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.

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