RBI hikes repo rate in Third Bi-monthly Monetary Policy Statement, 2018-19

Policy repo rate increased to 6.50% and the reverse repo rate under the LAF stands at 6.25%

On the basis of an assessment of the current and evolving macroeconomic situation, the Monetary Policy Committee (MPC) has decided to increase the policy repo rate under the liquidity adjustment facility (LAF) by 25 basis points to 6.50 per cent. Consequently, the reverse repo rate under the LAF stands adjusted to 6.25 per cent, and the marginal standing facility (MSF) rate and the Bank Rate to 6.75 per cent. The decision of the MPC is consistent with the neutral stance of monetary policy in consonance with the objective of achieving the medium-term target for consumer price index (CPI) inflation of 4 per cent within a band of +/- 2 per cent, while supporting growth.

The RBI policy rates so far

Components	5th April 2016	7th June 2016	09th August 2016	4th October 2016	7th December 2016	8th February 2017	6th April 2017	07th June 2017	02nd August 2017	4th Oct 2017	6th Dec 2017	7th Feb 2018	05th April 2018	06th June 2018	01st Aug 2018
CRR	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00 %	4.00%	4.00 %	4.00 %	4.00 %	4.00%	4.00%	4.00%
Repo Rate	6.5%	6.5%	6.5%	6.25%	6.25%	6.25%	6.25%	6.25 %	6.00%	6.00 %	6.00 %	6.00 %	6.00%	6.25%	6.50%
Reverse Repo Rate	6.00%	6.00%	6.00%	5.75%	5.75%	5.75%	6.0%	6.0%	5.75%	5.75 %	5.75 %	5.75 %	5.75%	6.0%	6.25%
WPI Inflation	(-) 0.91%	0.34% (Apr-	1.62 (Jun-	3.74% (Aug-	3.39% (Oct-16)	3.39% (Dec-16)	6.55% (Feb-17)	3.85 %	0.9% (Jun-	3.24 %	3.59 %	3.6% (Dec-	2.5% (Feb-	3.2% (Apr-	5.77% (Jun-

	@#*	2016)	16)	16)				(Apr-17)	17)	(Aug-17)	(Oct-17)	17)	18)	18)	18)
CPI inflation\@	5.39	5.77	5.77 (Jun-16)	5.05% (Aug-16)	4.2% (Oct-16)	3.4% (Dec-16)	3.65% (Feb-17)	2.99% (Apr-17)	1.5% (Jun-17)	3.36% (Aug-17)	3.6% (Oct-17)	5.2% (Dec-17)	4.44% (Feb-18)	4.6% (Apr-18)	5.00% (Jun-18)
IIP growth	-1.5% @#**	0.1% (Mar 16)	-0.8% (Apr-16)	-2.4% July 2016	0.7% (Sep-16)	5.7% (Nov-16)	2.7% (Jan-17)	2.5% (Mar-17)	1.7% (May-17)	1.2% (July-17)	3.8% (Sep-17)	8.4% (Nov-17)	7.5% (Jan-18)	4.4% (Mar-18)	3.2% (May-18)
Real GDP growth	7.6%^#	7.6%^#	7.6%^#	7.6%^#	7.1%^##	7.4%^###	7.4%^&*	7.3% ^&**	7.3% ^&***	6.7% ^&^	6.7% ^&^^	6.6% ^&^*	7.4% (2018-19)$#	7.4% 2018-19)$##	7.4% 2018-19)$###

Source: PHD Research Bureau, compiled from various sources, Note:, , #Data for Gross domestic product for Q2 of 2014-15, ^Data for Oct 2014, ^^ Data for November 2014 , ^^^December 2014," Data for Jan 2015, "" Data for Feb 2015, *Data for Sep 2014, ** Data for Oct 2014 and *** Data for Nov 2014.@ Data for Dec 2014. Note: The Ministry of Statistics & Programme Implementation has released the new series of national accounts, revising the base year from 2004-05 to 2011-12. With this backdrop, real GDP growth for 2012-13 is estimated at 5.1% and 6.9% for 2013-14, $Advance estimates of national income 2014-15 MOSPI, @*** Data for August 2015 @#* Feb 2016 @#** January 2016 @^^^^Data for Sep 2015; RBI projection of GVA growth for 2015-16, ^#GVA growth projection for 2016-17 by RBI \@CPI inflation for the respective month of the year. ^##GVA growth projection for 2016-17 by RBI in monetary policy dated 7 Dec 2016. ^### GVA growth as per Sixth Bi-monthly Monetary Policy Statement 2016-17 ^&* GVA growth for 2017-18 as per First Bi-monthly Monetary Policy Statement, 2017-18, ^&** GVA growth for 2017-18 as per Second Bi-monthly Monetary Policy Statement, 2017-18, ^&*** GVA growth for 2017-18 as per Third Bi-monthly Monetary Policy Statement, 2017-18. ^&^ GVA growth for 2017-18 as per Fourth Bi-monthly Monetary Policy Statement, 2017-18. ^&^^ GVA growth for 2017-18 as per Fifth Bi-monthly Monetary Policy Statement, 2017-18. ^&^* GVA growth for 2017-18 as per Sixth Bi-monthly Monetary Policy Statement, 2017-18. $# Projections by RBI in First Bi-monthly Monetary Policy Statement, 2018-19, $## Projections by RBI in Second Bi-monthly Monetary Policy Statement, 2018-19, $### Projections by RBI in Third Bi-monthly Monetary Policy Statement, 2018-19.

