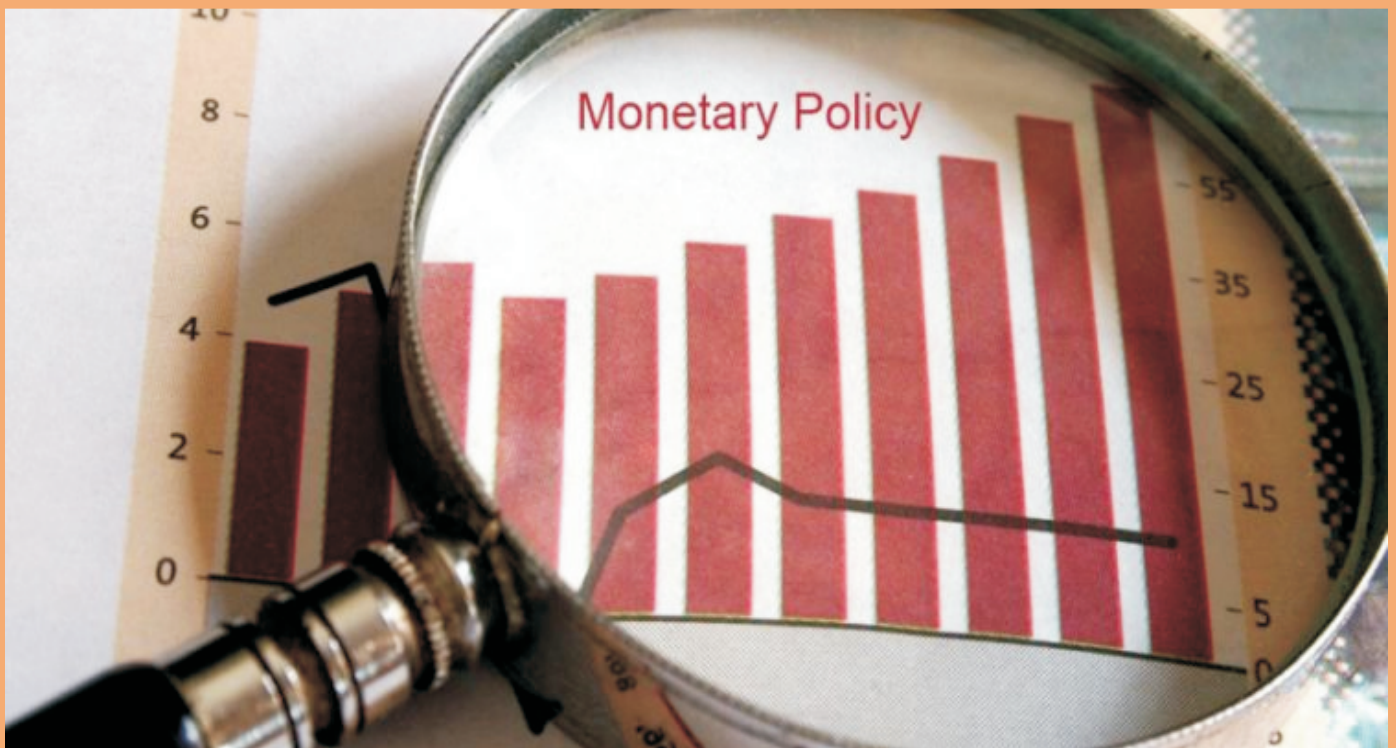


02 August 2018

ECONOMIC UPDATE



RBI 3rd Bi-Monthly Policy

RBI hikes Repo rate by 25 bps to 6.5%

- The RBI in its third bi-monthly monetary policy review for the fiscal year increased the repo rate by 25 bps and continued with maintaining a neutral stance. This is the second consecutive rate hike by the RBI in FY19.
- The RBI in its policy has detailed concerns about uncertainties surrounding inflation and global developments that needs to be monitored closely.

| Particulars | Current rates | Previous rates |
|---|---------------|----------------|
| Repo | 6.25% | 6.5% |
| Reverse Repo | 6% | 6.25% |
| Marginal Standing Facility Rate and Bank Rate | 6.5% | 6.75% |
| Cash Reserve Ratio | 4.0% | 4.0% |
| Statutory Liquidity Ratio | 19.50% | 19.50% |

The main considerations underlying the decision:

- Increased uncertainties amidst global trade tensions and Brexit negotiations.
- Moderation in economic growth in Japan, Eurozone, China, South Africa and Brazil.
- Elevated oil prices.
- Decline in metal prices.
- Rise in retail inflation coupled with increased expectations of inflation as indicated by the survey conducted by the RBI.
- Decline in FPIs flows on increased expectations of monetary policy tightening by the advanced economies.
- Robust industrial performance.
- Tight liquidity in the system.

Outlook for Inflation and Economic Growth

- The RBI has raised its expectations for inflation in H2FY19 from its earlier target of 4.7% to 4.8%. The RBI has estimated inflation to be at 5% in Q1FY20. The upside risks and uncertainties to inflation are expected to emanate from :
 - Increase in Minimum Support prices. However, the exact impact would depend upon the nature and scale of the government's procurement operations.
 - Volatility in the crude oil prices.
 - Turnaround of monsoons.
 - Volatility in the global financial markets.
 - Fiscal slippages by the state/ central government.
 - Staggered impact of HRA revision.

