

Is this the end of monetary easing cycle?

Even weaker growth is unlikely to nudge cautious RBI

- In line with market consensus, the Monetary Policy Committee (MPC) decided to keep the policy rates on hold today. The decision was taken with a majority of 5-1 votes.
- Interestingly, while the MPC kept its inflation projection for FY18 broadly unchanged (revised slightly from 4-4.5% to 4.2-4.6% for 2HFY18), the GVA growth forecast was cut from 7.3% to 6.7%.
- We believe that while inflation is likely to remain in line with the RBI's forecasts, there is still a downside risk to its revised GVA growth forecasts. Consequently, although there is a window to cut interest rates, we are highly doubtful if even slower growth would nudge the cautious RBI. Accordingly, the monetary easing cycle may have ended in India, in our view.

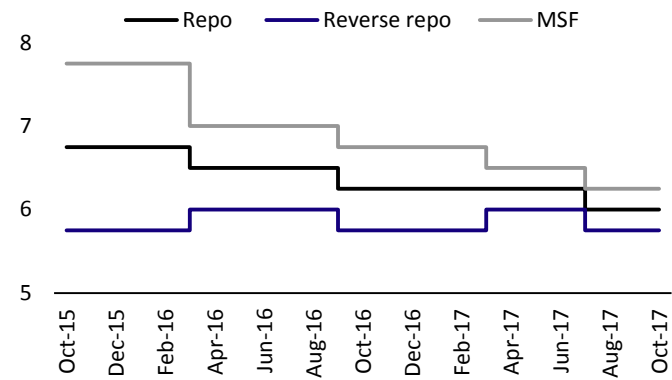
- **MPC maintains status quo:** In its fourth Bi-monthly Monetary Policy held today, the Monetary Policy Committee (MPC) kept its policy rates unchanged – the repo rate at 6%, the reverse repo rate at 5.75% and the marginal standing facility (MSF) rate at 6.25%. (*Exhibit 1*). The decision to keep rates on hold was in line with market expectations. We, however, had [argued](#) that there was sufficient room for the RBI to cut rates in its today's meeting, considering the sharp weakness in economic activity. The decision to hold rates was taken with a majority of 5-1 votes, with Dr Ravindra Dholakia voting for a cut of at least 25bp.
- **Inflation projection was broadly maintained for FY18...:** In terms of the economic outlook, the MPC largely maintained its inflation forecast range for 2HFY18 – as against 4-4.5% projected earlier, it was revised up marginally to 4.2-4.6%. Like in the previous policy, it highlighted upside risks to inflation, primarily due to (1) fiscal slippages owing to the implementation of farm loan waivers by the states and (2) the implementation of salary & allowances by the states (this could push up inflation by ~100bp). For 2018-19, the RBI expects inflation to average to about 4.7%, but soften to ~4.5% by 4QFY19. Overall, it seems that the RBI should not be too worried about inflation.
- **...while growth forecast was revised downward:** On the other hand, the RBI cut the GVA growth projections for FY18 sharply – from 7.3% projected earlier to 6.7%. On a quarterly basis, it expects real GVA to grow 6.4% in 2QFY18, but pick up to 7.7% by 4QFY18. Although it acknowledged the possibility of widening of the output gap, it needs more data to determine whether the current slowdown is transient or not. Assuming normal monsoon, fiscal consolidation and no major exogenous/policy shocks, it estimates real GVA to grow 7.4% in FY19.
- **Is this the end of monetary easing cycle?** We believe that there are still downside risks to the RBI's revised GVA growth forecasts for FY18 and FY19, even though FY18 inflation is likely to remain in line with the RBI's projections. Accordingly, although there is a window to cut interest rates, we are highly doubtful if even slower growth would nudge the cautious RBI. Accordingly, the monetary easing cycle may have ended in India.

