12 June 2018

ECONOMIC UPDATE

RBI 2nd Bi-Monthly Policy

RBI hikes Repo rate by 25 bps to 6.25%

In the second bi-monthly monetary policy for the fiscal year 2018-19, in a unanimous decision taken by the Monetary Policy Committee (MPC) members, the RBI has increased the repo rate by 25 bps in line with the markets expectations. This is the first rate hike since January 2014. The Monetary Policy Committee (MPC), however, maintained neutral stance, with an aim to achieve the medium-term CPI inflation target of 4 per cent within a band of +/- 2 per cent while supporting growth.

Particulars	Current rates	Previous rates
Repo	6.25%	6%
Reverse Repo	6%	5.75%
Marginal Standing Facility Rate and Bank Rate	6.5%	6.25%
Cash Reserve Ratio	4.0%	4.0%
Statutory Liquidity Ratio	19.50%	19.50%

The main considerations underlying the decision:

- Expansion in global economic activities, especially among the advanced economies
- Resilient performance of EMEs
- Strengthening global trade with waning geo-political concerns
- Rising oil and metal prices
- Strengthening US dollar and rise in US treasury yields
- Domestically, increase in economic growth underpinned by improved rural demand
- Forecast of normal monsoon
- Robust industrial performance
- Rising inflation especially in the non-food segment
- Surplus liquidity in the system

Outlook for Inflation and Economic Growth

- For H1FY19 the retail inflation projections have been revised to 4.8-4.9% than the earlier projections of 4.7-5.1% with upside risks. For H2FY19, the expectations for retail inflation have been revised upwards to 4.7% from the earlier estimate of 4.4% as per its April'18 policy.
- The inflation estimates have been revised upwards while the upside risk to the inflation path continues due to

  - Uncertainty in global financial markets

  - Increasing global oil and commodity prices

  - Persistent pick up in CPI inflation excluding food and fuel

  - Rise in households' inflationary expectations

  - The impact of HRA increases by the state governments

  - Revision in MSPs of kharif crops

- GDP growth projections for FY19 have been retained at 7.4%. The economic growth for H1 FY19 is expected to be in the range of 7.5-7.6% while that for H2 FY19 will be around 7.3-7.4%. Compared with the April'18 policy, the economic growth estimates for H1 have been revised upwards from 7.3-7.4% while for H2 FY19, the growth projections have been lowered from 7.3-7.6%. The growth for FY19 is expected to be guided by acceleration in investment and construction activities, improving capacity utilization, pick up in credit offtake, buoyant global demand resulting in increase in exports, robust consumption. Rising petroleum prices will however cap the economic growth by impacting the disposable income.

Developmental and Regulatory Policies Announced

- Increase in liquidity Coverage Ratio (LCR) 'carve out' from SLR to 13% of their Net Demand time Liability (NDTL) as against 11% earlier.

- In order to encourage State Governments to increase the corpus in both the funds, RBI has decided to lower down the rates for Special Drawing Facility (SDF) availed by State Governments against the collateral of the funds in GRF(Guarantee redemption fund) and CSF(Consolidated silnking fund). Therefore, it has been decided to lower the interest rate on SDF from 100 bps below the repo rate to 200 bps below the repo rate.

- Currently, state government securities are valued by using the YTM method. Going forward, valuation of traded state government securities will be based on their market price while the valuation non-traded securities will be based on the state-specific weighted average spread over the yield of the central government securities of equivalent maturity.

- RBI has decided to grant banks the option to spread MTM losses on investments held in Available for sale and Held for trading portfolio for the quarter ending June 30, 2018, equally over a period of 4 quarters.
- Voluntary transition of Urban Cooperative Banks (UCBs) into Small Finance Banks (SCBs) meeting the prescribed criteria.

- The RBI discontinued the classification of exposure of banks and NBFCs under GST registered MSMEs. Banks and NBFCs will be temporarily allowed to classify their exposures to all MSMEs up to Rs. 250 million including those not registered under GST as per the 180 days past due criterion.

- Increase of house loan limit for affordable housing. For priority sector, lending eligibility to Rs. 35 lakh from earlier Rs. 28 lakh (with population of ten lakh and above) For other sector, from Rs. 20 lakh to Rs. 25 lakh provided the overall cost of the dwelling unit in the metropolitan centre and at other centres does not exceed ₹45 lakh and ₹30 lakh, respectively.

