

## AUGUST MPC MINUTES

20 August 2020

### Rate cut cycle may be behind us

**While India's growth seems to have bottomed out in Q1FY21, growth trajectory still remains uncertain. Both consumption, apart from rural, and investment demand is likely to be weak. Even so, supply side inflation pressures may not allow MPC to reduce policy rate as inflation remains above upper end of tolerance band. MPC minutes suggest members are concerned about a broader generalisation of inflation despite weak demand. With inflation likely to be above RBI's target of 4% in H2FY21, we see no room for rate cuts as of now.**

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#### KEY HIGHLIGHTS

- MPC members worried about elevated inflation print.
- Growth trajectory uncertain.
- Further rate cuts seem difficult.

**Growth trajectory likely to be weak:** MPC members noted that while economic activity has recovered from the lows seen in Apr-May'20, the future growth trajectory remains uncertain and depends on the pandemic. Dr. Saggar and Dr. Ghate also cautioned against "hysteresis" which may impinge on growth recovery as there may be permanent damage to potential output. Dr. Patra stressed on sustained policy support to various sectors to resuscitate activity. RBI's assessment is that GDP is likely to shrink in H1 and GDP growth will be negative in the year, implying weak recovery in H2.

**Inflation surprises negatively:** Dr. Dholakia believes the economy is in a deep stagflation as supply shock is more pronounced than demand shock. Dr. Saggar pointed out that inflation may have upward bias and monetary factors may be contributing to elevated inflation. Dr. Patra cited inflation outcome can be on 2009-10 or 2016-17 experience depending upon policy action. In the near-term, we believe inflation is likely to move up further with vegetable prices in Aug'20 showing a further uptrend (17% MoM increase).

**Rate cut cycle may be behind us:** Dr. Patra said that MPC has signalled its concern in its stance by resolving to ensure that inflation remains within the target going forward. Dr. Dholakia believes that available space for policy space should now be used prudently. Dr. Dua said that data of few more months will be crucial and Dr. Ghate has been advocating a more cautious path for policy rate reductions. While MPC members will be regarding Apr'20 and May'20 prints as break in the series, the upward pressure on inflation is seen in most food items (as many as 8 out of 12 food and beverage items are reporting inflation in excess of 6%). While core inflation is driven by gold and higher taxes on petro products, the supply side pressures imply inflation is likely to average above 4% even in H2FY21 implying no room for rate cut as of now.



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