FIFTH BI-MONTHLY MONETARY POLICY STATEMENT, 2019-2020

Monetary Measures

- Monetary Policy Committee (MPC) maintained the policy repo rate under the liquidity adjustment facility (LAF) at 5.15%
- Consequently, the reverse repo rate under the LAF stands at 4.90%, and the marginal standing facility (MSF) rate and the Bank Rate at 5.40%. The decision to maintain status quo was unanimous.
- MPC continued its 'accommodative' stance of monetary policy and also indicated that it would continue as long as necessary to revive growth.

Analysis & Outlook

- Against a market consensus of a rate cut, RBI maintained status quo and continued with its accommodative stance given the evolving growth-inflation dynamics. In its post-policy conference, the Governor indicated that the MPC would wait for the impact of previous rate cuts to fully take effect before further easing.
- The MPC, notably, has sharply reduced its Gross Domestic Product (GDP) growth forecast for 2019-20 from 6.1% to 5.0%. The reduced expectation is based on weak high frequency indicators, low private capex and tepid consumer expenditure. GDP contraction is in line with the trend seen for advanced and some emerging economies, indicating that the slowdown is a global phenomenon.
- Headline CPI inflation inched up in October to 4.6% due to a spike in food inflation following unseasonal rains in October and early November adversely impacting kharif harvesting. Core inflation on the other hand has followed an opposite trajectory; CPI ex-food and fuel contracted from 4.2% in September to 3.4% in October. Going forward, RBI is expecting the rabi sowing to be in line with past trends and its positive outlook for rabi acreage is also bolstered by healthy fertiliser sales. CPI expectation for H2:2019-20 has been raised to 4.7-5.1% from its earlier estimate of 3.5-3.7% with risks evenly balanced. However, the MPC expects the inflation to moderate in Q1:2020-21 to 3.8-4.0%.
- Transmission of rate cut has improved across various money market segments and corporate bond market. As against the cumulative reduction in the policy repo rate by 135 bps during February-October 2019, transmission to various money and corporate debt market segments ranged from 137 bps (overnight call money market) to 218 bps (3-month CPs of non-banking finance companies). Transmission to the government securities market, however, has been partial at 113 bps (5-year government securities) and 89 bps (10-year government securities). Credit market transmission remains delayed but is picking up.
- Overall liquidity in the system remained in surplus in October and November 2019 despite an expansion of currency in circulation due to festival demand. Average daily net absorption under the LAF amounted to over Rs.1,98,000 crore in October. Surplus liquidity has been one of the major driver of effective and fast transmission of policy cuts. Reflecting easy liquidity conditions, the weighted average call rate (WACR) traded below the policy repo rate (on an average) by 8 basis points (bps) in October and by 10 bps in November.
- Possibility of a further rate cut still remains due to the accommodative stance. The Governor in its conference mentioned that the RBI will wait for next year's budget and look at any counter-cyclical measures being undertaken to spur growth before taking further policy action.
  - Yields at the longer end of the curve (maturity of more than one year) moved up by 15 bps with the benchmark 10-year paper yield at 6.58% at the time of writing.

  - Yields at the shorter end of the curve (up to one year) also moved up by 15-20 bps as the pricing-in of a rate cut was negated by the policy outcome.

- The MPC remains focused on its commitment to keeping headline inflation close to 4% on a durable basis.

Position of Funds

Duration funds:

- With slowing economy and benign inflation, interest rates are expected to come down further and credit spreads are likely to narrow.
- Therefore, it represents an excellent opportunity for investors to invest in fixed income duration funds with a medium to long-term horizon.

Money market funds:

- The yields at the shorter end of the curve will move in tandem with the liquidity in the system. With RBI likely to keep liquidity in surplus, short end rates are expected to be anchored to repo rate.

The next meeting of MPC is scheduled to be held on February 04 to 06, 2020.

MUTUAL FUND INVESTMENTS ARE SUBJECT TO MARKET RISKS, READ ALL SCHEME RELATED DOCUMENTS CAREFULLY.

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