RBI's Sixth Bi-monthly Monetary Policy (2018-19)

February 07, 2019

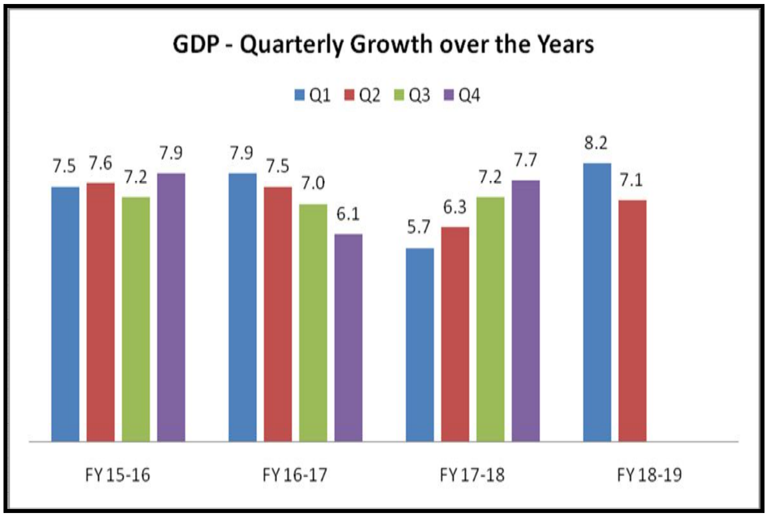
Cuts Key Policy Rates by 25 bps &
Eased its stance from 'Calibrated Tightening' to 'Neutral'

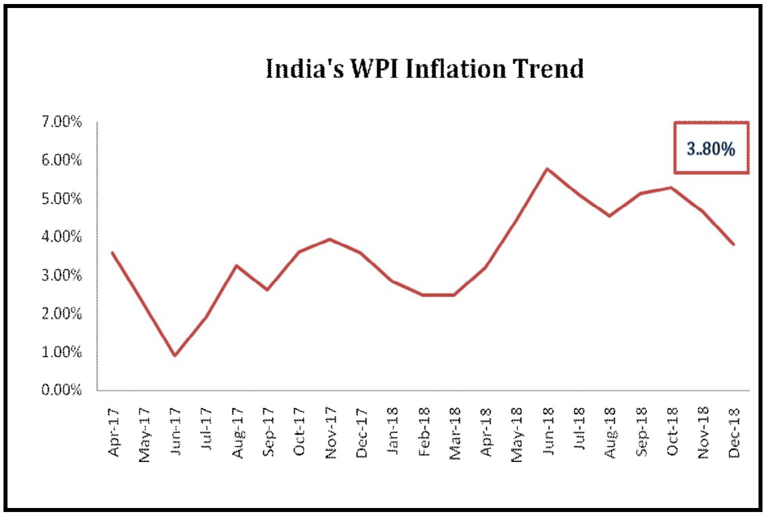
The Reserve Bank of India (RBI) announced its Sixth Bi-monthly Monetary Policy review (2018-19), wherein, it has cut the benchmark repo rate after almost seventeen months and mentioned about lurking inflationary threat, fiscal slippage, global crude oil price volatility, financial market volatility, slowdown in global economic activity and potential trade wars which poses a threat to the outlook.

