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Mutual Fund

RBI Policy Update

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An assessment of 6th Bi-monthly Monetary Policy Statement, FY 2019-20

Monetary Policy Stance:

The Monetary Policy Committee (the MPC), in a surprise move, has decided to hold the rates at 5.15% supported by a unanimous decision by the MPC Members, with stance **unchanged as 'accommodative'**. These decisions are in consonance with the objective of achieving the medium-term target for **Consumer Price Index (CPI) inflation of 4% +/- 2%, while supporting growth.**

- **keeps** the policy repo rate under the liquidity adjustment facility (LAF) **unchanged at 5.15%**;
- continue the monetary policy stance as **'accommodative'**

Source: www.rbi.org.in

Variable	Stands at
Repo	5.15%
Reverse Repo	4.90%
CRR	4.00%
MSF	5.40%
SLR	18.25%

Policy Stance & Rationale:

- The 6th bi-monthly monetary policy meeting of FY20, chaired by the Reserve Bank of India governor Shaktikanta Das, concluded with the unanimous decision of keeping the interest rates unchanged. The Committee voted 6-0 in favour of the decision and in the favour of continuation of the "accommodative" stance as long as it is necessary to revive growth, while ensuring that inflation remains within the target. Consequently, the reverse repo rate under the LAF stands at 4.90%, and the marginal standing facility (MSF) rate and the Bank Rate at 5.40%.

- With inflation remaining highly uncertain, the MPC decided to remain status quo amidst subdued economic activities including few indicators that are yet to show improvement. Globally, the economic environment continued to remain uncertain with US showing marginal growth, majorly due to slack in consumption growth. The declining consumer confidence impacted the major other economies as well in the Euro Zone as economic activity slackened in France and Italy contracted surprisingly along with decline in industrial production in UK. Japan economy also saw a decline in growth due to reduced consumption on top of the muted global demand. On the EM front, China reduced further to 6.1% on the back of tepid domestic demand and trade tensions. The economy such as Russia lost the momentum in activity with industrial production easing and Brazil saw slowdown due to contraction in industrial production and depressed retail sales.

- In recent past, on the back of easing geo-political worries, Crude and Gold softened. The scare caused by the threat of coronavirus spreading globally, crude oil prices dipped sharply due to selloffs however, Gold prices surged because of safe haven demand. Due to market participants taking riskier asset exposure bond yields hardened in the US in 2019 but the Fed stance of status quo on interest rates and the extension of repo operations led the yields softened in recent months. Bond yields shrank into negative terrain in the Euro Zone.

- On the domestic front, NSO during Jan'20 mentioned GDP growth for 2019-20 at 5% and the growth of real gross value added (GVA) at 4.9% in 2019-20. As per the revised estimates given in the Union Budget, growth in revenue expenditure has been estimated to be lower in Q4 compared with Q3. With the industrial activity improving, the IIP for Jan'20 picked up sharply to 55.5 in Jan'20 boosted by rise in new business and output. Retail inflation surged from 5.5% in Nov'19 to 7.4% in Dec'19 due to increase in food and fuel inflation.

- Under the liquidity management framework, RBI accepted the MPC recommendations of weighted average call rate to continue to be its operating target. Additionally, the liquidity management corridor continues, with the marginal standing facility (MSF) rate as its upper bound (ceiling) and the fixed rate reverse repo rate as the lower bound (floor), with the policy repo rate in the middle of the corridor. The width of the corridor remains unchanged at 50 basis points – the reverse repo rate being 25bps below the repo rate and the MSF rate 25bps above the repo rate.

Outlook:

- The much-awaited Monetary Policy Committee (MPC) outcome was as widely expected as RBI kept status quo whilst keeping the stance as "accommodative". Though recent inflation has been high, the MPC members thought that this was transitory and committed to keep rates low till growth revived.

- While on the rate side RBI has been proactive, financial transmission has been muted as credit growth remains low. In a novel and unexpected move, RBI announced long term repos (LTRO) for Rs 1 lac crore for 1 and 3 years to be conducted from mid-Feb. These would be done at repo rate i.e. 5.15%. This means that banks will be given 1- year and 3-year funds at 5.15%. The move is supposedly to reduce bank cost of funds and consequently bring down deposit rates as well as lending rates and aid transmission. Clearly as the 135-bps rate cut done by RBI in past as well as excess liquidity of more than Rs 3 lac crore was not helping in transmission. RBI is hoping that cheap funding at short end of the curve will nudge banks to do onward lending to a fund starved economy.

- The LTRO move ignited bond markets as the yields in short end crashed by 15-25bps. The impact on long term yields was less with 10Y moving down by only about 4-5 bps. Clearly RBI's focus has shifted to the short end of the curve. We expect that short-term curve (2-5 year corporate as well gilts) will likely continue to outperform and the curve will bull steepen.

- We have been recommending short term bonds as we felt that short term rates were high and were not aiding in transmission. With this move, the short-term funds like Savings fund, Short duration as well as corporate bond fund will likely to continue to do well in near term as RBI continues to focus on financial transmission.