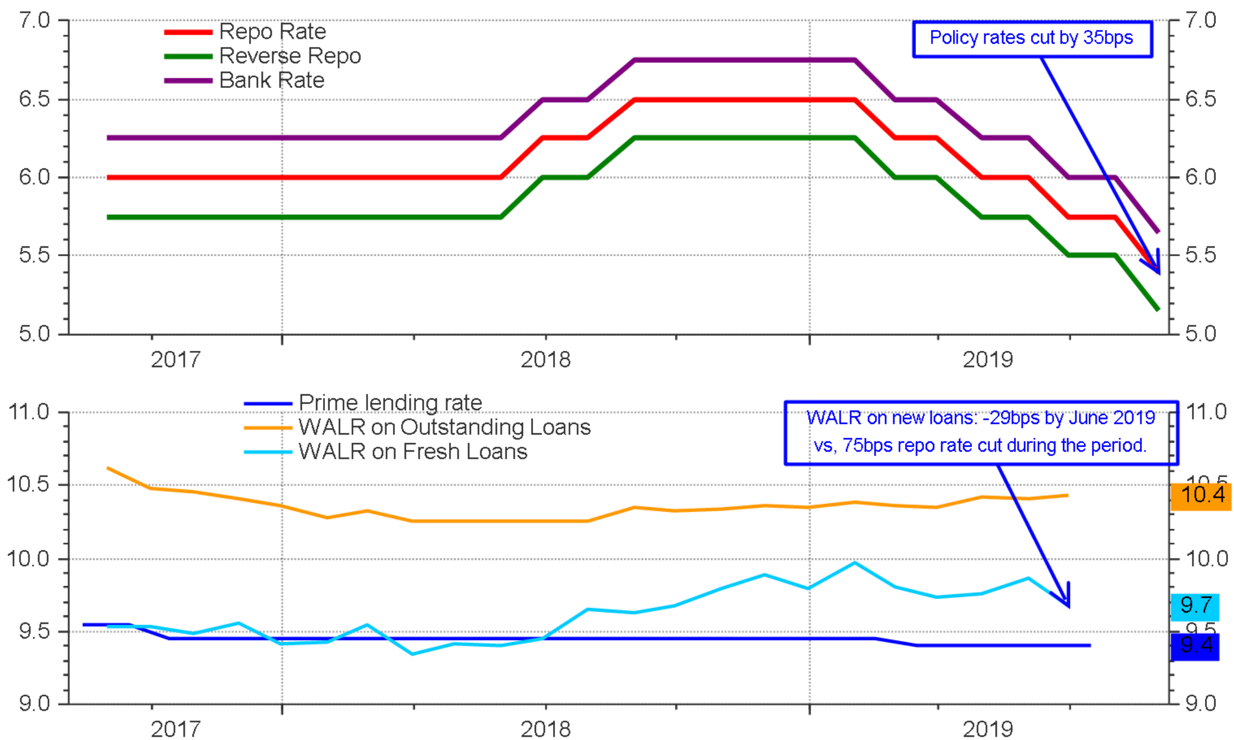
- **Repo cut by 35bps, accommodative stance**: The RBI's Monetary Policy Committee (MPC) has reduced the policy repo rate by an unconventional 35bps to 5.4% (the lowest in nine years), citing the usual 25bps cut being inadequate and 50bps being excessive given limited transmission thus far. This has translated into cumulative cuts of 110bps in 2019 thus far. In line, the reverse repo rate now stands at 5.15%, while the bank rate/Marginal Standing Facility (MSF) rate are at 5.65%. The MPC has also retained the 'accommodative' stance, with boosting aggregate demand being the highest priority at this juncture, signalling room for further monetary easing. Deterioration in domestic economic activity since the June, coupled with a benign inflation trajectory, necessitated a policy action in August.
- **Inflation outlook remains benign**: 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 forecasts have been broadly kept unchanged at 3.1% in Q2FY20, 3.5-3.7% in H2FY20 (3.4-3.7% earlier) and 3.6% in Q1FY21, with risks evenly balanced. Importantly, core inflation is expected to remain soft amid weak demand conditions, as also evident from the industrial outlook survey, where manufacturing firms expect output prices to ease in Q2. Additionally, the household inflation expectations for one-year ahead period have further moderated. On the negative side, sustained increase in food inflation, with a potentially uneven spatial and temporal distribution of Southwest monsoon adding to upside pressures, and volatile crude oil prices due to geopolitical tensions in the Middle-East are cited as key downside risks.
- **GDP growth projection further revised downwards**: The MPC has further reduced its GDP growth forecasts for FY20 for the third time in a row, expecting it at 6.9% vs. 7.0% earlier (7.2% in the April policy)—in the range of 5.8-6.6% in H1FY20 (6.4-6.7% earlier) and 7.3-7.5% in H2FY20 (7.2-7.5% earlier). Notably, the MPC views risks to its GDP growth forecast to be tilted to the downside as opposed to evenly balanced risks in the June policy meeting. Various high frequency indicators such as auto sales, monthly trade performance, and industrial growth suggest weakening of domestic demand conditions, with escalating trade tensions and global growth slowdown adding to the woes. Several global multilateral agencies such as IMF and ADB had also recently slashed India's growth forecasts for FY20.
- **Room open for further monetary easing:** The MPC is likely to focus more on addressing demand slowdown, particularly investment, as clearly articulated in the policy statement. This keeps the room open for further monetary easing—we expect another 25bps cut in this fiscal, *ceteris paribus*. 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 by June 2019 vs. 75bps cut in the policy rate since then. Performance of Southwest monsoon during August-September, coupled with global growth scenario and financial market volatility, would dictate the rate trajectory going forward.