Snapshot of the Third Bi-monthly Monetary Policy Statement, 2018-19

Since the last meeting of the MPC in June 2018, global economic activity has continued to maintain steam; however, global growth has become uneven and risks to the outlook have increased with rising trade tensions. Among advanced economies (AEs), the US economy rebounded strongly in Q2, after modest growth in Q1, on the back of rising personal consumption expenditures and exports. In the Euro Area, weak growth in Q1 continued in Q2 due to subdued consumer demand, weighed down by political uncertainty and a strong currency. In Japan, recent data on retail sales, consumer confidence and business sentiment point to moderation in growth.

Economic activity in major emerging market economies (EMEs) has slowed somewhat on volatile and elevated oil prices, mounting trade tensions and tightening of financial conditions. The Chinese economy lost some pace in Q2, pulled down by efforts to contain debt. The Russian economy picked up in Q1; recent data on employment, industrial production and exports indicate that the economy has gained further momentum. South Africa's economy contracted in Q1; though consumer sentiment has improved, high unemployment and weak exports pose challenges. In Brazil, economic activity suffered a setback in Q1 on nation-wide strikes; more recent data suggest that growth remained muted as industrial production contracted in May and the manufacturing purchasing managers' index (PMI) declined.

Global trade lost some traction due to intensification of trade wars and uncertainty stemming from Brexit negotiations. Crude oil prices, which remained volatile and elevated in May-June on a delicate demand-supply balance, eased modestly in the second half of July on higher supply from Organisation of Petroleum Exporting Countries (OPEC) and non-OPEC producers. Base metal prices have fallen on the general risk-off sentiment triggered by fears of an intensification of trade wars. Gold prices have softened on a stronger dollar. Inflation remained firm in the US, reflecting higher oil prices and stronger aggregate demand. Inflation has edged up also in some other major advanced and emerging economies, driven, in part, by rising energy prices and pass-through effects from currency depreciations.

On the domestic front, south-west monsoon has been recovering after a brief spell of deficiency in the second half of June. The cumulative rainfall up to July 31, 2018 was 6 per cent below the long-period average. In terms of spatial distribution, 28 of the 36 sub-divisions received normal or excess rainfall, whereas 8 sub-divisions received deficient rainfall as against three sub-divisions last year. The total sown area of kharif crops as on July 27 was 7.5 per cent lower than that a year ago. The live storage in major reservoirs as on July 26 was at 41 per cent of the full reservoir level compared with 36 per cent a year ago, which portends well for the rabi sowing season.

Industrial growth, measured by the index of industrial production (IIP), strengthened in April-May 2018 on a y-o-y basis. This was driven mainly by a significant turnaround in the production of capital goods and consumer durables. Growth in the infrastructure/construction sector accelerated sharply, reflecting the government's thrust on national highways and rural housing, while the growth of consumer non-durables decelerated significantly. The output of eight core industries accelerated in June due to higher production in petroleum refinery products, steel, coal and cement. Capacity utilisation in the manufacturing sector remains robust. The assessment based on the Reserve Bank's business expectations index (BEI) for Q1:2018-19 remained optimistic notwithstanding some softening in production, order books and exports. The July manufacturing PMI remained in expansion zone, although it eased from its level a month ago with slower growth in output, new orders and employment.

Export growth picked up in May and June 2018 on a y-o-y basis, aided by engineering goods, petroleum products, drugs and pharmaceuticals, and chemicals. Import growth also accelerated largely due to an increase in crude oil prices. Among non-oil imports, gold imports declined due to lower volume, while imports of machinery, coal, electronic goods, chemicals, and iron and steel increased sharply. Double-digit import growth in May and June pushed up the trade deficit. On the financing side, net foreign direct investment (FDI) flows improved significantly in the first two months of 2018-19. With the tightening of liquidity conditions in AEs, growing geopolitical concerns and with the escalation of protectionist sentiment, net foreign portfolio investment (FPI) outflows from the domestic capital market have continued, albeit at an increasingly slower rate. India's foreign exchange reserves were at US$ 404.2 billion on July 27, 2018.

Outlook

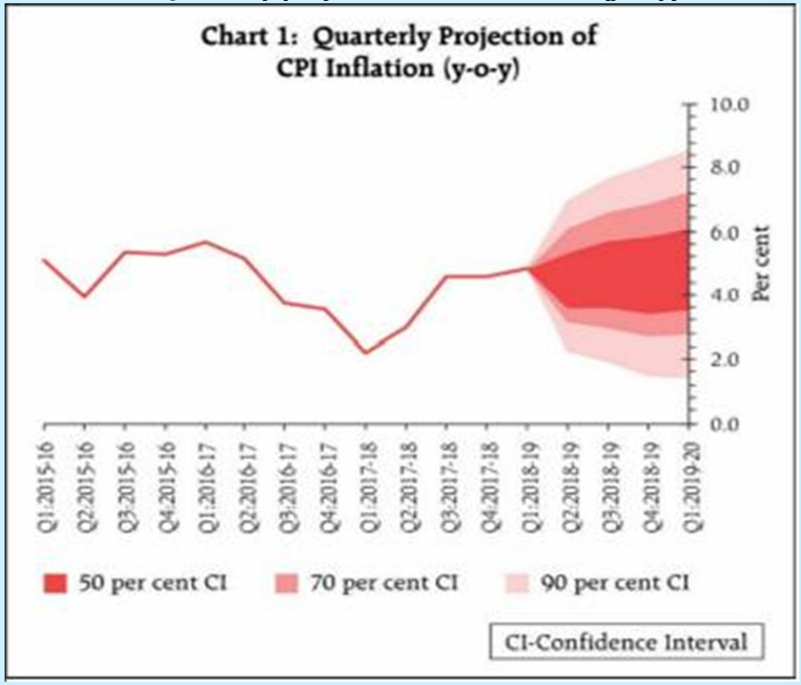
CPI inflation for 2018-19 is projected at 4.6 per cent in Q2, 4.8 per cent in H2 of 2018-19 and 5.0 per cent in Q1:2019-20, including the HRA impact for central government employees, with risks evenly balanced. While, GDP growth is projected at 7.4 per cent, ranging 7.5-7.6 per cent in H1 and 7.3-7.4 per cent in H2, with risks evenly balanced; GDP growth for Q1:2019-20 is projected at 7.5 per cent.

In the second bi-monthly resolution of 2018-19, CPI inflation for 2018-19 was projected at 4.8-4.9 per cent in H1 and 4.7 per cent in H2, including the HRA impact for central government employees, with risks tilted to the upside. Excluding the impact of HRA revisions, CPI inflation was projected at 4.6 per cent in H1 and 4.7 per cent in H2. Actual inflation outcomes have been slightly below the projected trajectory as the seasonal summer surge in vegetable prices has remained somewhat muted in comparison with its past behaviour and fruits prices have declined.

