



BWR expects 25 basis points rate cut in August 2019 MPC

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The Economic Survey 2018-19 and Union Budget 2019-20 indicated that the government aims to push the economy to USD 5 trillion by 2024-25. This would require the economy to grow at about 9% at the constant exchange rate. BWR feels that a rate cut would help to revive investment and provide consumption push to the economy and boost the critical factors contributing to the growth. Since the last June 2019 Monetary Policy Committee (MPC) meeting, indicators show economic activity has been slowing characterized by muted performances with respect to the high frequency indicators in critical sectors such as automobiles, cement and transport and communication. With the Index of Industrial Production (IIP) growth down to 3.1% in May 2019 as compared to 4.3% in the previous month and the Eight Core industries which comprise 40.27% of the weight of items included in IIP reporting virtual stagnancy in output growing at 0.2% during June 2019 and with inflation rate continuing to be benign, a rate cut would be an adrenaline shot for the economy. The critical issue here is further transmission of the rate cuts down the line.

Looking back, RBI has reduced the repo rate thrice so far in the calendar year 2019 (25 basis points each), translating into a cumulative reduction of 75 basis points; but, banks have barely transmitted it through their lending/deposit rate. The resultant transmission of lending rates has been limited with the indicators stated above not responding adequately. To date, base rate of scheduled commercial banks (SCBs) have increased marginally (9.33% in Dec 2018 to 9.34% in January 2019, continues to remain same till July). Thus, the transmission of the rate cut has emerged as a bigger challenge. With the banks still struggling with high NPAs and refusing to lend to NBFCs, there is a form of credit freeze. Transmission of policy rate cut is crucial at this juncture to improve the credit outlook; hence, the timely provisions for credit growth assumes utmost importance to create virtuous investment cycles.

The MPC had changed its monetary policy stance from neutral to accommodative and reduced key policy repo rate by 25 basis points in its June 2019 meeting, in line with BWR expectations. BWR had further advocated frontloading the rate cut by 50 bps in the June policy, as the impact of the monetary policy on the Indian economy comes with considerable lag.

The MPC in its June policy meeting lowered GDP growth forecast to 7.0% for 2019-20 from its earlier estimate of 7.2%. CPI inflation remained benign at 3.18% for June 2019 and inflation for items other than food and energy softened to 4% levels. With the softening of global crude oil prices, the policy rate cut is not likely to influence inflationary pressures in the near-term. While a mere cut in repo rate without a speedier transmission and a pick-up in demand, may not reinvigorate private investment activity, it does improve the overall sentiments in the economy and also helps the corporates reduce their borrowing costs.



Thus, although we would have preferred a 50 basis points cut in the policy rate; going by the past approach of the MPC, BWR expects a rate cut at least by 25 basis points in the upcoming meeting of MPC.

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