17 March 2017

ECONOMIC UPDATE

RBI
1st Bi-Monthly Policy

Monetary Policy Committee keeps repo rate unchanged

- On the basis of an assessment of the current and evolving macroeconomic situation at its meeting, the Monetary Policy Committee (MPC) decided to keep the repo rate unchanged at 6.25%. Consequent upon the narrowing of the LAF corridor from 50 bps to 25 bps, the reverse repo rate under the LAF is at 6% from 5.75%, and the marginal standing facility (MSF) rate and the Bank Rate are at 6.5% from 6.75%.

- The decision of the MPC is consistent with a neutral stance of monetary policy 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.

Monetary Policy Rates

Repo	6.25%
Reverse Repo	6.00%
Marginal Standing Facility Rate and Bank Rate	6.5%
Cash Reserve Ratio	4.0%
Statutory Liquidity Ratio	20.50%

Evaluation of Global Economic Scenario

Some of the key points that are noted by RBI regarding the global economic scenario are as follows

- The indicators of global growth suggest signs of stronger activity in most advanced economies (AEs) and easing of recessionary conditions in commodity exporting large emerging market economies (EMEs). In the US, the labour market, industrial production and retail sales are catalysing a recovery in Q1 of 2017 from a relatively subdued performance in the preceding quarter. In the Euro area, the manufacturing PMI rose to a six-year high in March amidst improving consumer confidence and steadily strengthening employment conditions.

- For EMEs, the outlook is gradually improving, with indications that the slowdown characterising 2016 could be bottoming out. In China, supportive macroeconomic policies, surging credit growth and a booming property market have held up the momentum of growth although amidst concerns about financial stability and capital outflows. In Brazil, hardening commodity prices are providing tailwinds to reforms undertaken by the authorities to pull the economy out of recession, although financial fragilities remain a risk. Russia is benefiting from the firming up of crude prices and it is widely expected that growth will return to positive territory in 2017.

- Inflation is edging up in AEs amid rising commodity prices. Global trade volumes are finally showing signs of improvement amidst shifts in terms of trade, with exports rising strongly in several EMEs as well as in some AEs whose currencies have depreciated.

Evaluation of Domestic Economic Scenario

Some of the key points that are noted by RBI regarding the domestic economic scenario are as follows

- The second advance estimates for 2016-17 on Feb'28, placing India's real GVA growth at 6.7% for the year, down from 7% in the first advance estimates released on January 6. Agriculture expanded robustly year-on-year after two consecutive years of sub-one % growth.

- Industrial output, measured by the index of industrial production (IIP), recovered in January from a contraction in the previous month, helped by a broad-based turnaround in manufacturing as well as mining and quarrying. Besides, electricity generation, Capital goods production improved appreciably. Consumer non-durables continued, however, to contract for the second successive month in spite of supportive base effects. Thus, investment and rural consumption demand remain muted.

- Activity in the services sector appears to be improving as the constraining effects of demonetisation wear off. On the one hand, rural demand remains depressed as reflected in lower sales of two- and three-wheelers and fertiliser. On the other hand, high frequency indicators relating to railway traffic, telephone subscribers, foreign tourist arrivals, passenger car and commercial vehicles are regaining pace, thereby positioning the services sector on a rising trajectory. After three consecutive months of contraction, the services PMI for February and March emerged into the expansion zone on improvement in new business.

- After moderating continuously over the last six months to a historic low, retail inflation (CPI) turned up in February to 3.7%. Food prices bottomed out at the preceding month's level. Prices of sugar, fruits, meat, fish, milk and processed foods increased, generating leap in momentum in the food group. In the fuel group, inflation increased as the continuous hardening of international prices lifted domestic prices of liquefied petroleum gas.

RBI Outlook

Inflation

- The RBI has projected upside pressure on inflation owing to uncertainties surrounding the possibility of El Nino conditions developing around July-August that is expected to affect normal rainfall in the country that is expected to pose a risk for Indian agriculture and commodity prices.

- Other factors taken in to consideration are increase in the house rent allowances, roll out of GST, and increase in international commodity prices.

- RBI expects inflation in FY18 to edge higher from the sub 4% inflation of Jan and Feb'17. For the first half of FY18, it is projected to average 4.5% and for the second half it is expected to be 5%. However, inflation could ease with the decline in international crude oil prices.

GVA growth

GVA growth is projected to reach 7.4% in 2017-18 from 6.7% in 2016-17 owing to a rebound in consumer spending due to the process of remonetisation, restoring in cash-intensive retail trade, hotels and restaurants and a higher capital expenditure i.e. expected to be incurred on the back of various proposals given in the Union Budget. The materialization of GST reforms and Insolvency and bankruptcy code is expected to boost investor confidence that will lead to large capital inflows.

Liquidity management

The surplus liquidity in the system declined from Rs 7,956 billion in Jan'17 to Rs 4,806 billion in Mar'17. RBI has relied on variable reverse repo rate to absorb the excess liquidity created in the market post demonetization. RBI has laid down various measures with which it is expected to absorb the surplus liquidity in the market. Tools such as Open markets operations, Market stabilisation scheme (MSS) bonds, cash management bills and variable reverse repo rate will be used to manage day-to-day liquidity. The introduction of Standing deposit facility is under consideration by the government.

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