MONETARY POLICY OUTLOOK- THE FIFTH BI-MONTHLY MONETARY POLICY REVIEW OF THE CURRENT FINANCIAL YEAR DECEMBER-MARCH 2018 -19

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	Q1 2017-18	Q2 2017-18	Q3 2017-18	Q4 2017-18	Q1 2018-19	Q2 2018-19
GDP	**8.0**	**6.3**	**7.0**	**7.7**	**8.2**	**7.1**

<u>Quarterly GDP Growth :</u>

- GDP has declined to 7.1% in Q2 (2018-19) from 8.2% in Q1 (2018-19)- the lowest in three quarters but it is still better than 6.3% in the same period of the previous year. The Indian economy had grown by 8.2% in Q1 of the current fiscal year.
- Reduction in manufacturing sector growth from 13.5% in Q1 2018-19 to 7.4% in Q2 2018-19 contributed to the decline in Q2 GDP growth.
- Higher fuel prices and the weak rupee were the primary factors dragging the industrial growth.
- Welcome developments, such as, the Rupee appreciation to 70 and significant softening of global crude oil prices, slipping below USD 60 per barrel from USD 86. However, India's economic growth slowed to 7.1% in the September quarter after peaking to an over two-year high in the first three months of this fiscal, because of moderation in consumption demand and weakness in the farm sector.

Sector-wise Growth in GVA

(Per cent)

Sector	2016-17				2017-18 (PE)				2018-19	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2

Agriculture, forestry and fishing	4.3	5.5	7.5	7.1	3.0	2.6	3.1	4.5	5.3	**3.8**
Mining and quarrying	10.5	9.1	12.1	18.8	1.7	6.9	1.4	2.7	0.1	**(-ve)2.4**
Manufacturing	9.9	7.7	8.1	6.1	-1.8	7.1	8.5	9.1	13.5	**7.4**
Electricity, gas, water supply and other utilities	12.4	7.1	9.5	8.1	7.1	7.7	6.1	7.7	7.3	**9.2**
Services	8.5	7.4	6.0	4.9	8.5	6.4	7.5	8.2	7.5	**7.8**
Construction	1.3	5.7	3.0	3.8	2.8	-3.9	1.8	3.1	8.7	**7.8**
Trade, hotels, transport, communication	7.2	8.0	8.9	7.2	7.5	5.5	8.4	8.5	6.7	**6.8**
Financial, real estate and professional services	6.0	6.6	10.5	8.3	2.8	1.0	8.4	6.1	6.5	**6.3**
Public administration, defence and other services	10.7	10.0	7.7	8.0	10.6	16.4	13.5	6.1	7.7	**10.9**
GVA at Basic Prices	7.1	6.5	8.3	7.2	6.9	6.0	5.6	6.1	8.0	**6.9**
PE: Provisional Estimates. Source: CSO.										

Half-Yearly Growth

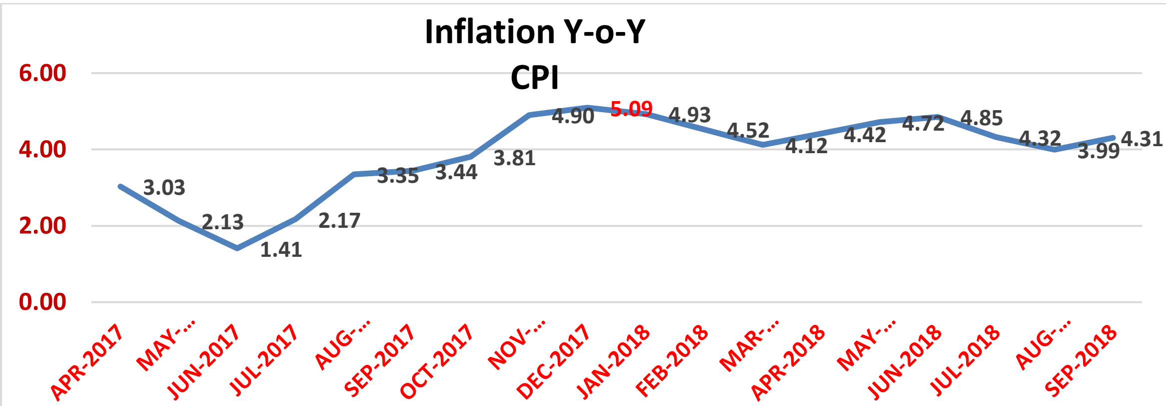
	April – Sept 2017-18	**April— Sept 2018-19**
Agriculture, Forestry &Fishing	**2.8**	**4.6**
Mining & Quarrying	**3.9**	**(-ve) 1**
Manufacturing	**2.6**	**10.3**
Electricity, Gas, Water Supply &Other Utility Services	**7.4**	**8.2**
Construction	**2.5**	**8.3**
Trade, Hotel, Transport,& Broadcasting Communication Services	**8.4**	**6.8**
Financial, Real Estate &Professional Services	**7.2**	**6.4**
Public Administration, Defence & Other Services	**9.6**	**10.5**
GVA at Basic Price	**5.8**	**7.4**