- Core investing companies (CICs) have been permitted to act as sponsors to InvIT issuances in order to promote infrastructure development through investment in InvIT.

- In line with international standards, the initial margin requirement for central government securities would be in the range of 0.5-4% while that for SDLs would be 2.5-6% in five different buckets of residual maturity.

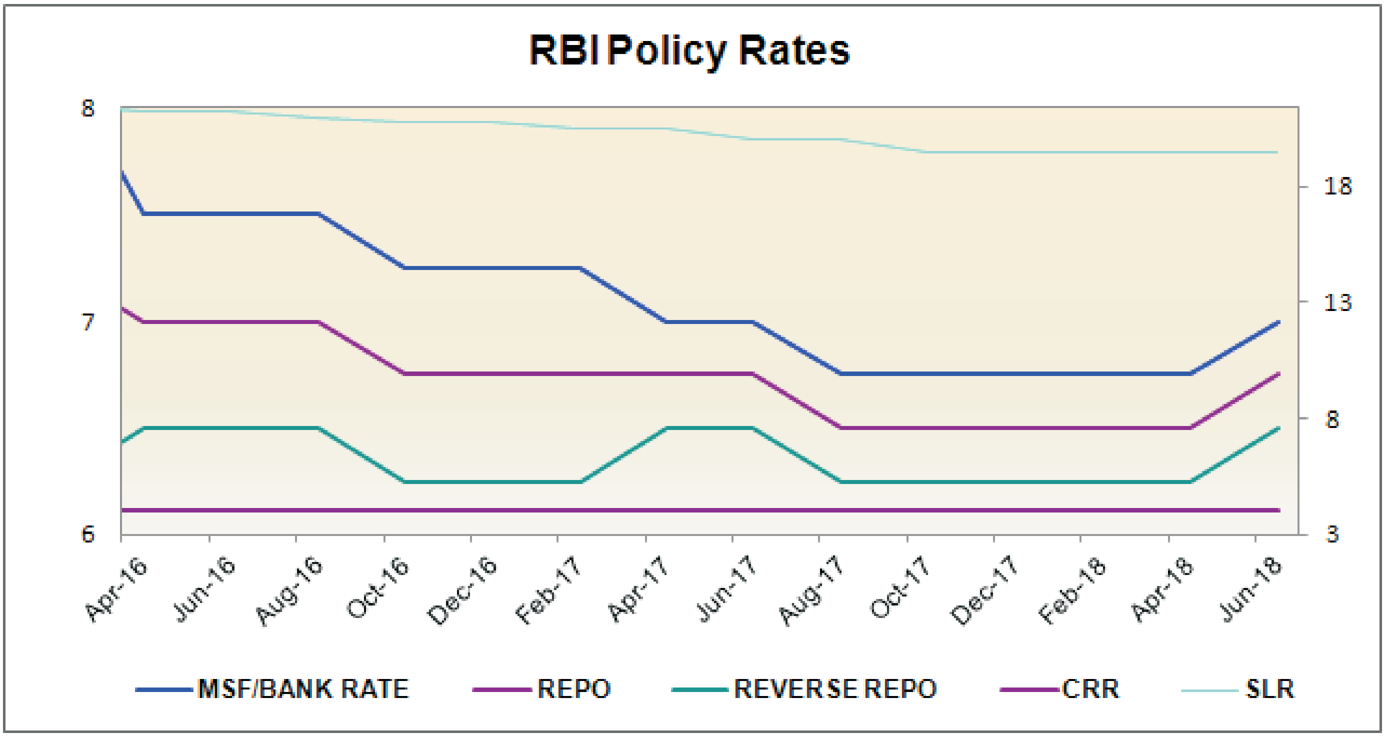
- With a view to incentivizing the State Governments to get SDLs a public rating, it has been decided that the initial margin requirement for rated SDLs shall be set at 1% lower than that of other SDLs for the same maturity buckets, i.e., in the range of 1.5-5%.

Outlook

- The upside risk to the inflation emanates from the rising crude oil prices globally along with MSP impact. Going ahead, the inflation will be guided by the progress and spread of monsoon.

- Rate hike in future will be dependent on the developments at the global front with regard to oil prices and its likely impact on domestic inflation.

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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