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MONETARY POLICY REVIEW

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Two done, more to come

MPC delivered two consecutive rate cuts of 25bps each with a 4-2 vote. Neutral stance maintained. The continuous undershoot of CPI inflation and downward revision to growth forecasts spurred the MPC members to cut rates. With weak global and domestic growth momentum and change in monetary policy stance of most global central banks, RBI has room for another rate cut as real rates remain high. The key risk to the above view is sharp jump in oil prices, poor monsoon or adverse election result.

Sameer Narang
+91 22 6698 5713
chief.economist@bankofbaroda.com

Dipanwita Mazumdar
dipanwita.mazumdar@bankofbaroda.com

Aditi Gupta
aditi.gupta3@bankofbaroda.com

Inflation forecast revised downwards: RBI lowered its quarterly FY20 CPI forecast by as much as 30-40bps. For Q4FY19, new forecast is 2.4% versus 2.8% in Feb'19, for H1FY20 new forecast is 3% versus 3.3%, for Q3FY20 new forecast is 3.5% versus 3.9% earlier. For Q4FY20 forecast is 3.8%. The annual forecast for FY20 and FY21 is at 3.4% and 3.95% respectively, below MPC's target of 4%. This downward revision is driven by benign food inflation and lower oil prices. The persistent negative output gap also gives credence to the inflation outlook. So does the dip in global growth momentum. The new forecasts are in line with our projection of 3.4% and 3.7% for FY20/ FY21.

FY20 growth forecast at 7.2% from 7.4%: RBI reduced its GDP forecast for FY20 to 7.2% (7% in H1FY20 and 7.4% in H2FY20) on the back of dip in global (FIG-1) and domestic growth momentum. While the former will impact exports which have turned sluggish off-late, the slowdown in consumption is driving domestic demand lower. Recent indicators such as non-oil-non-gold imports, capital goods imports, port and air passenger traffic, CV and auto sales are all pointing to muted growth outlook. Investment growth has been driving GDP higher, but mostly led by government spending on roads and affordable housing. With improving capacity utilization (now at 75.9%), growth can be sustained with a broad based investment recovery for which lower real rates will be of help.

High real rates and output gap: Compared with other large economies, real rates in India are on the higher side. At the same time, the negative output gap should ensure inflation remains below RBI's target. Hence, we believe RBI is likely to do another repo rate cut in its next policy meeting. The key risks to our view are any sharp jump in global oil prices, below normal monsoon and adverse election outcome.

KEY HIGHLIGHTS

- RBI cuts repo rate by 25bps, stance remained unchanged at neutral.
- Inflation projections for H1FY20 revised downward to 3%, for H2FY20 at 3.7%.
- GDP forecast also revised lower at 7.2% for FY20 from 7.4% earlier.

Regulatory announcements

- RBI has permitted banks to reckon an additional 2% Government securities within the mandatory SLR requirement, as FALLCR for the purpose of computing LCR. The revised schedule for the total HQLA carve out from SLR as a percentage of NDTL stands at 15.50% as on 4 Apr 2019, which will be increased to 17% as on 1 Apr 2020 in a phased manner.
- In a major relief to bank's capital position, RBI has decided not to activate countercyclical capital buffer (CCCB) at this point in time.
- RBI has decided to constitute a Committee to assess the state of housing finance securitisation markets in India with the aim of developing a well-functioning securitisation market in India. This will lower the costs of mortgage finance in the country by enabling better management of credit and liquidity risks for banks and non-bank mortgage originators.
- Recognising the need for an active secondary market for corporate loans in India, RBI has decided to set up a task force to study the relevant aspects including best international practices and propose measures for developing an active secondary market for corporate loans in India. The Task Force is expected to submit its report by end of August, 2019.
- Benchmarking India's Payments Systems is necessary to gauge India's progress against payment systems and instruments in major countries and give further impetus to the planned efforts for deepening the digitisation of payments. A report containing the findings of such an exercise will be placed on the RBI website by the end of May 2019
- RBI has decided to extend the housing loan limits for eligibility under Priority Sector Lending applicable for SCBs (revised in Jun'18) to RRBs and SFCs. This will bring these banks at a level-playing field with other SCBs.
- RBI has extended its Ombudsman Scheme for handling grievances of customers of NBFCs to cover those non-deposit taking NBFCs having customer interface and asset size of Rs 1bn and above, by the end of April 2019

FIG 1 – BASE LINE ASSUMPTIONS IN MPR

Indicator	October 2017 MPR	April 2018 MPR	October 2018MPR	April 2019 MPR
Crude Oil (Indian Basket)	US$ 55 per barrel during H2FY18	US$ 68 per barrel during FY19	US$ 80 per barrel during H2FY19	US$ 67 per barrel during FY20
Exchange rate	65/US$	Current level	72.5/US$	69/US$
Monsoon	5% below LPA in 2017	Normal for 2018	9% below LPA	Normal for 2019
Global growth	3.5% in 2017 & 3.6% in 2018	3.9% in 2018 & 3.9% in 2019	3.9% in 2018 & 3.9% in 2019	3.5% for 2019 & 3.6% in 2020
Fiscal deficit	To remain within BE FY18: 3.2%	To remain within BE FY19 Centre: 3.3% Combined: 6.0%	To remain within BE FY19 Centre: 3.3% Combined: 5.9%	To remain within BEFY20 Centre: 3.4% Combined: 5.9%
Domestic macroeconomic/ structural policies during the forecast period	No major change	No major change	No major change	No major change

Source: RBI, Monetary Policy Report

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For further details about this publication, please contact:

Economics Research Department

Bank of Baroda

+91 22 6698 5713

chief.economist@bankofbaroda.com