EcoScope
The Economy Observer

RBI keeps rates unchanged; maintains neutral stance

No rate action expected in remaining part of FY18

- **The Monetary Policy Committee (MPC) decided to maintain status quo on rates and its policy stance in its fifth bi-monthly monetary policy meeting held today. The decision to hold rates was taken with a majority of 5-1 votes and was in line with market expectations.**
- **As far as the economic forecasts are concerned, the RBI increased its inflation forecast for 2HFY18 slightly to 4.3-4.7% from 4.2-4.6% earlier. However, it maintained its FY18 real GVA growth forecast at 6.7%. The central bank expects a sharp acceleration in growth to 7% in 3Q and further to 7.8% in 4Q, from 6.1% in 2QFY18.**
- **We expect inflation to rise towards 5% by March 2018, primarily on account of low base. On the other hand, we expect real GVA to rise more slowly than the RBI's expectations. The combination of higher inflation due to low base and weak growth is unlikely to allow the RBI to change rates in the remaining part of FY18.**

- **RBI keeps rates unchanged, in line with expectations:** The Monetary Policy Committee (MPC) kept policy rates unchanged – repo rate at 6%, reverse repo rate at 5.75%, and marginal standing facility (MSF) rate at 6.25% *(Exhibit 1)* – in its fifth bi-monthly policy meeting today. This was in line with our as well as market expectations. The decision to hold rates was taken with a majority of 5-1 votes. Like the last meeting, Dr Ravindra Dholakia voted for a 25bp cut in this meeting also. The MPC continued with its 'neutral' policy stance.
- **Inflation projections nudged up slightly…:** The RBI increased its inflation projections for 2HFY18 slightly to 4.3-4.7% from 4.2-4.6% earlier. It cited upside risks to inflation owing to a firming up of three-month ahead and one-year ahead household inflation expectations as well as expected pass-through of the increase in input prices to output prices by firms. Further, a possibility of fiscal slippage and global financial stability also pose risks. The RBI stated that these risks could be offset by seasonal moderation in prices of fruits & vegetables and the recent lowering of GST rates.
- **…while growth forecasts maintained:** The RBI had cut its GVA growth projection for FY18 to 6.7% from 7.3% in the previous policy meeting. It retained this projection, expecting GVA growth to accelerate to 7% in 3Q and further to 7.8% in 4Q from 6.1% in 2QFY18. The central bank believes that risks in GVA forecasts emerge from increases in oil prices and shortfall in agricultural production, which could be offset by revival in credit demand. We believe that the RBI's 2HFY18 estimates are on the higher side.
- **No rate action expected in remaining part of FY18:** We expect inflation to rise to 4.3% in November 2017 and move further up to touch 5% by March 2018, primarily on account of low base. Core inflation, however, is likely to be capped at ~4.7%, up from 4.4% in the past two months. On the other hand, we believe that RBI's GVA forecasts are highly ambitious and will be substantially under-achieved. Overall, the combination of higher inflation due to low base and weak growth is unlikely to allow the RBI to change rates in the remaining part of FY18.

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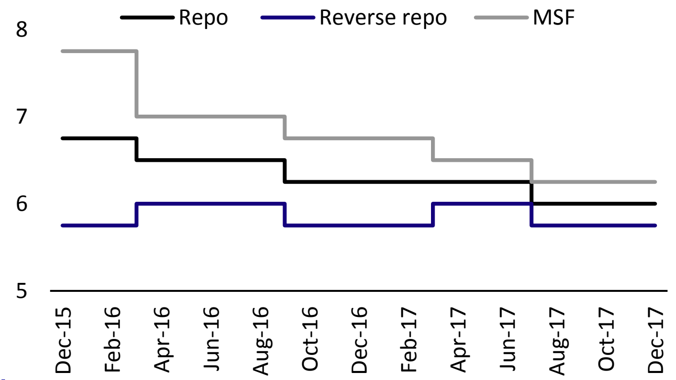
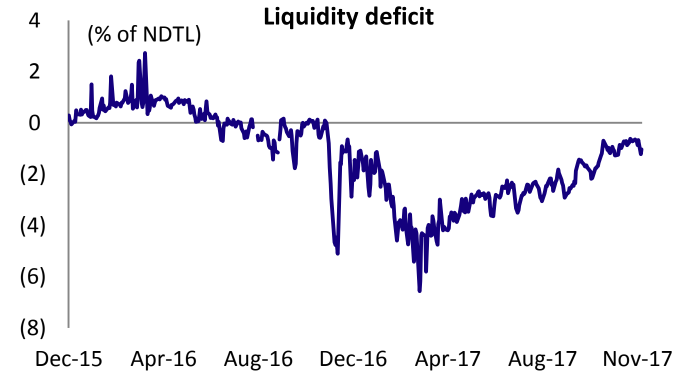
Exhibit 1: RBI keeps policy rates unchanged



