

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

**Policy repo rate increased to 6.25% and the reverse repo rate under the LAF stands at 6%**

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 6.25 per cent. Consequently, the reverse repo rate under the LAF stands adjusted to 6.0 per cent, and the marginal standing facility (MSF) rate and the Bank Rate to 6.50 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

| Component         | 2 <sup>nd</sup><br>Feb<br>2016 | 5 <sup>th</sup><br>April<br>2016 | 7 <sup>th</sup><br>June<br>2016 | 09 <sup>th</sup><br>August<br>2016 | 4 <sup>th</sup><br>October<br>2016 | 7 <sup>th</sup><br>December<br>2016 | 8 <sup>th</sup><br>February<br>2017 | 6 <sup>th</sup> April<br>2017 | 07 <sup>th</sup><br>June<br>2017 | 02 <sup>nd</sup><br>August<br>2017 | 4 <sup>th</sup><br>Oct<br>2017 | 6 <sup>th</sup><br>Dec<br>2017 | 7 <sup>th</sup><br>Feb<br>2018 | 05 <sup>th</sup><br>April<br>2018 | 06 <sup>th</sup><br>June<br>2018 |
|-------------------|--------------------------------|----------------------------------|---------------------------------|------------------------------------|------------------------------------|-------------------------------------|-------------------------------------|-------------------------------|----------------------------------|------------------------------------|--------------------------------|--------------------------------|--------------------------------|-----------------------------------|----------------------------------|
| CRR               | 4.00<br>%                      | 4.00%                            | 4.00%                           | 4.00%                              | 4.00%                              | 4.00%                               | 4.00%                               | 4.00%                         | 4.00<br>%                        | 4.00%                              | 4.00<br>%                      | 4.00<br>%                      | 4.00<br>%                      | 4.00%                             | 4.00<br>%                        |
| Repo Rate         | 6.75<br>%                      | 6.5%                             | 6.5%                            | 6.5%                               | 6.25%                              | 6.25%                               | 6.25%                               | 6.25%                         | 6.25<br>%                        | 6.00%                              | 6.00<br>%                      | 6.00<br>%                      | 6.00<br>%                      | 6.00%                             | 6.25<br>%                        |
| Reverse Repo Rate | 5.75<br>%                      | 6.00%                            | 6.00%                           | 6.00%                              | 5.75%                              | 5.75%                               | 5.75%                               | 6.0%                          | 6.0%                             | 5.75%                              | 5.75<br>%                      | 5.75<br>%                      | 5.75<br>%                      | 5.75%                             | 6.0%                             |
| WPI Inflation     | (-)<br>0.73                    | (-)<br>0.91%                     | 0.34%<br>(Apr-                  | 1.62<br>(Jun-                      | 3.74%<br>(Aug-                     | 3.39%<br>(Oct-16)                   | 3.39%<br>(Dec-16)                   | 6.55%<br>(Feb-17)             | 3.85<br>%                        | 0.9%<br>(Jun-                      | 3.24<br>%                      | 3.59<br>%                      | 3.6%<br>(Dec-                  | 2.5%<br>(Feb-                     | 3.2%<br>(Apr-                    |

|                 | @#        | @#*        | 2016)         | 16)            | 16)             |               |               |                | (Apr-17)       | 17)           | (Aug-17)       | (Oct-17)      | 17)           | 18)             | 18)           |
|-----------------|-----------|------------|---------------|----------------|-----------------|---------------|---------------|----------------|----------------|---------------|----------------|---------------|---------------|-----------------|---------------|
| CPI inflation\@ | 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) | 4.44% (Feb-18)  | 4.6% (Apr-18) |
| IIP growth      | -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) | 7.5% (Jan-18)   | 4.4% (Mar-18) |
| Real GDP growth | 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%#&^*      | 7.4% (2018-19)# | 7.4%          |

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 @# December 2015 @#\* Feb 2016 @#\*\* January 2016 @^^^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. \$# Projections by RBI in First Bi-monthly Monetary Policy Statement, 2018-19

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

Since the last meeting of the MPC in April, global economic activity has continued to expand, though there has been some easing of momentum. Among advanced economies (AEs), the US economy began the year on a weak note on soft private spending and reduced residential investment; however, there seems to be a rebound in Q2:2018 with strong retail sales and improved employment data. The Euro Area growth decelerated in Q1; recent industrial production data as well as weak consumer and business sentiment suggest a loss of pace. The Japanese economy contracted in Q1, though it is expected to turn around in Q2 as indicated by recent data prints on exports and the manufacturing purchasing managers' index (PMI).