- Mining & Quarrying, Electricity, Gas, Water Supply &Other Utility Services, Trade, Hotel, Transport, & Broadcasting Communication Services

& Financial, Real Estate &Professional Services recorded sluggish growth during April-Sept 2018-19 compared its corresponding period in the previous year.

- Global uncertainties, rupee depreciation, high crude oil prices coupled with monetary policy tightening resulted in moderation in GDP growth during Q2 2018-19 compared to Q2 2017-18.

Inflation



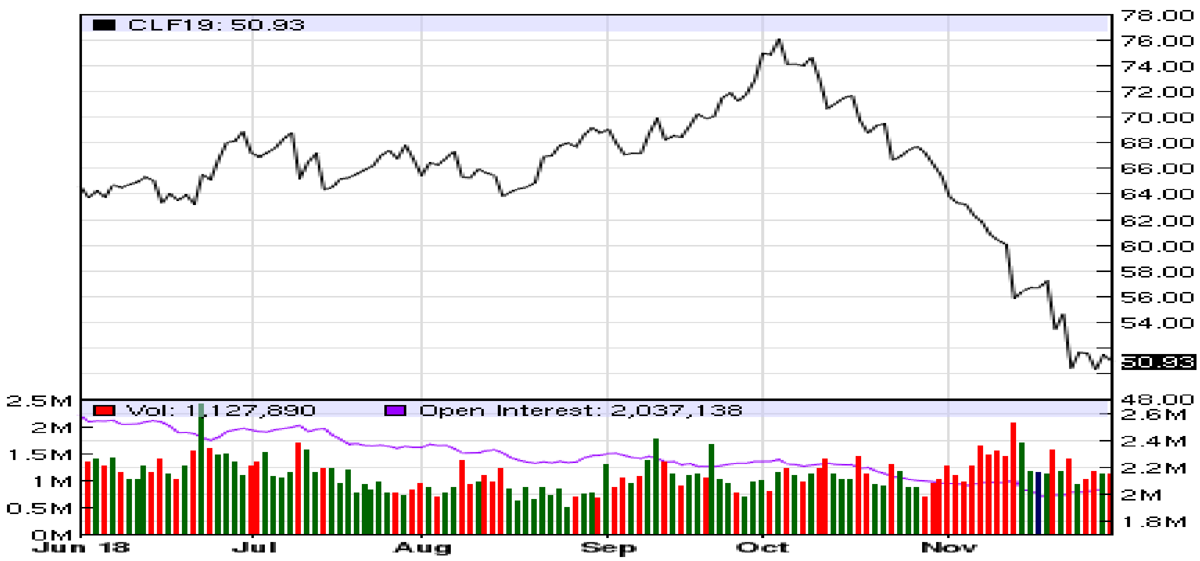
- After migrating to 5.09% in Dec 2017, Y-o-Y inflation (in CPI) has been declining over the months. However, it is hovering above 4%.

- Given the fact that the RBI's inflation projections have been overshooting the actual figures, there is a distinct possibility that th**e** RBI may prune inflation projection. A close and careful analysis of the inflation figures reveals that only in three of the past 24 months through October 2018 food inflation exceeded the 4% mark, having averaged just 1.7%. Food inflation fell from a peak of 3.1% in May 2018 to deflation (-0.9%) in October. Accordingly, though core inflation crossed the 5%-mark during this period, the CPI-IW level was contained.
- This thesis can also be substantiated by the RBI's forecast. Let us do some number crunching. The monetary policy statement in April projected CPI inflation for the first half of 2018-19 at 4.7-5.1% and 4.4% for the second half. In June, it revised it to 4.8-4.9% for H1 and 4.7% for H2. In August, it projected 4.6% inflation for the September quarter and 4.8% for the second half of this fiscal, but the actual average CPI inflation in H1 stood at 4.3%. Inflation is averaging at 4.2 % for the first seven months of the fiscal because of *inter-alia*, lower procurement of food crops by the government through the minimum support price (MSP) mechanism. In October, it again revisited the inflation forecast and predicted inflation in the 3.9-4.5% range for H2FY19. Given the current benign retail inflation scenario, it is widely expected that the retail inflation may undershoot

the RBI’s projection of 3.9-4.5 % in H2 of FY19. Retail inflation in October slowed to 3.3%, i.e., the lowest since September 2017, when it touched 3.28%. It thus eased for the third successive month.

