

MPC cuts repo rate by 25 bps with stance unchanged at ‘Neutral’

RBI’s monetary policy has emerged as a critical policy tool for achieving overall macroeconomic management, price stability and growth. The first bi-monthly Monetary Policy Committee (MPC) in FY20 met from 2-4 April, 2019 to review the monetary policy framework of the country, decide on the repo rate, reverse repo rate, inflation projection and forecast of GDP growth rate.

MPC, in the last meeting had cut the repo rate to 6.25% and the monetary policy stance to ‘neutral’ from the earlier ‘calibrated tightening’ stance. Economists were of the view that the committee might go for an ‘accommodative’ stance, owing to softening of inflation and growth, dwindling private sector investment and US Federal Reserve wait-and-see stance on interest rates after raising them at a regular clip since February 2015. In addition, the central bank also was expected to consider factors like post election budget, monsoons and oil prices.

Highlights of Monetary Policy:

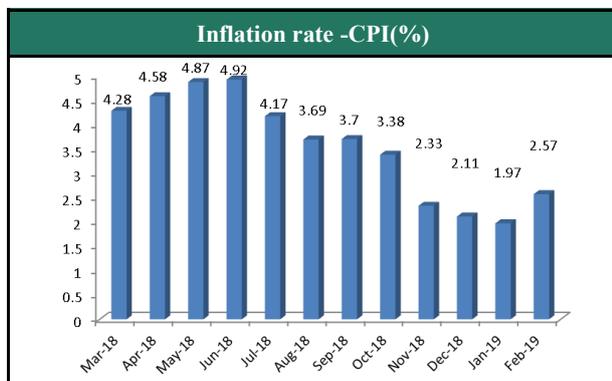
- Repo Rate: 6% (6.25% in February 2019)
- Reverse Repo Rate: 5.75% (6% in February 2019)
- Bank Rate: 6.25% (6.5% in February 2019)
- Inflation Projection: RBI lowers the CPI inflation projection to 2.9-3.0% in H1FY20 and 3.5-3.8% in H2FY20
- GDP Projection: The RBI has forecasted GDP growth of 7.2% for 2019-20. Further, the GDP growth has been projected at 6.8-7.1% in H1FY20 and 7.3-7.4% in H2FY20.

The RBI has cut the Repo Rate by 25bps to 6% in its first bi-monthly monetary policy meeting, while maintaining the ‘neutral’ stance, owing to softer headline inflation near 3.8% with domestic economy showing muted growth prospects.

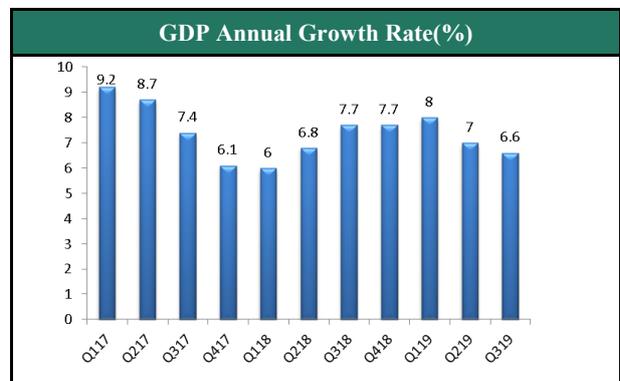
Why a rate cut was expected:

Many analysts expected the RBI to cut the repo rate in its first bi-monthly meeting of FY20. Few set of reasons are:

- Indian economy grew at 6.6% during Oct-Dec 2018, which was slowest in the last five quarters. Thus, a rate cut will incentivize credit growth and boost private investment.
- Inflation outlook is still benign where CPI stood at 2.57%, while core inflation numbers remained sticky at above 5%.
- US Federal Reserve in its recent March meeting, changed its perception to dovish, thus markets are expecting no rate hikes in 2019.



Source: tradingeconomics.com



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Our View:

We expected the MPC to go for a 25bps rate cut with an ‘accommodative’ stance due to factors slated above. However, the RBI opted for a rate cut (with 4:2 votes) but maintained a neutral stance, taking into account recent monsoon forecast highlighting El Nino, fiscal situations, risk of abrupt reversal of vegetable prices and unsustainability about the sustainability of fuel price, which softened in H2FY19. RBI’s short term outlook on food inflation remains benign. To boost liquidity, banks are further allowed to effectively reduce holdings in SLR bonds by 2%.

After analyzing the RBI commentary, we conclude that although the RBI Governor had highlighted the upside risks of inflation to favor neutral stance, the tone was highly dovish. If inflation continues to undershoot below 4%, another rate cut of 25bps cannot be ruled out in the next meeting.

The Final Verdict:

POLICY AT A GLANCE		
REPO	REVERSE	MPC's
CUT	CUT	NEUTRAL STANCE
To 6%	To 5.75%	

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