SHRIRAM Insight

10 October 2018

ECONOMIC UPDATE

RBI

4th Bi-Monthly Policy

RBI maintains status quo on policy rates

- The RBI in its fourth bi-monthly monetary policy review for the fiscal year retained the policy rates, contrary to market's expectations. The RBI however changed its stance from neutral to calibrated tightening of monetary policy.

- The RBI in its policy has detailed concerns about uncertainties surrounding inflation (in the form of higher crude oil prices), tightening of global financial conditions and escalating trade tensions that calls for strengthening of domestic macroeconomic fundamentals.

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

The main considerations underlying the decision are:

- Resilient global economic activity despite ongoing trade tensions.
- Rising oil prices on account of increased concerns over supply ahead of US sanctions on Iran and decline in US stockpiles.
- Rise in inflation in U.S., Eurozone (on account of higher oil prices) and EMEs (on account of higher oil prices and depreciation in currencies).
- Volatility in financial markets on monetary policy stance adopted by advanced economies.
- Increase in India's economic growth (nine-quarter high of 8.2% in Q1-FY19).
- Increase in kharif food production in FY19 (0.6%) compared with the previous year as per the first advance estimates.
- Moderation in retail inflation from 4.9% in June to 3.7% in August (on account of decline in food inflation).
- Tight liquidity in the system.
- Double-digit growth in exports in July and August'18 (led by petroleum goods, engineering goods, gems and jewellery, drugs and pharm and chemicals.)
- Widening of trade deficit with imports growing at a faster rate than exports.
- Foreign capital outflows.

Outlook for Inflation and Economic Growth

The RBI has lowered its expectations for inflation for Q2-FY19, H2-FY19 and Q1-FY20 as follows:

- Moderation in food inflation especially in key food items such as pulses, edible oil, sugar, fruits and vegetables along with increase in kharif food production has led RBI to lower down its inflation targets. However, upside risks to inflation still persists in the form of:

  - Rising crude oil prices.

  - Higher input costs.

  - Fiscal slippages by the government.

  - Staggered impact of HRA.

  - Volatility in the financial markets with significant depreciation in EME currencies.

SHRIRAM INSIGHT SHARE BROKERS LTD., CK-5, Sector-II, Saltlake City, Kolkata - 700 091 Tel : 2359-4612, 2359-4614, 2359-4877
Fax : (033) 2321-8429 E-mail : helpdesk@shriraminsight.com

Outlook for GDP growth

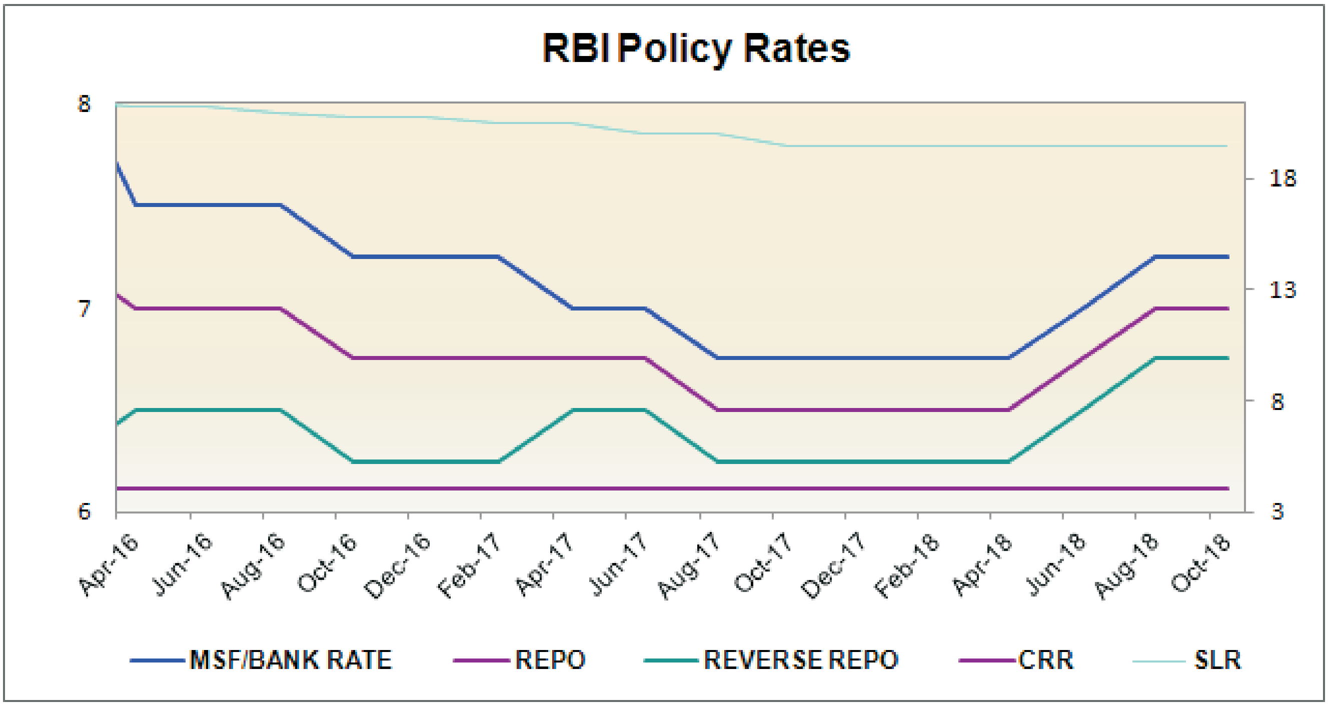
- The RBI has retained the GDP growth projections for FY19 at 7.4%, citing risks to increase in investment activity as a result of higher crude oil prices and other input costs (that have the potential of lowering down the profit margins of the corporates).
- Sharp depreciation of rupee has also been cited as one of the concerns by the RBI.

Development and Regulatory Policies Announced

- Voluntary Retention Route (VPR) for Investment by Foreign Portfolio Investors (FPIs)
- RBI has proposed a special route called "Voluntary Retention Route (VPR)" in order to encourage FPIs to undertake long-term investments. The route will enable FPIs to have more operational flexibility in terms of instrument choices as well as exemptions from regulatory provisions. A discussion paper will be placed on RBI's website today for public consultation.
- Regulation of Financial Benchmarks
- A regulatory framework for financial benchmarks (initially for the benchmarks issued by Financial Benchmarks of India Limited) has been proposed by the RBI to ensure robustness and reliability for efficient pricing and valuation of financial instruments.

Outlook

Interest rate hikes in near future will be dependent on the inflation trajectory (which will in turn depend on movement of oil prices and depreciation in the Indian currency). The concept of calibrated tightening could be indicating such a hike.



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