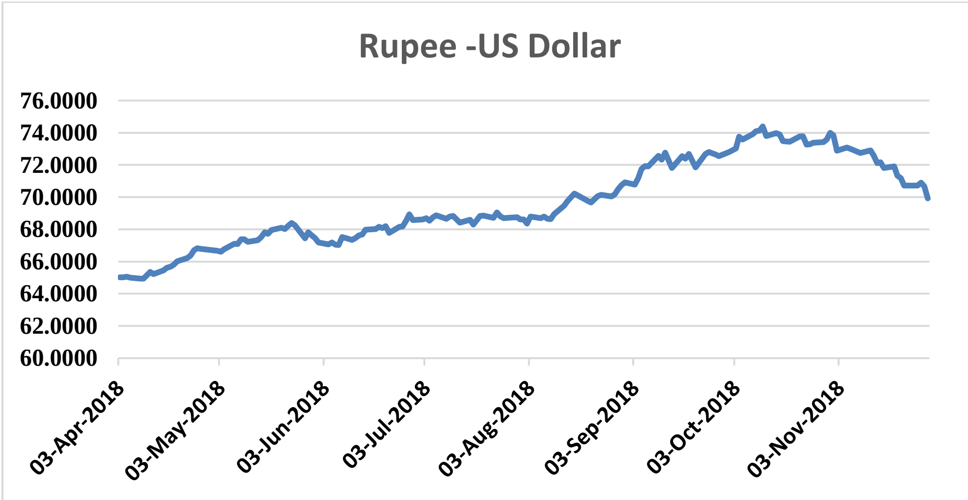
- The MPC’s mandate is flexible inflation targeting and the interest rate is a policy instrument to achieve the 4 % medium-term CPI inflation within a band of +/- 2%. The RBI has hiked rates twice by a cumulative 0.50 % this fiscal, responding to inflationary concerns from factors like rupee depreciation which lost over 13 % year to date and higher oil prices which had jumped to $86 a barrel earlier this month but have now steadily moved southwards. Thus both the recent crude prices and the rupee movements augur well for the macro-economic situation, including the fiscal deficit and the current account deficit. There are also factors like the RBI's inflation modelling and hardening of rates in the US, which may lead to capital outflows. All these factors thus need to be carefully considered in a comprehensive examination of the Indian economy.

<u>Futures Price Quotes for Crude Oil at NYMEX</u>



- A positive sign for the Indian economy is that Crude oil price is receding from the level of $90 per barrel to around $50.

Exchange Rate



- Rupee depreciation adversely impacted GDP growth during August- October 2018. Depreciation of rupee against US$ has been checked and it would reduce the current account deficit and improve the growth scenario in coming months.

Financial Market and Banking

Select Economic Indicators				
	2017		2018	
	Aug.	**Sep.**	Aug.	Sep.
Scheduled Commercial Banks				
Deposits	8.9	8.2	8.9	8.1
Credit	6.2	6.5	13.4	12.5
Non-food Credit	7.1	7.1	13.5	12.6
Broad Money (M3)	6.7	5.6	10.8	9.4
Interest Rates (%)				
Policy Repo Rate	6.00	6.00	6.50	6.50
Reverse Repo Rate	5.75	5.75	6.25	6.25
Marginal Standing Facility (MSF) Rate	6.25	6.25	6.75	6.75
Bank Rate	6.25	6.25	6.75	6.75
Base Rate	9.00/9.55	9.00/9.55	8.75/9.45	8.85/9.45
MCLR (Overnight)	7.75/8.10	7.75/8.10	7.90/8.05	7.90/8.30
Term Deposit Rate >1 Year	6.25/6.75	6.25/6.75	6.25/7.25	6.25/7.25

Call Money Rate (Weighted Average)	5.93	5.88	6.36	6.49
91-Day Treasury Bill (Primary) Yield	6.11	6.11	6.81	7.19
10-Year G-Sec Par Yield	6.65	6.83	7.95	8.00
Foreign Trade (% Change)				
Imports	23.1	19.2	25.6	10.5
Exports	8.1	25.5	19.5	-2.3

- Compared to September last year, September, current year
  - ✓ bank credit has improved marginally.
  - ✓ Broad money supply has grown marginally
  - ✓ Policy rates have been tightened
  - ✓ Banks' lending (MCLR) and deposits rate increased.
  - ✓ Increased in call money rates indicate liquidity shortage in market
  - ✓ Almost 100 bps increased in Gsec 10 Yr Yield which indicate revival of interest rate cycle
  - ✓ Though imports have declined, exports recorded negative growth.

