June 06, 2019 **ECONOMIC UPDATE**

Monetary Policy—June 2019

MPC cuts repo rate by 25bps with change in stance to 'Accommodative'

RBI's monetary policy has emerged as a critical policy tool for achieving overall macroeconomic management, price stability and growth. The Monetary Policy Committee (MPC) met on June 3,4 and 6, 2019 for the second bi-monthly monetary policy framework of the country, deciding on the repo rate, reverse repo rate, inflation projection and forecasting of GDP growth rate.

MPC, in the last meeting had cut the repo rate to 6% and maintained the neutral stance of the monetary policy. In this monetary policy, half of the economists were of the view that the committee might go for a 'neutral' stance with 25bps rate cut, majorly addressing the current slowdown in the economy, inflation risks from a possible monsoon deficit, uncertainty in crude oil prices and global trade war tensions. There was also an expectation that the RBI for the first time could use the rate change, other than in the multiples of 25bps, appropriate in a volatile situation which can very well convey the stance of the policy itself. Thus, a rate cut of 35-50bps was also expected through this policy. Also, RBI policy needs to deal with rate transmission issue, in addition to addressing the ongoing liquidity issue.

Highlights of Monetary Policy:

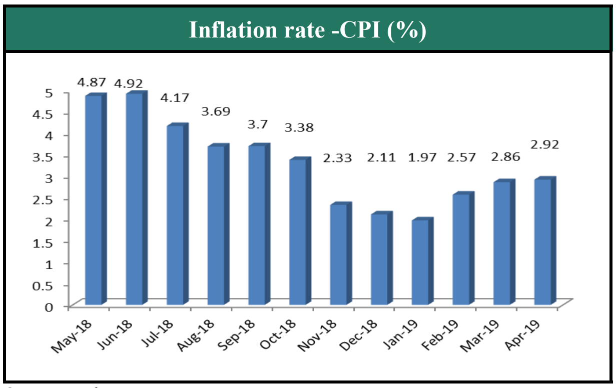
- Repo Rate: 5.75% (6% in April 2019)
- Reverse Repo Rate: 5.50% (5.75% in April 2019)
- Bank Rate: 6% (6.25% in April 2019)
- Inflation Projection: CPI inflation seen at 3-3.1% in H1FY20, 3.4-3.7% in H2FY20
- GDP Projection: FY20 GDP growth forecast cut to 7% from 7.2% earlier
- H1FY20 GDP growth forecast cut to 6.4-6.7% from 6.8-7.1%
- H2FY20 GDP growth forecast revised to 7.2-7.5% from 7.3-7.4%

The RBI has cut the Repo Rate by 25bps to 5.75% in its second bi-monthly monetary policy meeting and changed the stance to 'Accommodative', mainly to factor in the muted growth prospects.

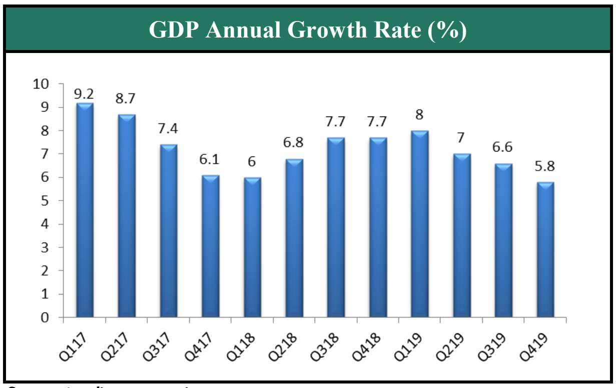
Why a rate cut was expected:

Many analysts expected the RBI to cut the repo rate by 35-50bps in its second bi-monthly meeting of FY20 with /without a change in stance. Few set of reasons are:

- Recent GDP data of fourth quarter of FY19 showed Indian economy growing at 5.8%, which is the slowest in the last two years. Thus, a rate cut would incentivize credit growth and boost private investment.
- Inflation outlook being still benign, with April CPI, stood at 2.92%, well within the range projected by RBI.
- Further rate cut expected by US Federal Reserve due on ongoing uncertainty in global trade regime



Source: tradingeconomics.com



Source: tradingeconomics.com

Our View:

We had expected the MPC to go for a 25-35bps rate cut with a neutral stance. However, the RBI opted for a rate cut of 25bps (with unanimous votes) with a change in stance, amid the slowing economic growth and rising global uncertainty. The decisions are in consonance with the objective of achieving the medium-term target for CPI inflation of 4% within a band of +/- 2%, while supporting growth. Risks around the baseline inflation trajectory emanate from uncertainties relating to the monsoon, unseasonal spikes in vegetable prices, international fuel prices and their pass-through to domestic prices, geo-political tensions, financial market volatility and the fiscal scenario. If inflation continues to undershoot below 4% and growth concerns coming to the forefront, another rate cut of 25bps cannot be ruled out in the next meeting.

FINAL VERDICT			
MPC Meetings	**REPO**	**REVERSE**	**CURRENT STANCE**
April 2019	*6%*	*5.75%*	**ACCOMODATIVE**
June 2019	**5.75%**	**5.50%**	

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