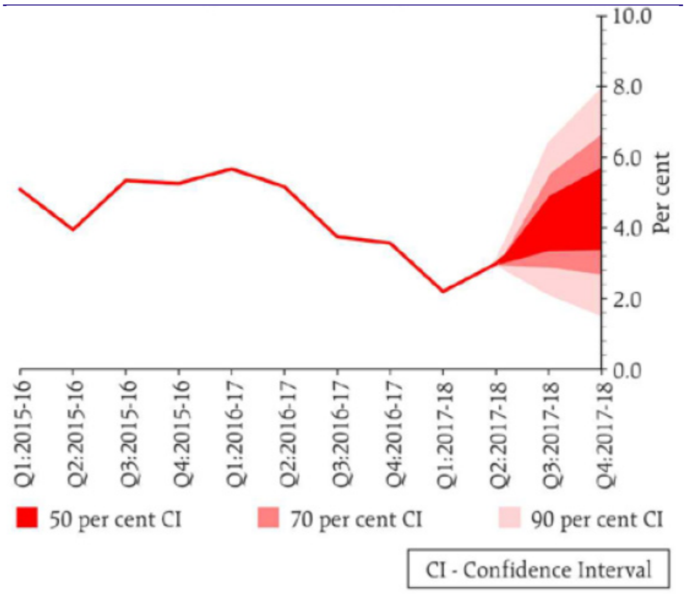
Source: RBI

Exhibit 2: Liquidity surplus continues to decline



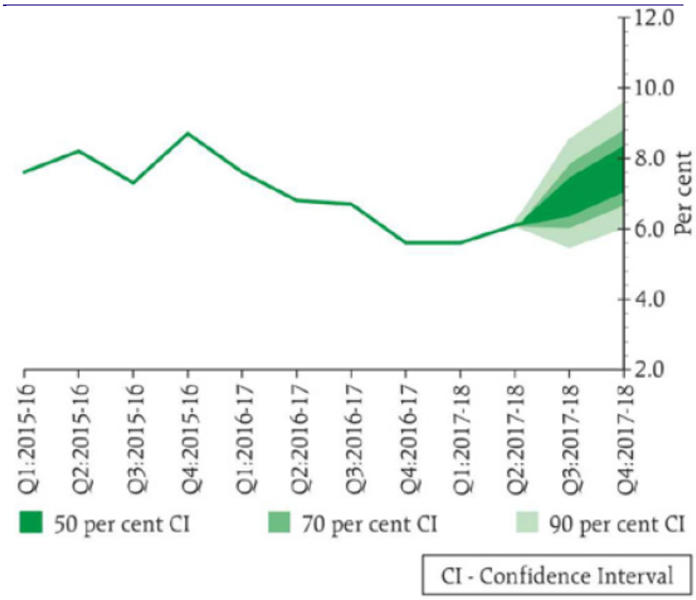
Source: RBI

Exhibit 3: RBI sees upward trajectory in inflation in 2HFY18…



Source: RBI

Exhibit 4: …and expects GVA to rise by 6.7% in FY18



Source: RBI

NOTES

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