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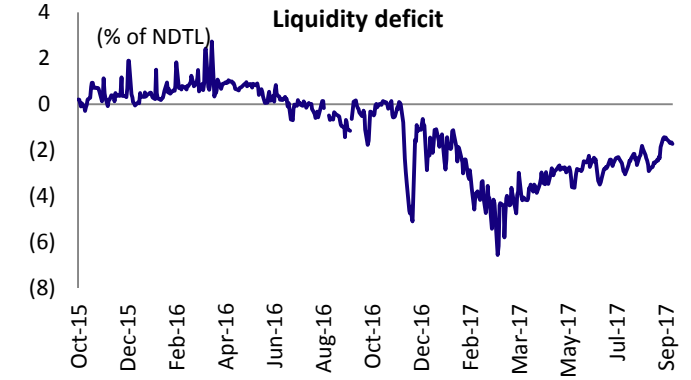
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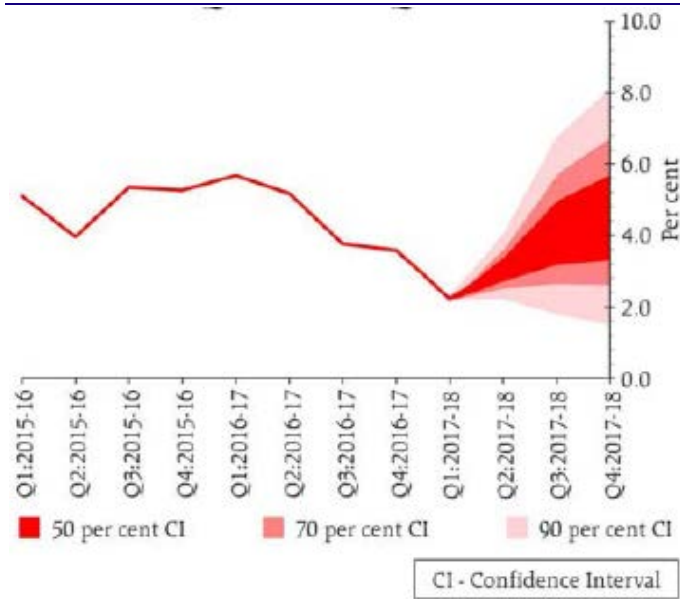
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Exhibit 1: RBI keeps policy rates unchanged

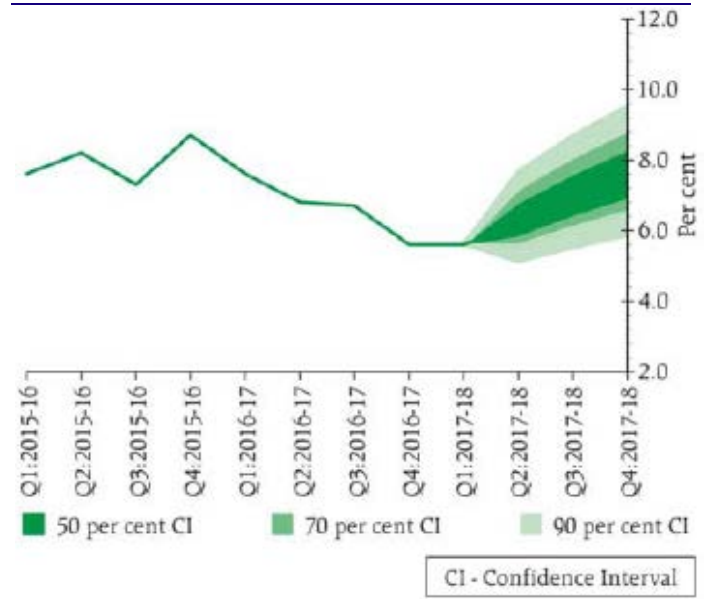
Source: RBI

Exhibit 2: Liquidity remains comfortable

Source: RBI

Exhibit 3: RBI sees upward trajectory in inflation in FY18...

Source: RBI

Exhibit 4: ...and expects GVA growth to slow down to 6.7% in FY18

Source: RBI

NOTES

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