- Along with revival of interest rate cycle, 11 out of 19 public sector banks in India are in PCA category with negative RoA/ low capital base/ high Net NPA
- But the big picture masks some skew in credit dispensation by the banking industry. The share of bank credit to micro and small enterprises (MSEs) has been shrinking for the last three years — from 5.9% in October 2015 to 4.5% in October 2018. The issue of credit to MSEs has been aggravated by the double whammy of demonetisation and GST. The figures are quite stark: in the first seven months of the current fiscal (up to October 26), outstanding loans to MSEs have come down by Rs 8,800 cr to Rs 3.64 lakh crore. This reduced lending to MSEs has been largely offset by enhanced credit to large businesses. Banks lent an additional Rs 5,100 crore to large businesses, which owe Rs 22.27 lakh — a big chunk of the Rs 26.96 lakh crore credit to the industry. Besides, businesses raised an extra Rs 59,000 crore from banks by issuing bonds and commercial papers, with banks growing their corporate bond portfolios by 8% to Rs 7.27 lakh crore.

Despite overall industry growth being flat, bank credit has been showing a healthy rise because of a spike in lending to housing and non-banking financial companies (NBFCs). Of the Rs 3.14 lakh crore loans that banks added to their books in the first seven months of FY19, almost half (47%) has been to these two sectors.

In view of high and mounting NPAs, banks have focused on home loans with low margins and low defaults. In FY19, banks have grown their home loan books by Rs 3.27lakh crore from March 30, 2018, to Rs 10.62 lakh crore — a 9% increase. Home loans account for 26% (Rs 87,800 crore) of all incremental lending this year up to October.

Similarly, outstanding bank loans to NBFCs grew Rs 66,200 crore (13%) from their March-30 level to Rs 5.62 lakh crore by end-October. They are now 7% of all bank credit, up from 5% a year earlier. The only other sectors to have grown their shares in total bank credit are "other services" and "other personal loans", where the loan book has grown by Rs 50,000 crore and Rs 40,000 crore, respectively.

<u>Outlook for December –March</u>

- The annual GDP growth for2018-19 would be around 7.2%- 7.6%
- Negative growth in exports, rising current account deficit, fiscal slippage and reversal in interest rate cycle may limit the growth scenario in the coming months.
- With decline in crude oil price, CPI based inflation would be around 4.3% for 2018-19, with a minimum andmaximum range of 4.0% and 4.8% respectively.
- With the revival of interest rate cycle and increase in deposits rate, the chances of upward movements of banks credit in coming months may be expected.
- Availability of liquidity in market would play a leading role in the coming months for credit offtake in the economy.
- With the expectation of inflation around 4% to 4.5%, it is expected that RBI may not increase any policy rates including CRR in the coming December – March quarter.
- Any increase in CRR or policy rates would adversely liquidity in the economy and impact negatively the growth scenario in the economy.

<u>Policy Action</u>

Viewed thereof, the RBI is likely to keep the repo rate unchanged at 6.50 % in its fifth bi-monthly monetary policy review on December 5 against the backdrop of retail inflation declining to a one-year low of 3.31 % for October and the GDP growing at a slower-than-expected rate in the second quarter. In sum, the benign position of currency, oil, external condition, and headline CPI inflation, make a strong and compelling case for the RBI pressing the pause button.

The RBI is expected to persist with its calibrated tightening stance in view of possible upside risks that remain because of pass-through of minimum support price hikes for agriculture commodities, reversal in the current soft global crude oil prices, volatility in the global financial markets and possible fiscal slippage, among others. The interest rate could start inching up once again in the next financial year with oil and currency direction playing the spoilsport.

In the four bi-monthly monetary policy reviews so far in FY19, the RBI has upped the Repo rate twice by 25 basis points each in June (6 % to 6.25 %) and August (6.25 % to 6.50 %). In the October policy review, the RBI changed its policy stance from “neutral” to “calibrated tightening”. However, given the contextual significance of greater liquidity, or cash availability in the Indian financial and banking landscape at the present juncture (India’s banks have been net borrowers from the RBI since October 8, with the daily deficit of Rrs. 1.4 lakh crore), liquidity boosting measures, including reduction in the cash reserve ratio (CRR) would be welcome. Towards this end, apart from liquidity infusion through OMOs (open market operations), meeting the liquidity concerns of identified segments like NBFCs has to be an integral element of the growth calculus.

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