Figure 1: Policy rates reduced by 110bps since start of 2019



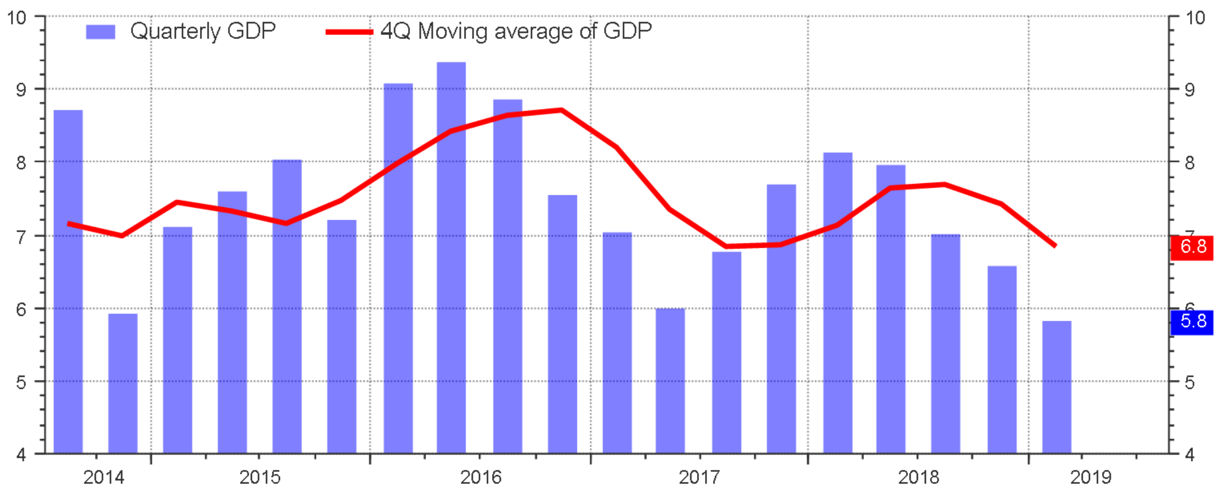
Source: RBI, Thomson Reuters. WALR: Weighted Average Lending Rate

Figure 2: Whither Transmission? Repo -75bps by June 2019; 'New loan' WALR -29bps, 'Old loan' WALR +5bps



Source: RBI, Thomson Reuters. WALR: Weighted Average Lending Rate

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?	Implications
Financial Markets			
1	Stripping/reconstitution facility for State Development Loans (SDLs)	Conversion of period coupon payments into tradeable zero-coupon securities (stripping) and reassembling of coupon and principal strips (reconstitution) would be introduced for SDLs. This would be implemented in consultation with respective state governments.	Will help in the development of the SDL market in both primary and secondary segments.
Payment and Settlement Systems			
2	Round-the-Clock Availability of National Electronic Funds Transfer (NEFT) System	NEFT payment system would be made available on a 24/7 basis from December 2019. Currently it is available from 8am to 7pm on all working days of the month (except 2nd/4th Saturdays).	Would revolutionise the retail payment systems in India.
3	Expansion of Biller Categories for Bharat Bill Payment System (BBPS)	All categories of billers (except prepaid recharges) who provide for recurring bill payments would be permitted to participate in BBPS on a voluntary basis. Currently, it covers only five segments, viz. direct-to-home, electricity, gas, telecom and water bills.	Would help in digitisation of cash-based bill payments.
4	'On-tap' Authorisation for Retail Payment Systems	'On tap' authorisation to be offered to entities desirous to function/operate/provide platforms for Bharat Bill Payment Operating Unit (BBPOU), Trade Receivables Discounting System (TReDS), and White Label ATMs (WLAs). To be implemented by the end of Sep 2019	In addition to minimising concentration risk in retail payment systems from a financial stability perspective, this would result in diversification of risk and encourage innovation and competition.
5	Creation of a Central Payments Fraud Information Registry	The Central Payment Fraud Registry would track frauds in the payment systems. Payment system participants will be provided access to this registry for near-real time fraud monitoring. A detailed framework to be put in place by Oct-2019 end.	Would enable effective fraud risk monitoring and management by the stakeholders of payment systems. Publishing of the aggregate fraud data would help educate customers on emerging risks.
Banking Regulation, Financial Inclusion and Credit flow to NBFCs			
6	Reduction in risk weight for consumer credit except credit card receivables	Risk weight for consumer credit, including personal loans but excluding credit card receivables, to be reduced from 125% to 100%. Guidelines to be issued by the end of Aug 2019.	Would help release capital for the banking industry and facilitate monetary policy transmission.
7	Enhanced credit flow to NBFC Sector	1) A bank's exposure limit to a single NBFC raised from 15% of Tier-1 capital to 20%, bringing it at par with other sectors. 2) Bank lending to registered NBFCs (other than MFIs) for on-lending to Agriculture (investment credit) up to Rs1mn, Micro & Small Enterprises up to Rs2mn and housing up to Rs2mn per borrower (up from Rs1mn currently) to be classified as priority sector lending. Detailed guidelines to be issued by Aug 2019 end.	1) To ease credit flow to the NBFC sector 2) To increase credit flow to certain priority sectors, contributing significantly to economic growth and employment generation.

Source: RBI, NSE

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