June 06, 2018 ECONOMIC UPDATE

Monetary Policy—June 2018

Hikes Repo Rate by 25bps, but a Neutral Stance

The Monetary Policy Committee (MPC) met from 4-6 June to review the monetary policy framework of the country, to decide on the repo rate, reverse repo rate, inflation projection and forecast of GDP growth rate. The framework aimed at setting the policy (Repo) rate based on an assessment of the current and evolving macroeconomic situation; and modulation of liquidity conditions to anchor money market rates at or around the repo rate.

Highlights of June Monetary policy:

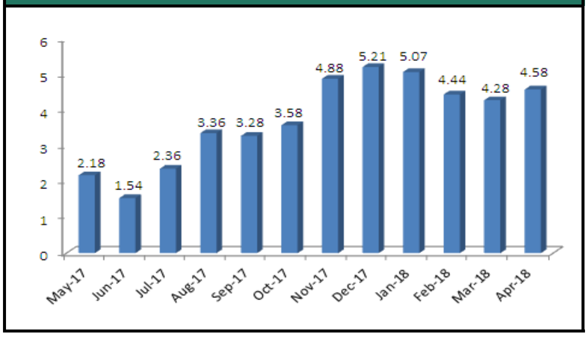
- Repo Rate: 6.25% (was kept unchanged at 6% in April 2018)
- Reverse Repo Rate: 6% (was left unchanged at 5.75% and the bank rate at 6.25% in April 2018)
- RBI revised the inflation projection to 4.8-4.9% in the H1FY19 and 4.7% in H2.
- The RBI forecasted a GDP growth of 7.4% including home rent allowance impact in FY19 from 6.6% in FY18. Further, the GDP growth has been projected at 7.5-7.6% in H1FY19 and 7.3-7.4% in H2FY19.

The RBI has hiked the repo rate in the second bi-monthly monetary policy meeting of the new fiscal year, the first repo rate hike after 4.5 years; however maintained a NEUTRAL stance.

Market expectations: It was a mixed view:

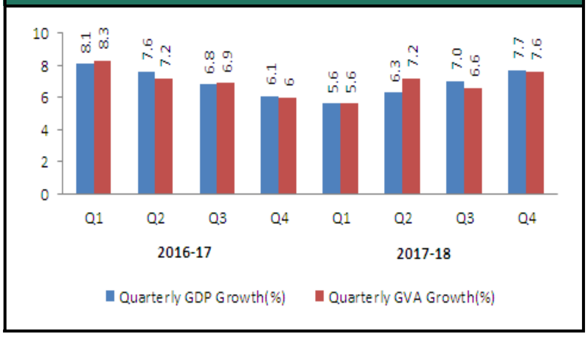
Factors like lack of clarity on the Monsoons 2018, Minimum Support Price (MSP) and fiscal risks ruled out the probability of an immediate rate hike. On the other hand, given the increase in CPI from 4.4% to 4.6% in April, in conjunction with higher than expected GDP to 7.7% in the fourth quarter, suggested that a back-ended rate hike cannot be ruled out. Growth accelerated to 7.7% in the fourth quarter of the financial year making it the fastest growing major economy. That's added to the tilt for Governor Urjit Patel to pull the rate trigger and follow central banks in emerging markets from Argentina to Indonesia that have stepped up action to stem outflows and curb a rout in their currencies.

India Inflation Rate



Source: Company

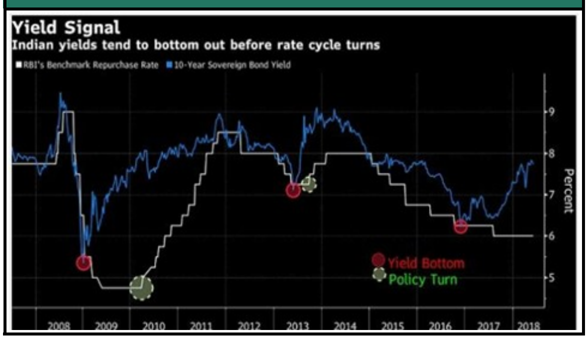
Quaterly GDP & GVA Growth (%)



Source: Company

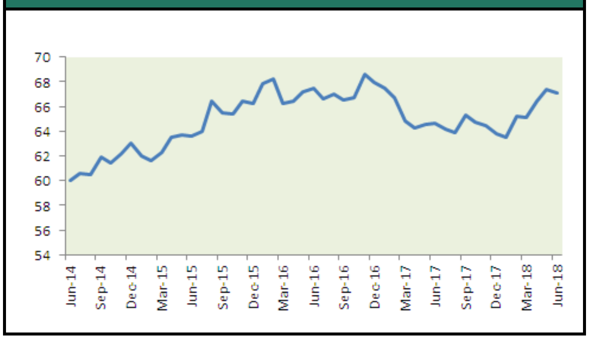
Rupee is the worst performing currency in Asia this year, down more than 5% against the dollar, coupled with surging oil prices, a major threat to inflation. The RBI aims to keep inflation at 4% over the medium term, and it's already running well above that, at 4.6%, which is further expected by economists to increase more than 5% in coming months. The gap between the 10-year government bond yield and the RBI's benchmark repurchase rate shows the increasing gap to 190basis points earlier this month, which widens at the start of the tightening cycle. All of this is indicating that the hike cycle is about to begin.

India Inflation Rate



Source: Bloomberg

USD INR Fluctuations



Source: Company

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Rate hike to come in-but not immediate- Was our opinion:

As expected by 90% of the poll to maintain the repo rate unchanged, our opinion was not any different. We had the view that the risks being considered in terms of the MSP, inflation, cautious outlook by major central banks, weaker rupee and the recent pick up in GDP are yet to fructify. These didn't tender for a rate hike immediately. However, the hike in Repo Rate was balanced well with the Neutral Stance, keeping in mind the objective of achieving medium term target for CPI inflation of 4% (within band of +/-2%) while supporting growth as indicated in the tone of the MPC.

The Final Verdict:

POLICY AT A GLANCE		
REPO	REVERSE	MPC's
HIKED	HIKED	STANCE NEUTRAL
To 6.25%	To 6%	

"As rightly said, financial markets are mainly driven by monetary policy expectations globally"

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