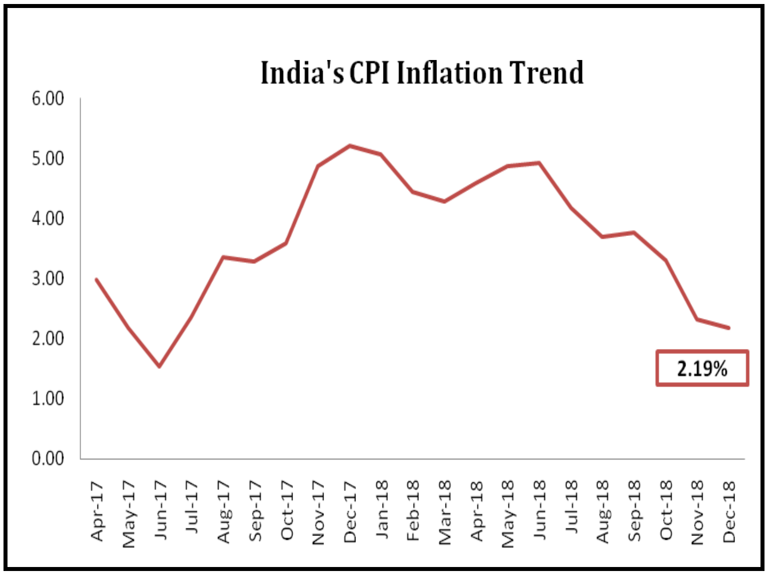
The Monetary Policy Committee (MPC) decided to change the monetary policy stance from calibrated tightening to neutral. These decisions are in consonance with the objective of achieving the medium-term target for consumer price index (CPI) inflation of 4% within a band of +/- 2%, while supporting growth.

Following are the policy measures and vital announcements by the RBI:

- The RBI reduces the Repo Rate under the Liquidity Adjustment Facility (LAF) by 25 basis points (bps) from 6.50% to 6.25% in its sixth bi-monthly policy for 2018-19. Accordingly, Reverse Repo Rate under the LAF determined with a spread of 25 basis points below the Repo rates changed to 6.00%. Marginal Standing Facility (MSF) and the Bank rate both determined with a spread of 25 basis points above the Repo rate changed to 6.50%. On the liquidity front, RBI left the Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) of scheduled Banks unchanged at 4.00% and 19.25% of their net demand and time liability (NDTL) respectively.
- GDP growth outlook for 2018-19 in the December policy was projected at 7.4% (7.2-7.3% in H2) and at 7.5% for H1:2019-20, with risks somewhat to the downside. The CSO has estimated GDP growth at 7.2% for 2018-19. Taking into consideration the various factors, GDP growth for 2019-20 is projected at 7.4% – in the range of 7.2-7.4% in H1, and 7.5% in Q3 – with risks evenly balanced.
- The core industries growth decelerated to 2.6% YoY in December, pulled down by a slowdown in the production of electricity and coal; and contraction in petroleum refinery products, crude oil and fertilizers output.
- There have been downward revisions in inflation projections during the course of the year, reflecting mainly the unprecedented soft inflation recorded across food sub-groups. Taking into consideration these developments and assuming a normal monsoon in 2019, the CPI inflation is revised downwards to 2.8% in Q4:2018-19, 3.2-3.4% in H1:2019-20 and 3.9% in Q3:2019-20, with risks broadly balanced around the central trajectory.
- As per the Central Statistics Office (CSO) in its first advance estimates (FAE) for 2018-19 featured acceleration in gross fixed capital formation (GFCF) and a slowdown in consumption expenditure (both private and government). The drag from net exports is estimated to decline in 2018-19.
- On the supply side, the FAE have placed the growth of real gross value added (GVA) at 7.0% in 2018-19 as compared with 6.9% in 2017-18. The estimates incorporated a slowdown in agricultural GVA growth and an acceleration in industrial GVA growth. Services GVA growth is set to soften and growth in public administration & defence services is likely to moderate.
- Rabi sowing so far (up to February 1, 2019) has been lower than in the previous year, but the overall shortfall of 4.0% across various crops is expected to catch up as the season comes to a close.
- Housing inflation continued to edge down as the impact of the house rent allowance (HRA) increase for central government employees dissipated. Inflation expectations of households, measured by the December 2018 round of the Reserve Bank's survey, softened by 80 basis points for the three-month ahead horizon and by 130 basis points for the twelve-month ahead horizon over the last round, reflecting the continued decline in food and fuel prices.
- On the financing side, net FDI flows to India during April-November 2018 were higher than a year ago. Foreign portfolio flows turned negative in January 2019, after rebounding in November and December 2018. India's foreign exchange reserves were at USD 400.2 billion on February 1, 2019.
- Several proposals in the union budget for 2019-20 are likely to boost aggregate demand by raising disposable incomes, but the full effect of some of the measures is likely to materialize over a period of time.
- Several factors are likely to influence the inflation outlook and inflation is projected to remain soft in the near term. The outlook is clouded with several uncertainties such as volatile vegetable prices, crude oil prices outlook, trade tensions and geo-political uncertainties, spike in the prices of health and education, volatile financial market and monsoon outcome.





