

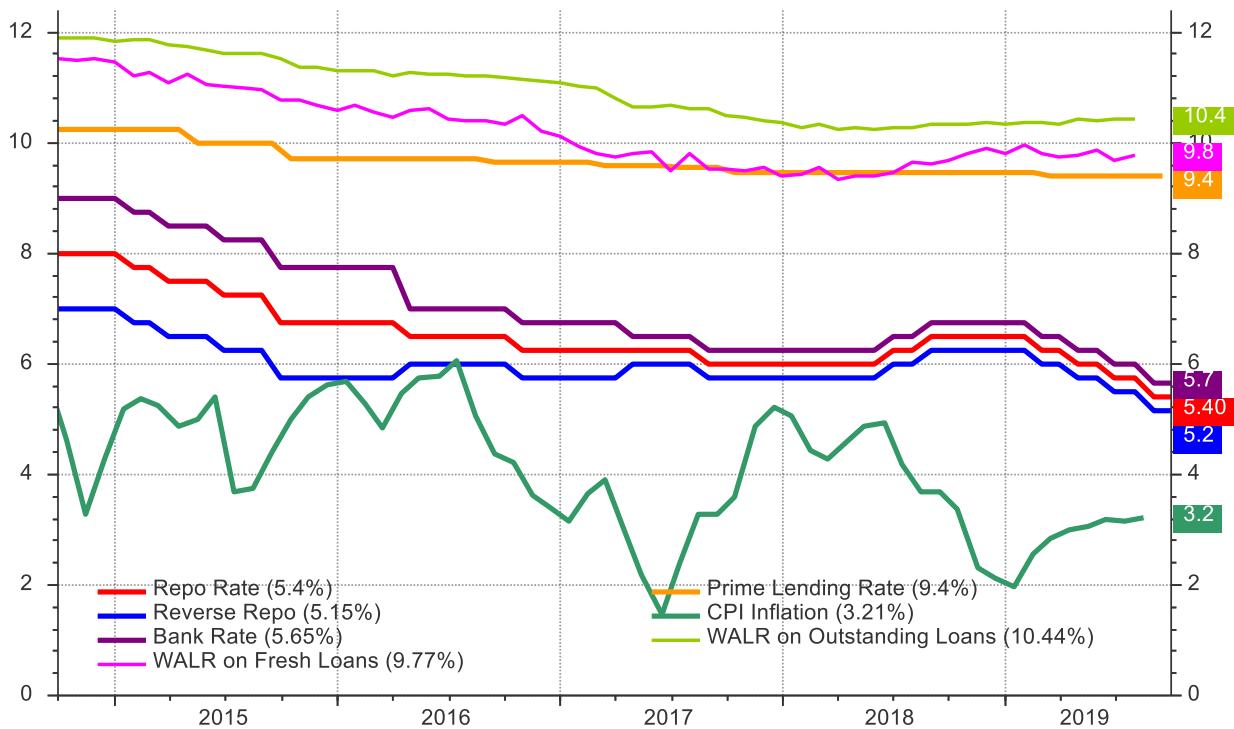
## Monetary Policy: Growth over inflation for now; expect 25bps rate cut on Oct 4<sup>th</sup>

Following four consecutive cuts in the policy rates in 2019 thus far, including an unconventional 35bps cut in the last policy review, we expect the RBI's Monetary Policy Committee (MPC) to trim the policy repo rate by another 25bps on October 4<sup>th</sup>, 2019. The economy has showed no signs of improvement since the last policy in August, as seen from continued deterioration in several high frequency indicators, e.g., auto sales, eight-core sector growth, and monthly merchandise trade performance. The Asian Development Bank (ADB) slashed its growth forecast for India for FY20 from 7.0% projected in July to 6.5%, citing a slowdown in consumption and investment activities. Inflation, on the other hand, has remained benign amid continued moderation in core inflation, even as surge in oil prices and rising food inflation poses upside risks in the near-term. Nevertheless, inflation is expected to remain within the RBI's target band of 4% +/- 2%. On the negative side, a significant fiscal stimulus in the form of cut in corporate tax rates poses pressures on the fiscal front, even as any upside impact on inflation is expected to be limited.

