

RBI December Post Policy Review

December 6, 2017

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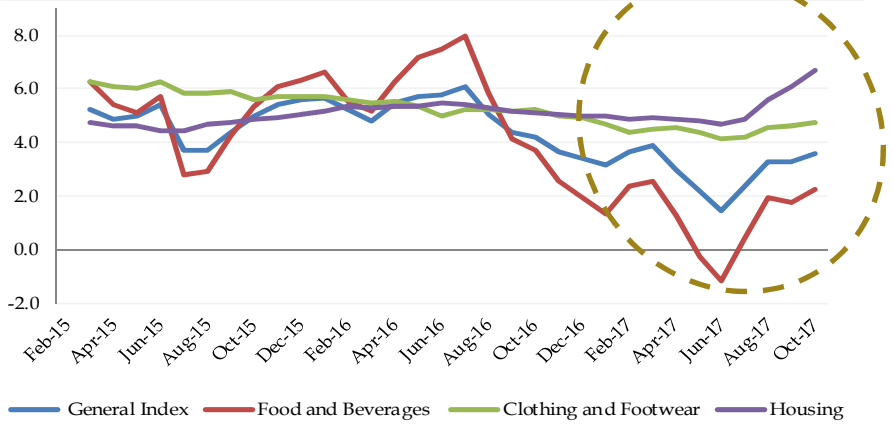
RBI Monetary Policy Review highlights

- **December Monetary Policy Review 2017-2018**
  - Policy Action
    - Keep the policy repo rate unchanged at 6.0 per cent;
  - Guidance
    - The MPC notes that the evolving trajectory of inflation needs to be carefully monitored.
    - The implementation of farm loan waivers by select states, partial roll back of excise duty and VAT in the case of petroleum products, and decrease in revenue on account of reduction in GST rates for several goods and services may result in fiscal slippage with attendant implications for inflation.
    - In the MPC's assessment, there have been several significant developments in the recent period which augur well for growth prospects, going forward. However, the MPC notes that the impact of these factors can be buttressed by reducing the cost of domestic borrowings through improved transmission by banks of past monetary policy changes on outstanding loans.
- October Monetary Policy Review 2017-2018
  - Policy Action
    - Keep the policy repo rate unchanged at 6.0 per cent;
    - Reduce SLR by 50bps to 19.5%
  - Guidance
    - The MPC has noted that increased price pressures have coincided with an escalation of global geo-political uncertainty and heightened volatility in financial markets due to the US Fed's plans of balance sheet unwinding and the risk of normalisation by the ECB. Such juxtaposition of risks to inflation needs to be carefully managed.
    - Although the domestic food price outlook remains largely stable, generalised momentum is building in prices of items excluding food, especially emanating from crude oil. The possibility of fiscal slippages may add to this momentum in the future.
    - The MPC is of the view that various structural reforms introduced in the recent period will likely be growth augmenting over the medium- to long-term by improving the business environment, enhancing transparency and increasing formalisation of the economy.

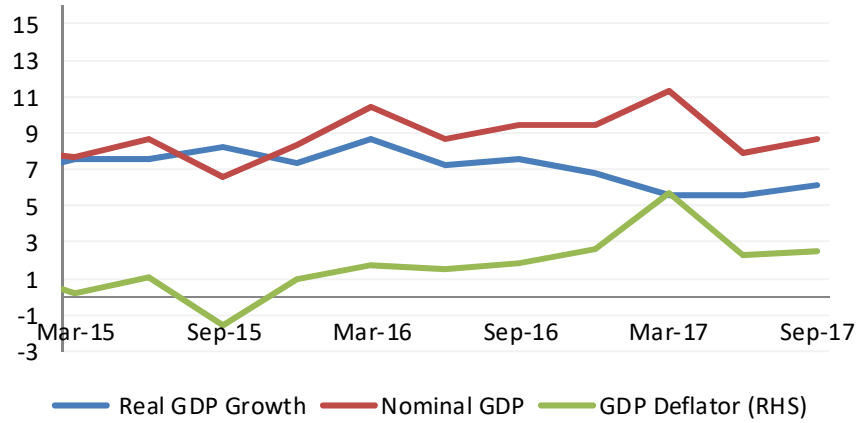
RBI leaves inflation and GVA growth forecasts mainly unchanged

- Noting that CPI inflation has continued to rise since its last meeting, the MPC decided it leave its policy repo rate unchanged in its December meeting.
- There RBI continued to highlight several factors contributing to uncertainty around the inflation trajectory including implementation of farm loan waivers and salary allowance awards by States and which may result in possible fiscal slippages and undermine the quality of public spending, entailing inflationary spillovers. Taking into account these factors, the RBI expects inflation to rise from its current level and range between 4.3-4.7% in the second half of this year, including the house rent allowance by the Centre.
- From a growth perspective, the RBI noted that shortfalls in *kharif* production and *rabi* sowing pose downside risks to the outlook for agriculture but the positive side, there has been some pick up in credit growth in recent months. Taking into account the these factors, the projection of real GVA growth for 2017-18 has been left unchanged at 6.7% with risks evenly balanced.