Economic activity in major emerging market economies (EMEs) remained largely resilient. The Chinese economy maintained a strong momentum in Q1; more recent data on industrial production and PMI suggest that growth is likely to hold steady in Q2. The Russian economy appears to have picked up in recent months after a soft end to 2017; both manufacturing and services PMI rose in April. In South Africa, growth prospects have improved with the return of political stability as reflected in consumer confidence, manufacturing PMI and retail sales. In contrast, a stream of poor data from Brazil on high unemployment and soft industrial production show that the effects of recession linger.

Global trade growth has continued to strengthen, though geo-political tensions have contributed recently to declining export orders and air freight. Crude oil prices rose sharply till May 24 on heightened geo-political tensions, but moderated thereafter on expectations of easing of supplies by the Organisation of Petroleum Exporting Countries (OPEC) and Russia. Base metal prices, especially aluminium, have risen on account of US sanctions on Russia. Gold has witnessed selling pressure on a stronger dollar, but the metal gained last week on political uncertainty in the Euro Area. Inflation pressures have emerged in some key advanced and emerging economies, driven in part by rising commodity prices.

On the domestic front, the Central Statistics Office (CSO) released on May 31 the quarterly estimates of national income accounts for Q4:2017-18 and provisional estimates for 2017-18. Gross domestic product (GDP) growth for 2017-18 has been estimated at 6.7 per cent, up by 0.1 percentage point from the second advance estimates released on February 28. This increase in growth has been underpinned by a significant upward revision in private final consumption expenditure (PFCE) due especially to improved rural demand on the back of a bumper harvest and the government's thrust on rural housing and infrastructure. Quarterly data suggest that the economy grew at 7.7 per cent in Q4:2017-18 – the fastest pace in the last seven quarters. Gross fixed capital formation (GFCF) growth accelerated for three consecutive quarters up to Q4.

Industrial growth also strengthened, reflecting the robust performance of manufacturing, which accelerated for three consecutive quarters in Q4. Capacity utilisation by manufacturing firms increased significantly in Q4:2017-18 as revealed in the latest round of the Reserve Bank's order books, inventories and capacity utilisation survey (OBICUS). The output of eight core industries accelerated in April on account of a sharp expansion in coal production, which reached a 42-month peak. Cement output also posted double-digit growth for the sixth consecutive month in April. However, electricity generation slowed down. As per the early results of the Reserve Bank's April-June round of the industrial outlook survey (IOS), activity is expected to expand at a lower rate in Q1:2018-19 due to a significant rise in input prices and perceptions of softening domestic and external demand conditions. However, the manufacturing PMI remained in an expansionary mode for the tenth consecutive month in May on the back of new domestic orders and exports.

## Outlook

CPI inflation for 2018-19 is revised to 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. While, GDP growth is projected in the range of 7.5-7.6 per cent in H1 and 7.3-7.4 per cent in H2, with risks evenly balanced

The first bi-monthly resolution of 2018-19 in April projected CPI inflation in the range of 4.7-5.1 per cent in H1:2018-19 and 4.4 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 4.4-4.7 per cent in H1:2018-19 and 4.4 per cent in H2. Actual inflation outcomes since the April policy have evolved broadly on the lines of the projected trajectory. However, there has been an important compositional shift. While the summer momentum in vegetable prices was weaker than the usual pattern, there was an abrupt acceleration in CPI inflation excluding food and fuel.