While inflation is seen rising in the near-term, albeit moderately, thanks to an unfavourable base, it may take a few quarters for the fiscal and monetary impulses to close the negative output gap. In this context, with growth getting the 'highest priority' by the MPC at the moment, there is room available for another 25bps rate in December, *ceteris paribus*. Key risks include a higher-than-expected spike in food prices and volatile crude oil prices amid geopolitical tensions.

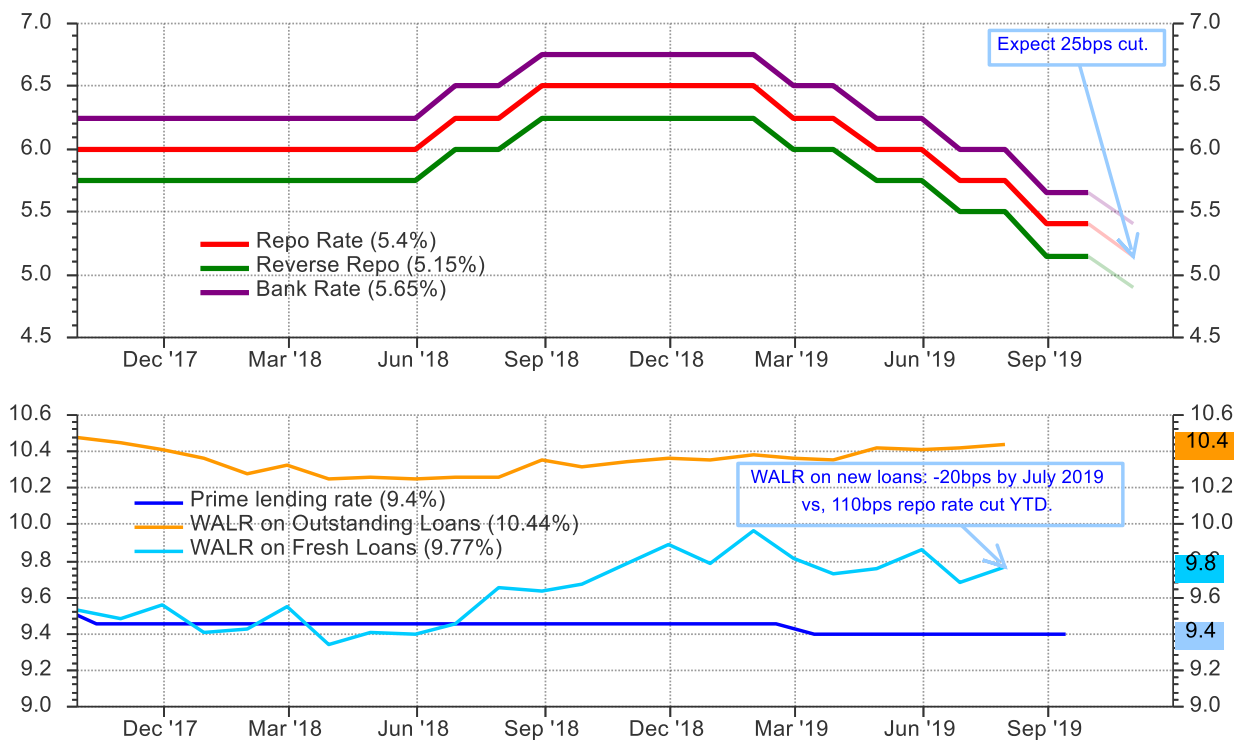
- **Expect another 25bps rate cut accompanied by retention of an accommodative stance:** The RBI's Monetary Policy Committee, in its fourth bi-monthly policy review meeting of this fiscal scheduled for October 4<sup>th</sup>, 2019, is expected to reduce the policy rates by another 25bps (repo rate to be reduced from 5.4% to 5.15%). This would take the total quantum of rate cuts in 2019 thus far to 135bps. The MPC is expected to retain its monetary policy stance to 'accommodative', as weak domestic growth-inflation dynamics, coupled with an unfavourable global demand outlook, is likely to keep the room open for further monetary accommodation.
- **Inflation trajectory to remain comfortable:** The average retail inflation (CPI) in the fiscal thus far (Apr-Aug 2019) at 3.1% has broadly followed the RBI's projected trajectory. In fact, CPI inflation has remained below the RBI's medium-term target of 4% for the 13<sup>th</sup> consecutive month. On the negative side, food inflation has been picking up, largely on account of higher vegetables and pulses inflation, even as a strong revival in the South west monsoon in the second half of the season (August-September 2019—cumulative rainfall in the season picked up meaningfully from a deficit of ~9% as of July-end to 10% surplus as of September-end) is likely to provide some support. The core inflation (ex-food ex-fuel), on the other hand, continues to moderate, signalling weakening domestic and external demand. This, in turn, is expected to keep the headline inflation under check, even as an unfavourable base effect may impart upside pressure in the near-term.
- **Growth impulses remain weak:** Since the last policy review in August 2019, growth has failed to show any signs of improvement, as signalled from several high frequency indicators—1) India's export/import bill declined by 6.0%/13.5% in August, with the fall in imports being the steepest in three years. 2) Auto sales continue to decline, with the domestic passenger car sales falling by 41.1% YoY in August 2019 (-29.4% in FY20TD). 3) Output of India's eight core infrastructure sectors contracted for the first time in more than four years in August, falling by -0.5%. The ADB slashed India's FY20 GDP growth forecast from 7.0% in July to 6.5%, following a six-year low GDP growth of 5% in Q1 FY20, thanks to slowing consumption as well as investment demand.
- **Room open for further monetary easing; transmission to gather pace:** Amidst a benign inflation trajectory and weakening growth outlook, we believe there is room available for a total of 40-50bps incremental rate cuts in rest of the fiscal, *ceteris paribus*. Monetary transmission thus far has been weak (weighted average lending rate on fresh loans down by 20bps by July 2019), and is likely to be so until financial conditions remain tight, and supply of funds from weak economic growth and falling household savings are effectively balanced by fiscal demands. The RBI's proposed liquidity framework coupled with the decision to link floating rate loans with an external benchmark rate effective Oct 1<sup>st</sup>, 2019 should expedite the process.