CPI Inflation



GVA Growth (2011-12 Series)

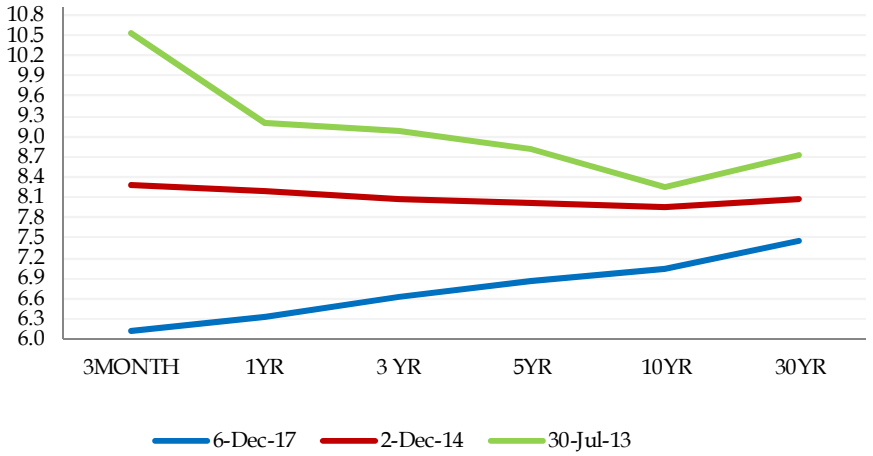


Source: Bloomberg, RBI, Trust Research

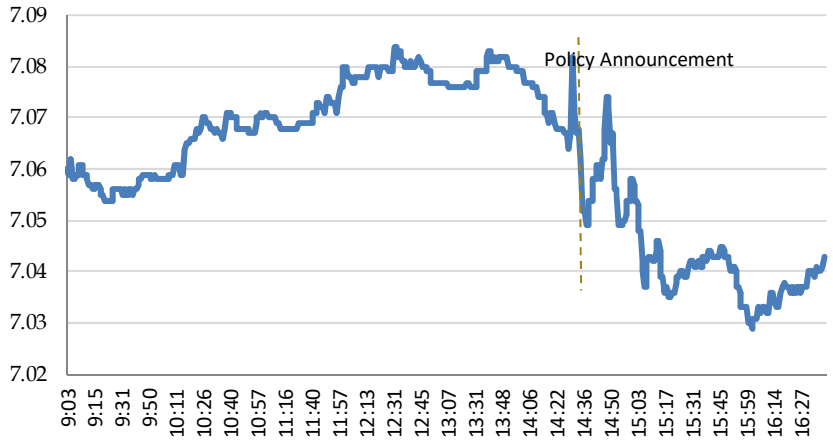
Yields fell slightly on policy announcement

- The yield curve has normalized and moved down over time as improved liquidity and lower policy rates bring yields down
- Equity market reaction was muted as the outcome was expected
- The reaction of the bond market was positive as the yield on the government securities fell. The fixed income market had feared a very hawkish tone from the RBI, however the RBI only slightly raised its inflation forecast and stated that risks were evenly balanced

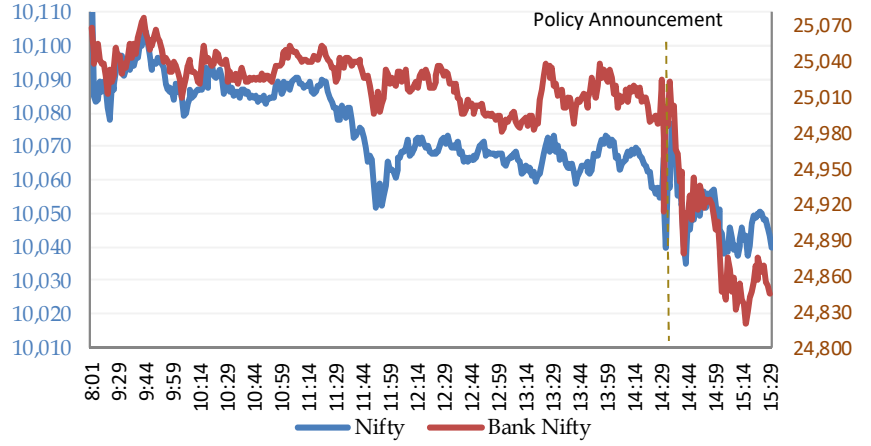
Yield Curve



10 Yr Gsec Yield (6.79 bond) – December 6, 2017



Equity Market – December 6, 2017



Source: Bloomberg, RBI, Trust Research

Conclusion

- As expected by us and the market, the RBI kept the policy repo rate unchanged in its December policy meeting. The decision by the six member MPC was not unanimous but was adopted by the majority of members.
- After the observing inflation picking up since its last policy meeting the RBI decided room for further monetary accommodation was not available. The RBI has maintained its neutral policy stance and remains concerned with various upside risks to inflation. The RBI has always maintained the neutral stance gives it flexibility to respond to incoming data.
- In keeping the policy rate unchanged, the RBI noted that the moderation in inflation excluding food and fuel has reversed and that the upward trajectory may continue in the near term. The RBI further noted that, the possibility of fiscal slippages may add to this momentum in the future. The RBI also noted that the recent rise in international crude oil prices may sustain, especially on account of the OPEC's decision to maintain production cuts through next year. In such a scenario, any adverse supply shock due to geo-political developments could push up prices even further.
- Adding to the RBI's concern is the current global environment. The RBI noted that global financial instability on account of the pace of/uncertainty over monetary policy normalisation in advanced economies and fiscal expansion in the US carry risks for inflation.
- On the growth front the RBI believes that there have been several significant developments in the recent period which augur well for growth prospects including increased capital raised from primary capital markets, improvement in the ease of doing business and large distressed borrowers being referenced to the insolvency and bankruptcy code (IBC) and public sector banks are being recapitalised. This outlook seems to suggest that the RBI believes current rate stance is not impeding growth prospects.
- The RBI also announced several other developmental and regulatory measures consistent with its five-pillar organising framework. This approach emphasises the strengthening of the monetary policy framework; fortifying the banking structure; broadening and deepening financial markets; expanding access to finance; and dealing with stress in corporate and financial assets and putting them back to work.

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Thank You

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