However, reduction in Goods and Services tax for certain commodities is likely to bring down the inflation.

The RBI has retained the GDP growth projections for FY19 at 7.4%. The economic growth is expected to be in the range of 7.5-7.6% for H1FY19 and 7.3-7.4% in H2FY19. The growth is expected to be influenced by:

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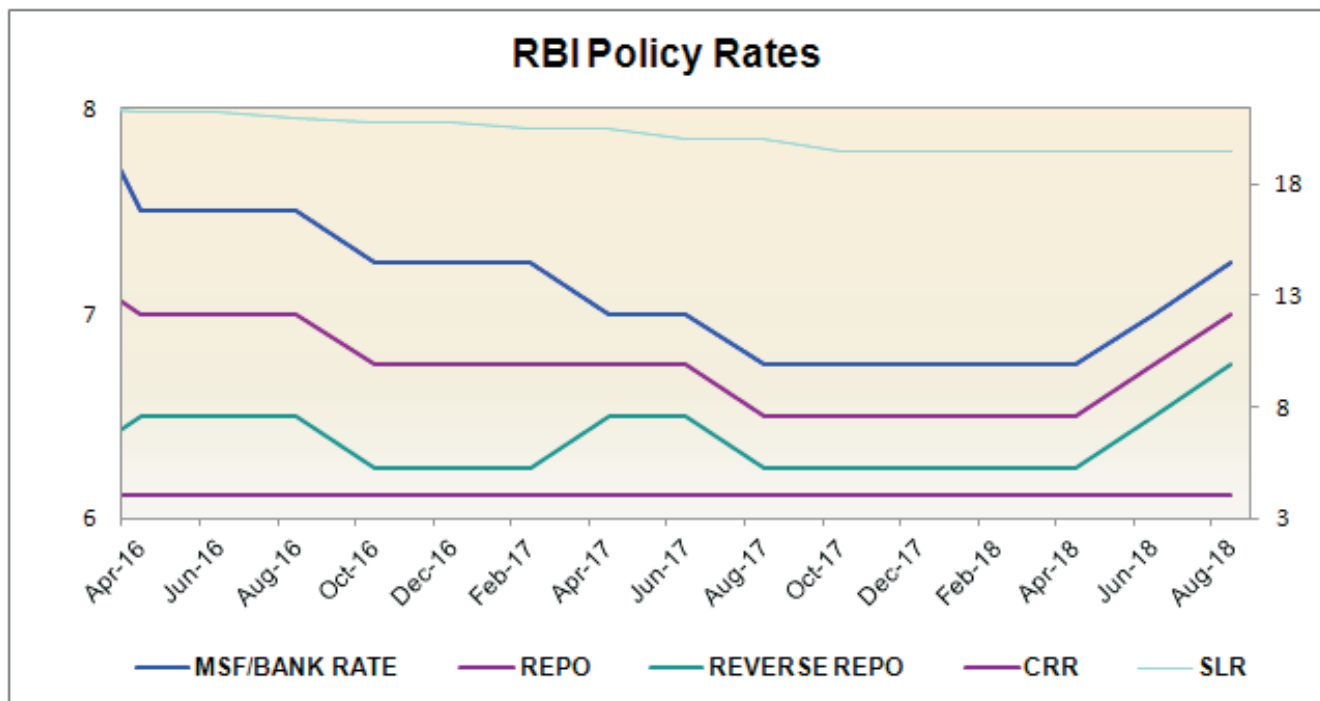
- Increase in rural demand as a result of higher farmers' income on account of normal monsoons and increase in MSPs of kharif crops.
- Revival in investments on account of increased FDI inflows and continued buoyant domestic capital market conditions.
- However, escalating trade tensions are likely to impact exports and economic growth.

Developmental and Regulatory Policies Announced

- The Scheduled Primary (Urban) Cooperative Banks have been allowed access to Marginal Standing Facility.
- Scheduled State Co-operative Banks have been granted an access to Liquidity Adjustment Facility (LAF) and Marginal Standing Facility (MSF). This has been done in order to improve the transmission of monetary policy to money market rates.
- Primary (Urban) Cooperative Banks have been permitted to invest in Non-SLR securities.
- Co-origination of loans by scheduled commercial banks (excluding Regional Rural Banks and Small Finance Banks) and NBFCs has been permitted by the RBI to provide level playing field for credit to priority sector.
- A comprehensive review of Foreign Exchange Management Regulation has been proposed by the RBI with an aim to allow India multinationals to hedge the currency risks and to reduce the administrative requirements for undertaking derivative transactions.
- It has also been proposed to review the SGL/CSGL guidelines to enhance participation in the government securities and making it easier for the participants to open and operate Subsidiary General Ledger (SGL) and Constituent Subsidiary General Ledger (CSGL)Accounts.

Outlook

- One more interest rate hike by at least 25 bps during FY19 which will be dependent upon the inflation trajectory and on developments on the global front with regard to trade policies adopted by the US, monetary policy stance by major Central Banks and movement in the oil prices.





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