BWR expects a rate cut in August Policy due to the recent slump in growth numbers and benign inflation

Brickwork Ratings, 06 June 2019, Mumbai: The Monetary Policy Committee (MPC) of the Reserve Bank of India (RBI) reduced the key policy repo rate by 25 bps to 5.75%; which is a third consecutive cut in the policy rate and changed the stance to accommodative from neutral. The rate cut and stance both are in line with BWR expectations. All six members of the MPC, including the Governor of RBI, unanimously decided to reduce the policy repo rate and change the policy stance.

This is largely on the back of slower than expected GDP growth of 5.8% in Q4 FY19 thereby dragging the overall GDP growth estimates for FY19 at 6.8% as against the previous estimate of 7%. Also, lower inflation provided further room to RBI for a rate cut in today's policy review.

Brickwork Ratings expects the MPC to cut the repo rate again in the August policy

If the government is able to revive the consumption in the economy and the monsoon is in line with IMD's forecast, the RBI might cut rates again in August policy albeit inflation remains within the target.

"MPC outcome (rate action and stance) is on our expected lines. Going forward, we may see more reduction in the key policy rate in the August policy, subject to upside risk to inflation,” said AP Kamath, Senior Director- Ratings, at Brickwork Ratings.

"On the inflation front, the agency sees prints to inch up, with an expectation of retail inflation to be around 3.0-3.5% during the first half of FY20. Meanwhile, the agency expects the first half of FY20 to witness growth prints to see slower pace, around 6.0-6.25% while second half to achieve around 6.75-7.0%,” Kamath added.

The MPC release noted that the domestic economy is still facing challenges. Gross Fixed Capital Formation (GFCF) declined sharply to 3.6%, after remaining in double digits in the previous five quarters. Private consumption growth also moderated. The drag on aggregate demand from net exports increased in Q4 due to a sharper deceleration in exports relative to imports. However, the overall slowdown in growth was cushioned by a large increase in government final consumption expenditure (GFCE).

Commenting on the monetary policy committee’s unified decision, Bal Krishna Piparaiya, Senior Director- Ratings with Brickwork Ratings said, “The third rate cut within these last 4 months by RBI in Repo rate from 6.5% to 5.75% along with the recent change in stance of the policy to accommodative from neutral is a clear signal of southward trend in interest rates. The cut is at the back of low inflation and recessionary trends leading to decline in GDP growth during the last quarter which is also reflected in decline in the growth rate of sale of consumer products coupled with liquidity crunch, particularly in NBFC segment.

“While the cut is a step in the right direction, however, to get its desired impact, the transmission in bank lending rates needs to be ensured as the same has been partial and slow during the previous two cuts and is expected to be similar particularly when the Q4 profitability results of banks were not good. The transmission in other segments particularly in bond and money markets has already taken place in anticipation by more than expected, with 10-year Gsec Yield dropping from 7.56% before the first rate cut on Feb 7, 2019 to the current level of 6.92%”, Piparaiya added.
Going forward, the key dictators will be the Union budget, which will be presented in July and the monsoon. Monsoon rainfall which is crucial for inflationary forecasts, expected to be normal (at 96% of the long period average) as per the India Meteorological Department (IMD).

Taking into consideration the impact of recent policy rate cuts (75 bps in 2019), the broad-based pick-up in prices in several food items, weakening of domestic and external demand conditions and volatile crude oil prices, MPC revised the path of CPI inflation to slightly higher at 3.0-3.1% for H1:2019-20 (2.9-3.0% previous forecast) and to 3.4-3.7% for H2:2019-20 (3.5-3.8% previous forecast), in the bi-monthly monetary policy resolution of June 2019.

Transmission of the cumulative reduction of 50 bps in the policy repo rate in February and April 2019 was 21 bps to the weighted average lending rate (WALR) on fresh rupee loans. However, the WALR on outstanding rupee loans increased by 4 bps as the past loans continue to be priced at high rates. Interest rates on longer tenor money market instruments remained broadly aligned with the overnight WACR, reflecting near full transmission of the reduction in the policy rate.

Other developments announced by the RBI were to form committee/ working group reviewing liquidity management framework, regulatory and supervisory framework for Core Investment Companies (CIC), ‘on tap’ licensing of small finance banks, comprehensive Review of money market directions, and review of Charges for RBI-operated Payment Systems and ATM Interchange Fee Structure.

The agency also believes that the clarity with the release of new circular by Central Bank on review of charges for RBI-operated Payment Systems and changes in the ATM interchange fee structure shall pass the benefits to the customers and boost digitalization.

Contacts:

**A P Kamath**
Senior Director - Ratings
apkamath@brickworkratings.com
+91 22 6745 6634

**BK Piparaiya**
Senior Director - Ratings
piparaiya.bk@brickworkratings.com 022-28311426 Ext- 614

**Investor & Media Queries**
+91 77388 75550
investordesk@brickworkratings.com

**Ria Matwani**
Research Editor
ria.m@brickworkratings.com
+91 22 6745 6675

About Brickwork Ratings: Brickwork Ratings (BWR) is India’s home grown credit rating agency built with superior analytical prowess from industry’s most experienced credit analysts, bankers and regulators. Established in 2007, Brickwork Ratings aims to provide reliable credit ratings by creating new standards for assessing risk and by offering accurate and transparent ratings. Brickwork Ratings provides investors and lenders timely and in-depth research across the Structured Finance, Public Finance, Financial Institutions, Project Finance and Corporate sectors.

Brickwork Ratings has employed over 350 credit analysts and credit market professionals across 8 offices in India. Our experienced analysts have published over 12,000 ratings across asset classes. Brickwork Ratings is committed to provide the investment community with the products and services needed to make informed investment decisions. Brickwork Ratings is a registered credit rating agency by Securities and Exchange Board of India (SEBI) and a recognised external credit assessment agency (ECAI) by Reserve Bank of India (RBI) to carry out credit ratings in India.

Brickwork Ratings is promoted by Canara Bank, India’s leading public sector bank. More on Canara Bank available at www.canarabank.co.in

For more information, visit www.brickworkratings.com
DISCLAIMER
Copyright © 2019 by Brickwork Ratings India Pvt Ltd., 3rd Floor, Raj Alkaa Park, 29/3 & 32/2, Bannerghatta Main Rd, Kalena Agrahara, Bengaluru, Karnataka 560076. Telephone: +91 80 4040 9940. Fax: +91 80 4040 9941. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings, Brickwork Ratings relies on factual information it receives from issuers and underwriters and from other sources. Brickwork Ratings believes its ratings methodology to be credible. Brickwork Ratings conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Brickwork Ratings’ factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold, and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Brickwork Ratings’ ratings should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Brickwork Ratings relies on in connection with a rating will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Brickwork Ratings and to the market in offering documents and other reports. In issuing its ratings, Brickwork Ratings must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings can be affected by future events or conditions that were not anticipated at the time a rating was issued or affirmed.

The information in this report is provided "as is" without any representation or warranty of any kind. A Brickwork Ratings rating is an opinion as to the creditworthiness of a security. This opinion is based on established criteria and methodologies that Brickwork Ratings is continuously evaluating and updating. Therefore, ratings are the collective work product of Brickwork Ratings and no individual, or group of individuals, is solely responsible for a rating. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Brickwork Ratings is not engaged in the offer or sale of any security. All Brickwork Ratings reports have shared authorship. Individuals identified in a Brickwork Ratings report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Brickwork Ratings rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at anytime for any reason in the sole discretion of Brickwork Ratings. Brickwork Ratings does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Brickwork Ratings receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities.