RBI maintains status quo in Sixth Bi-monthly Monetary Policy Statement, 2017-18

Policy repo rate unchanged at 6.0% and the reverse repo rate under the LAF remains at 5.75%

On the basis of an assessment of the current and evolving macroeconomic situation, the Monetary Policy Committee (MPC) of RBI has decided to keep the policy repo rate under the liquidity adjustment facility (LAF) unchanged at 6%. Consequently, the reverse repo rate under the LAF remains at 5.75%, and the marginal standing facility (MSF) rate and the Bank Rate at 6.25%. 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% within a band of +/- 2 per cent, while supporting growth.

The RBI policy rates so far

Components	29-Sep 2015	1st Dec 2015	2nd Feb 2016	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
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	6.75%	6.75%	6.75%	6.5%	6.5%	6.5%	6.25%	6.25%	6.25%	6.25%	6.25%	6.00%	6.00%	6.00%	6.00%
Reverse Repo Rate	5.75%	5.75%	5.75%	6.00%	6.00%	6.00%	5.75%	5.75%	5.75%	6.0%	6.0%	5.75%	5.75%	5.75%	5.75%
WPI Inflation	(-)4.95@***	(-)3.8@****	(-)0.73@#	(-)0.91%@#*	0.34% (Apr-2016)	1.62 (Jun-16)	3.74% (Aug-16)	3.39% (Oct-16)	3.39% (Dec-16)	6.55% (Feb-17)	3.85% (Apr-17)	0.9% (Jun-17)	3.24% (Aug-17)	3.59% (Oct-17)	3.6% (Dec-17)
CPI inflation \@	4.41	5.61	5.18	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)
IIP growth	4.2 @^^^	3.6@^^^^	-3.2%@##	-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)
Real GDP growth	7.4%;;	7.4%;;	7.4%;;	7.6%^#	7.6%^#	7.6%^#	7.6% ^#	7.1%^ ##	7.4% ^###	7.4% ^&*	7.3%^&**	7.3%^&***	6.7%^&^	6.7%^&^^	6.6%^&^*

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 @**** Data for Oct 2015, @# December 2015 @#* Feb 2016 @#** January 2016 @^^^ Data for July 2015, @^^^^Data for Sep 2015 , @## Nov 2015; RBI projection of GVA growth for 2015-16, ;; RBI projections according to 4th, 5th & 6th Bi-monthly Monetary Policy Statement, 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.

Snapshot of the Sixth Bi-monthly Monetary Policy Statement, 2017-18

Since the MPC's last meeting in December 2017, global economic activity has gained further pace with growth impulses becoming more synchronised across regions. Among advanced economies (AEs), the Euro area expanded at a robust pace, supported by consumption and investment. Economic optimism alongside falling unemployment and low interest rates are supporting the recovery. The US economy lost some momentum with growth slowing down in Q4 of 2017 even as manufacturing activity touched a multi-month high in December. The Japanese economy continued to grow as manufacturing activity gathered pace in January on strong external demand, providing fillip to the already bullish business confidence.

Economic activity accelerated in emerging market economies (EMEs) in the final quarter of 2017. The Chinese economy grew above the official target, driven by strong domestic consumption and robust exports. However, some downside risks to growth remain, especially from easing fixed asset investment and surging debt levels. In Russia, strong private consumption, rising oil prices and high exports are supporting economic activity, although weak investment and economic sanctions are weighing on its growth prospects. In Brazil, data on household spending and unemployment were positive in Q4. However, recovery remains vulnerable to political uncertainty, which has dampened consumer confidence. South Africa continues to face challenges on both domestic and external fronts, including high unemployment and declining factory activity.

Global trade continued to expand, underpinned by strong investment and robust manufacturing activity. Crude oil prices touched a three-year high as production cuts by the OPEC coupled with falling inventories weighed on the global demand-supply balance. Bullion prices touched a multi-month high on a weak US dollar. Inflation remained contained in most AEs, barring the UK, on subdued wage pressures. Inflation was divergent in key EMEs due to country-specific factors.

Financial markets have become volatile in recent days due to uncertainty over the pace of normalisation of the US Fed monetary policy in view of January payrolls data showing rapidly accelerating wage growth and better than expected employment. The volatility index (VIX) has climbed to its highest level since Brexit. Equity markets have witnessed a sharp correction, both in AEs and EMEs. Bond yields in the US have hardened sharply, adding to the upward pressures seen during January, with concomitant rise in bond yields in other AEs and EMEs. Forex markets have become volatile as well. Until this episode of recent volatility, global financial markets were buoyed by investor appetite for risk, corporate tax cuts by the US, and stable economic conditions. Equity markets had gained significantly in January, driven by robust Chinese growth, uptick in commodity prices, and positive corporate sentiment in general. In currency markets, the US dollar had touched a multi-month low on February 1 on fiscal risks and improving growth prospects in other AEs.

On the domestic front, the real gross value added (GVA) growth as per the first advance estimates (FAE) released by the Central Statistics Office (CSO) is estimated to decelerate to 6.1 per cent in 2017-18 from 7.1 per cent in 2016-17 due mainly to slowdown in agriculture and allied activities, mining and quarrying, manufacturing, and public administration and defence (PADO) services.

Outlook

The projection of real GVA growth for 2017-18 is at 6.6 per cent and GVA growth for 2018-19 is projected at 7.2 per cent overall – in the range of 7.3-7.4 per cent in H1 and 7.1-7.2 per cent in H2

The December bi-monthly resolution projected inflation in the range of 4.3-4.7 per cent in the second half of 2017-18, including the impact of increase in HRA. In terms of actual outcomes, headline inflation averaged 4.6 per cent in Q3, driven primarily by an unusual pick-up in food prices in November. Though prices eased in December, the winter seasonal food price moderation was less than usual. Domestic pump prices of petrol and diesel rose sharply in January, reflecting lagged pass-through of the past increases in international crude oil prices. Considering these factors, inflation is now estimated at 5.1 per cent in Q4, including the HRA impact.

The inflation outlook beyond the current year is likely to be shaped by several factors. First, international crude oil prices have firmed up sharply since August 2017, driven by both demand and supply side factors. Second, non-oil industrial raw material prices have also witnessed a global uptick. Firms polled in the Reserve Bank's IOS expect input prices to harden in Q4. In a scenario of improving economic activity, rising input costs are likely to be passed on to consumers. Third, the inflation outlook will depend on the monsoon, which is assumed to be normal. Taking these factors into consideration, CPI inflation for 2018-19 is estimated in the range of 5.1-5.6 per cent in H1, including diminishing statistical HRA impact of central government employees, and 4.5-4.6 per cent in H2, with risks tilted to the upside. The projected moderation in inflation in the second half is on account of strong favourable base effects, including unwinding of the 7th CPC's HRA impact, and a softer food inflation forecast, given the assumption of normal monsoon and effective supply management by the Government.

Turning to the growth outlook, GVA growth for 2017-18 is projected at 6.6 per cent. Beyond the current year, the growth outlook will be influenced by several factors. First, GST implementation is stabilising, which augurs well for economic activity. Second, there are early signs of revival in investment activity as reflected in improving credit offtake, large resource mobilisation from the primary capital market, and improving capital goods production and imports. Third, the process of recapitalisation of public sector banks has got underway. Large distressed borrowers are being referenced for resolution under the Insolvency and Bankruptcy Code (IBC). This should improve credit flows further and create demand for fresh investment. Fourth, although export growth is expected to improve further on account of improving global demand, elevated commodity prices, especially of oil, may act as a drag on aggregate demand. Taking into consideration the above factors, GVA growth for 2018-19 is projected at 7.2 per cent overall – in the range of 7.3-7.4 per cent in H1 and 7.1-7.2 per cent in H2 – with risks evenly balanced.

Quarterly projection of CPI inflation (y-o-y) for Q4: 2017-18 to Q4: 2018-19

Quarterly projection of growth in GVA at basic prices (y-o-y) for Q3 :2017-18 to Q4: 2018-19

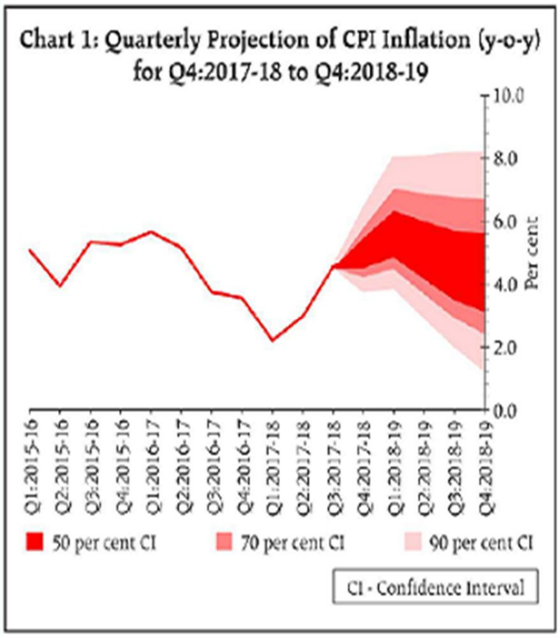

Chart 1: Quarterly Projection of CPI Inflation (y-o-y) for Q4:2017-18 to Q4:2018-19

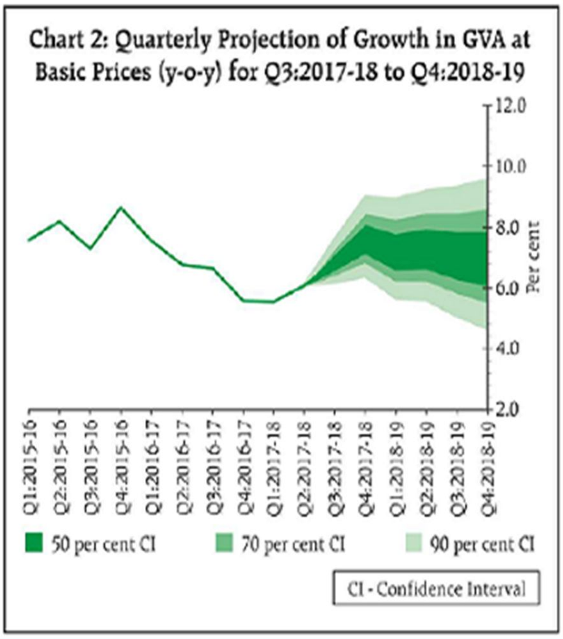

Chart 2: Quarterly Projection of Growth in GVA at Basic Prices (y-o-y) for Q3:2017-18 to Q4:2018-19

Source: RBI

The MPC notes that the inflation outlook is clouded by several uncertainties on the upside. First, the staggered impact of HRA increases by various state governments may push up headline inflation further over the baseline in 2018-19, and potentially induce second-round effects. Second, a pick-up in global growth may exert further pressure on crude oil and commodity prices with implications for domestic inflation. Third, the Union Budget 2018-19 has proposed revised guidelines for arriving at the minimum support prices (MSPs) for kharif crops, although the exact magnitude of its impact on inflation cannot be fully assessed at this stage. Fourth, the Union Budget has also proposed an increase in customs duty on a number of items. Fifth, fiscal slippage as indicated in the Union Budget could impinge on the inflation outlook. Apart from the direct impact on inflation, fiscal slippage has broader macro-financial implications, notably on economy-wide costs of borrowing which have already started to rise. This may feed into inflation. Sixth, the confluence of domestic fiscal developments and normalisation of monetary policy by major advanced economies could further adversely impact financing conditions and undermine the confidence of external investors. There is, therefore, need for vigilance around the evolving inflation scenario in the coming months.

There are also mitigating factors. First, capacity utilisation remains subdued. Second, oil prices have moved both ways in the recent period and can potentially soften from current levels based on production response. Third, rural real wage growth is moderate.

Accordingly, the MPC has decided to keep the policy repo rate on hold and continue with the neutral stance. The MPC reiterates its commitment to keep headline inflation close to 4 per cent on a durable basis. The MPC notes that the economy is on a recovery path, including early signs of a revival of investment activity. Global demand is improving, which should help strengthen domestic investment activity. The focus of the Union Budget on the rural and infrastructure sectors is also a welcome development as it would support rural incomes and investment, and in turn provide a further push to aggregate demand and economic activity. On the downside, the deterioration in public finances risks crowding out of private financing and investment. The Committee is of the view that the nascent recovery needs to be carefully nurtured and growth put on a sustainably higher path through conducive and stable macro-financial management.

Please contact for any query related to this mail to Ms. Neha Gupta, Research Associate at neha.gupta@phdcci.in with a cc to Dr. S P Sharma, Chief Economist at spsharma@phdcci.in and Ms. Surbhi Sharma, Senior Research Officer at surbhi@phdcci.in , 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

"We Walk Our Talk"

PHD CHAMBER OF COMMERCE AND INDUSTRY
PHD House, 4/2 Siri Institutional Area, August Kranti Marg, New Delhi - 110 016 (India) • Tel. : +91-11-2686 3801-04, 49545454, 49545400
Fax : +91-11-2685 5450 • E-mail : president@phdcci.in • Website : www.phdcci.in, CIN: U74899DL1951GAP001947