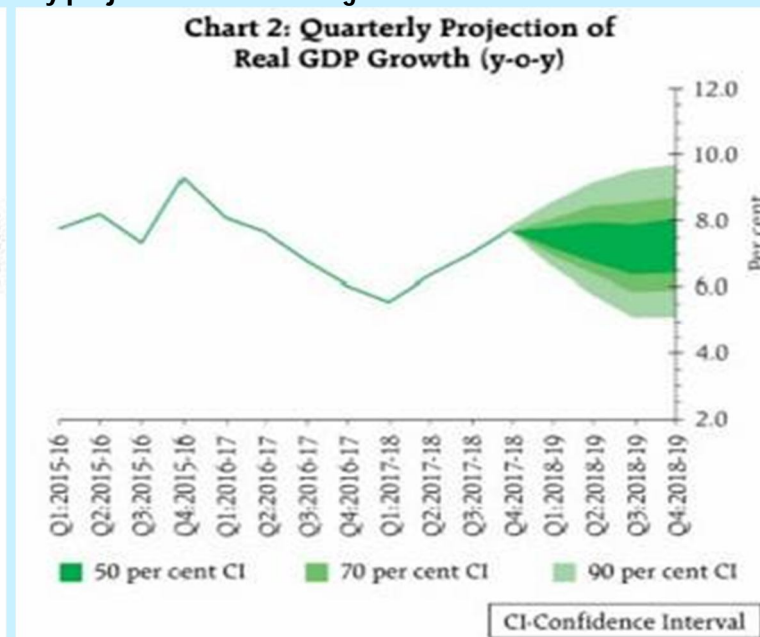
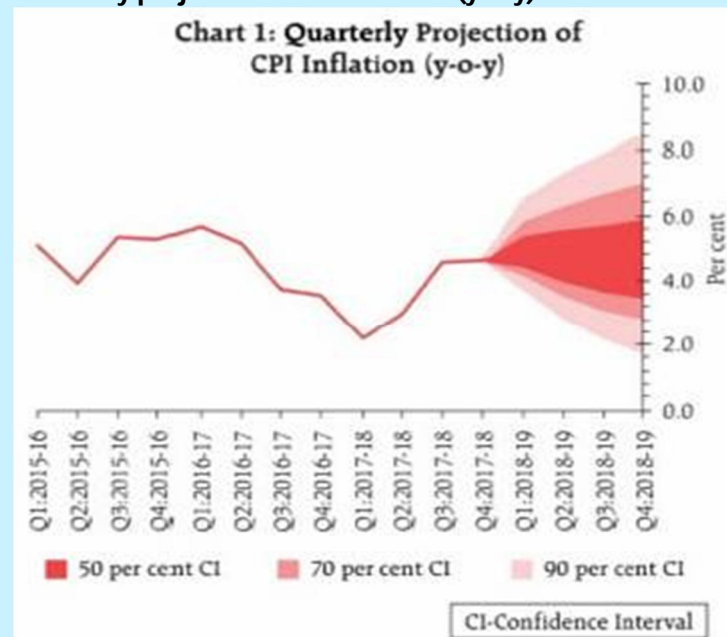
The headline inflation outlook is driven primarily by two countervailing effects. On the one hand, CPI inflation excluding food and fuel rose sharply in April over March by 80 basis points to reach an ex-HRA level of 5.3 per cent, suggesting a hardening of underlying inflationary pressures. Furthermore, since the MPC's meeting in early April, the price of Indian basket of crude surged from US\$ 66 a barrel to US\$ 74. This, along with an increase in other global commodity prices and recent global financial market developments, has resulted in a firming up of input cost pressures, as also confirmed in the Reserve Bank's IOS for manufacturing firms in Q2:2018-19. The resulting pick-up in the momentum of inflation excluding food, fuel and HRA has imparted persistence into higher CPI projections for 2018-19. On the other hand, food inflation has remained muted over the past few months and the usual seasonal pickup delayed, softening the projections in the short run. Taking these effects into account, projected CPI inflation for 2018-19 is revised to 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 is projected at 4.6 per cent in H1 and 4.7 per cent in H2.

Turning to the growth outlook, the CSO's provisional estimates have placed GDP growth for Q4:2017-18 at 7.7 per cent – 70 basis points higher than that in Q3 – given the sharp acceleration in investment and construction activity. With improving capacity utilisation and credit offtake, investment activity is expected to remain robust even as there has been some tightening of financing conditions in recent months. Global demand has also been buoyant, which should encourage exports and provide a further thrust to investment. The sharp rise in petroleum product prices, however, is likely to impact disposable incomes. Consumption, both rural and urban, remains healthy and is expected to strengthen further. According to the early results of the Reserve Bank's IOS, activity in the manufacturing sector is expected to moderate marginally in Q2:2018-19 on account of deterioration in the overall business situation and order book. On the basis of an overall assessment, GDP growth for 2018-19 is retained at 7.4 per cent as in the April policy. GDP growth is projected in the range of

7.5-7.6 per cent in H1 and 7.3-7.4 per cent in H2, with risks evenly balanced.

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

#### Quarterly projection of real GDP growth



Source: RBI

A major upside risk to the baseline inflation path in the April resolution has materialised, viz., 12 per cent increase in the price of Indian crude basket, which was sharper, earlier than expected and seems to be durable. Crude oil prices have been volatile recently and this imparts considerable uncertainty to the inflation outlook – both on the upside and the downside. Several other risks remain. First, global financial market developments have emerged as another important source of uncertainty. Second, the significant rise in households' inflation expectations as gathered in the May 2018 round of the Reserve Bank's survey could feed into wages and input costs in the coming months. However, the pass-through to output prices remains muted presently. Third, the staggered impact of HRA revisions by various state governments may push headline inflation up. While the statistical impact of HRA revisions will be looked through, there is a need to watch out for any second round impact on inflation. Fourth, the impact of the revision in the MSP formula for *kharif* crops is not possible to assess at this stage in the absence of adequate details. Fifth, as forecast by the IMD, if the monsoon is normal and well-distributed temporally and spatially, it may help keep food inflation benign. Against the above backdrop, the MPC decided to increase the

policy repo rate by 25 basis points and keep the stance neutral. The MPC reiterates its commitment to achieving the medium-term target for headline inflation of 4 per cent on a durable basis.

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**Warm regards,**

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