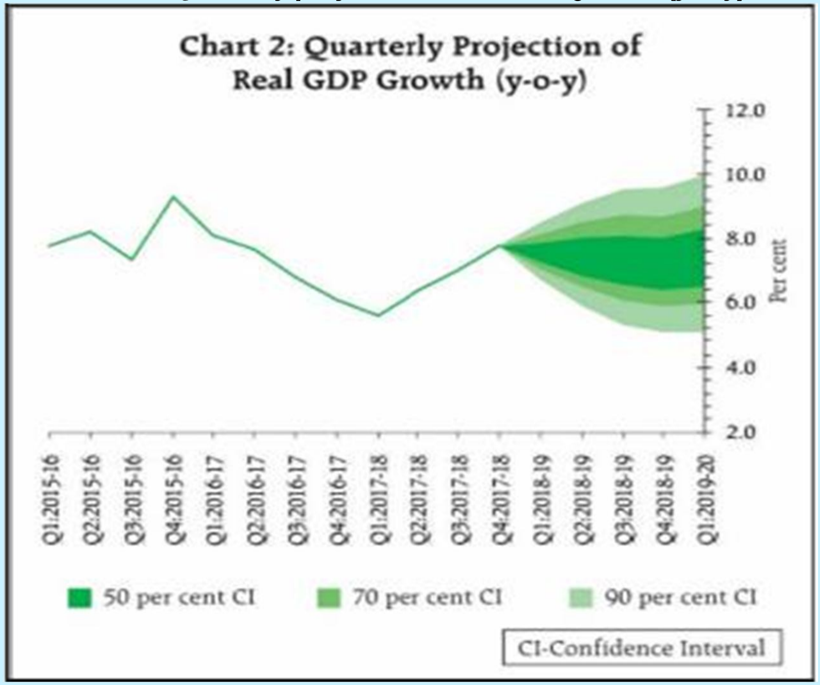
The inflation outlook is likely to be shaped by several factors. First, the central government has decided to fix the minimum support prices (MSPs) of at least 150 per cent of the cost of production for all kharif crops for the sowing season of 2018-19. This increase in MSPs for kharif crops, which is much larger than the average increase seen in the past few years, will have a direct impact on food inflation and second round effects on headline inflation. A part of the increase in MSPs based on historical trends was already included in the June baseline projections. As such, only the incremental increase in MSPs over the average increase in the past will impact inflation projections. However, there is a considerable uncertainty and the exact impact would depend on the nature and scale of the government's procurement operations. Second, the overall performance of the monsoon so far augurs well for food inflation in the medium-term. Third, crude oil prices have moderated slightly, but remain at elevated levels. Fourth, the central government has reduced Goods and Services Tax (GST) rates on several goods and services. This will have some direct moderating impact on inflation, provided there is a pass-through of reduced GST rates to retail consumers. Fifth, inflation in items excluding food and fuel has been broad-based and has risen significantly in recent months, reflecting greater pass-through of rising input costs and improving demand conditions. Finally, financial markets continue to be volatile. Based on an assessment of the above-mentioned factors, inflation is projected at 4.6 per cent in Q2, 4.8 per cent in H2 of 2018-19 and 5.0 per cent in Q1:2019-20, with risks evenly balanced. Excluding the HRA impact, CPI inflation is projected at 4.4 per cent in Q2, 4.7-4.8 per cent in H2 and 5.0 per cent in Q1:2019-20.

Turning to the growth outlook, various indicators suggest that economic activity has continued to be strong. The progress of the monsoon so far and a sharper than the usual increase in MSPs of kharif crops are expected to boost rural demand by raising farmers' income. Robust corporate earnings, especially of fast moving consumer goods (FMCG) companies, also reflect buoyant rural demand. Investment activity remains firm even as there has been some tightening of financing conditions in the recent period. Increased FDI flows in recent months and continued buoyant domestic capital market conditions bode well for investment activity. The Reserve Bank's IOS indicates that activity in the manufacturing sector is expected to remain robust in Q2, though there may be some moderation in pace. Rising trade tensions may, however, have an adverse impact on India's exports. Based on an overall assessment, GDP growth projection for 2018-19 is retained, as in the June statement, at 7.4 per cent, ranging 7.5-7.6 per cent in H1 and 7.3-7.4 per cent in H2, with risks evenly balanced; GDP growth for Q1:2019-20 is projected at 7.5 per cent.

Quarterly projection of CPI inflation (y-o-y)



Quarterly projection of real GDP growth (y-o-y)



Source: RBI

The Monetary Policy Committee has noted that domestic economic activity has continued to sustain momentum and the output gap has virtually closed. However, uncertainty around domestic inflation needs to be carefully monitored in the coming months. In addition, recent global developments raise some concerns. Rising trade protectionism poses a grave risk to near-term and long-term global growth prospects by adversely impacting investment, disrupting global supply chains and hampering productivity. Geopolitical tensions and elevated oil prices continue to be the other sources of risk to global growth..

Please contact for any query related to this mail to Ms. Kritika Bhasin, Research Officer at kritika.bhasin@phdcci.in, with a cc to Dr. S P Sharma, Chief Economist at spsharma@phdcci.in and Ms. Surbhi Sharma, Associate Economist at surbhi@phdcci.in of PHD Chamber of Commerce & Industry.

Warm regards,

Dr. S P Sharma
Chief Economist

PHD Chamber of Commerce and Industry
PHD House, 4/2 Siri Institutional Area
August Kranti Marg, New Delhi-110016
Ph.: + 91-11-26863801-04, 49545454
Fax: +91- 26855450, 49545451
Email: spsharma@phdcci.in
Website: www.phdcci.in