JUNE MPC MINUTES

20 June 2019

Another rate cut in August

The significant undershoot of Q4 growth to a 20-quarter low of 5.8%, drove the MPC members to cut policy rate by 25bps. The need to improve transmission to reduce real interest rates guided change in stance to accommodative. So did the benign outlook on core inflation and recent decline in oil prices. The risk to inflation as noted by several members is from food inflation which is gradually inching up. In our view, the global and domestic growth slowdown calls for another 25bps rate cut along with surplus liquidity conditions to continue.

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KEY HIGHLIGHTS

- Growth remained a major concern for MPC members.
- Inadequate transmission of rate cuts emerged as an underlying theme in the minutes.
- Room remains for another rate cut in Aug'19.

Growth concerns made MPC cut rates: With Q4 growth slowing down to a 20-quarter low of 5.8%, MPC members unanimously raised concerns on current slowdown. Notably, the growth in investments fell to 3.6%, a 14-quarter low. In order to kick-start the investment cycle, MPC members reduced policy rate by 25bps. Since then, global growth has deteriorated. Even India's domestic growth is likely to be lukewarm with monsoon being 45% below normal. This implies further room for easing as in the words of Dr. Michael Patra "with inflation projected to remain below target, a higher weightage needs to be assigned to growth relative to previous meetings".

Inflation outlook remains balanced: MPC members observed that the recent decline in core inflation (90bps in two months) suggests that underlying demand is weak. Dr. Acharya is of the view that core inflation is a better indicator of future inflation as it is more persistent. While core inflation is likely to come down further, food inflation has and is likely to increase due to a base effect as also below normal rainfall. Prices of vegetables, pulses and certain protein items will go up. Even so, the MPC's target of 4% will be achieved as global oil prices have receded and will provide cushion.

Another rate cut in August: Inadequate transmission of rate cuts emerged as an underlying theme in the minutes. In order to give confidence to markets on trajectory of policy rates and liquidity, MPC members changed policy stance to accommodative. Since the policy, India's 10Y yield has fallen by 23bps, in-line with US 10Y (11bps decline). Dr. Acharya observed that 6% policy rate is optimal for fiscal slippage of 0.5% or a 10% spike in oil prices. However, a policy rate of 5.75% will provide growth stimulus. Given the commentary from US Fed and ECB since RBI policy, we believe the current global and domestic economic context implies room for another 25bps cut in Aug'19.

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