**Figure 1: Policy rates reduced by 110bps since start of 2019; expect another 25bps cut on October 4<sup>th</sup>**  
 India policy rate, inflation, lending rate (%)



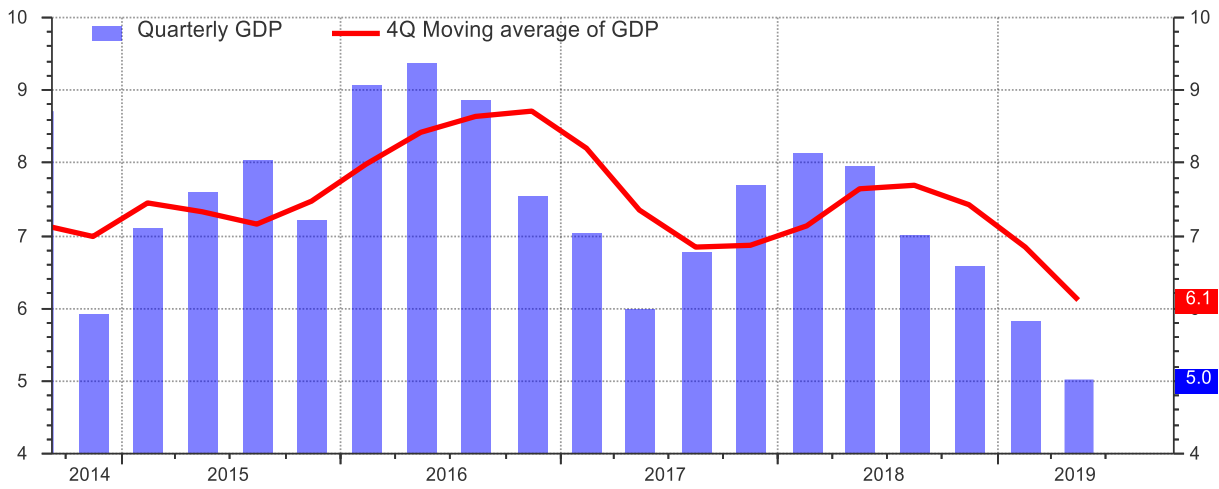
Source: RBI, Refinitiv Datastream. WALR: Weighted Average Lending Rate

**Figure 2: Whither Transmission? Repo -110bps; 'New loan' WALR -20bps, 'Old loan' WALR +6bps**  
 Policy rate and lending rates (%)



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

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



Source: RBI, Refinitiv Datastream

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