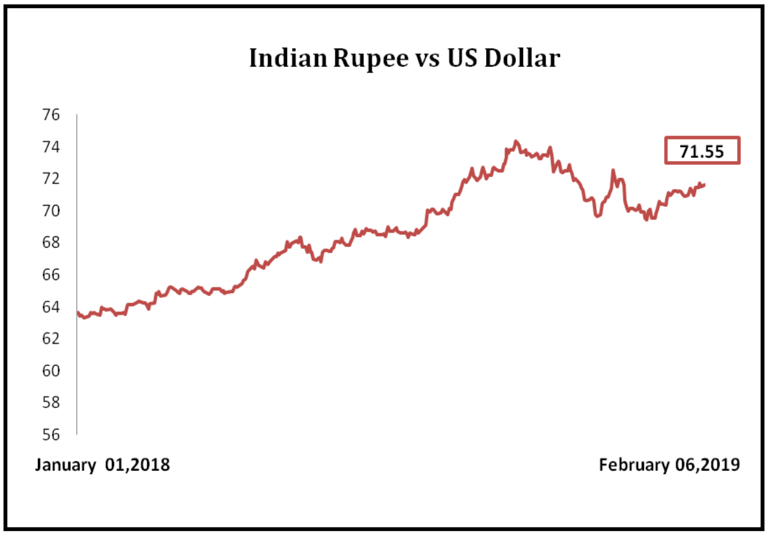


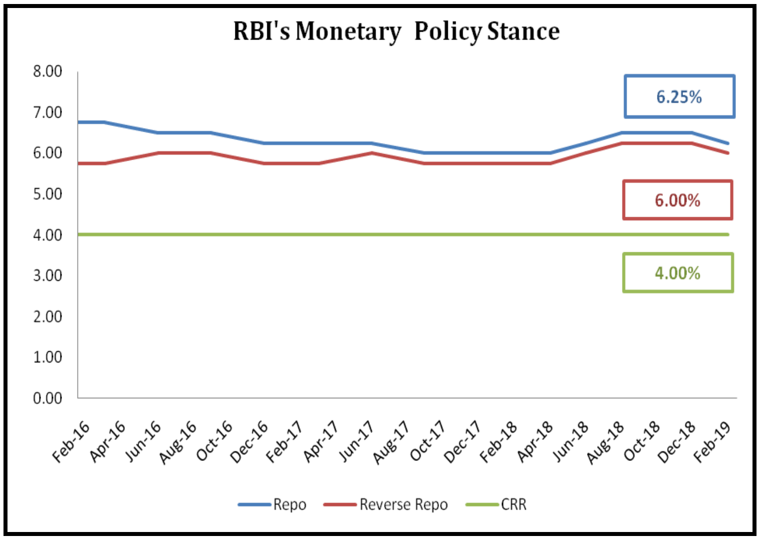
The Consumer price index **(CPI)** inflation, a measure of retail inflation, fell to 18-months low of 2.19% in December compared with 2.33% in November 2018, as food prices continued to decline and lower crude costs brought down fuel inflation.

The annual rate of inflation, based on monthly Wholesale Price Index **(WPI)** continued to decline. It fell to 8-month low of 3.80% compared to 4.64% in November driven down by decline in prices of food articles, especially vegetables, and some easing in rates of petro products.

India's Industrial production **(IIP)** or factory output dropped to a 17-month low of 0.5% in November compared with revised 8.4% in October, on account of contraction in manufacturing sector, particularly consumer and capital goods.

Indian rupee appreciated to around 71 from its all time record low breaching 74 mark against the US dollar towards the latter half of 2018 due to correction in crude prices.





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