REVIEW OF CREDIT POLICY: DECEMBER 2017

December 6, 2017 I Economics

Contact:

Madan Sabnavis
Chief Economist
madan.sabnavis@careratings.com
91-22-67543489

Shivam Kaushik
Associate Economist
Shivam.Kaushik@careratings.com
91-22-67543408

Mradul Mishra (Media Contact)
mradul.mishra@careratings.com
91-22-67543515

The RBI's fifth bi-monthly monetary policy review for this fiscal year maintained status quo in regards to policy rates. *CARE Ratings had expected status quo in interest rates. The RBI has maintained status quo amid concerns regarding the upside risks to inflation remain.*

Major Highlights:

- Repo Rate unchanged at 6.0%
- Consequently, Reverse Repo rate maintained 5.75%
- Marginal Standing Facility remains at 6.25%
- CRR retained at 4.0%
- SLR retained at 19.5%
- RBI has maintained a neutral monetary policy stance

The main considerations underlying the decision are as follows:

- CPI reached a 7 month high in Oct'17.
- Core inflation is stable in Sept-Oct.
- Fall in estimated kharif production and subdued rabi sowing
- Fiscal slippages
- Rising international oil prices

Assessment of the Indian Economy:

1. **GDP Growth**

GDP growth has improved from the previous quarter having increased to 6.3% (yoy) in Q2FY18 as against 5.7% (yoy) in Q1FY18. This is the first rise in five quarters and suggests a broad based improvement in the economy, driven largely by industrial activity, particularly in mining. This is likely in response to higher demand and post-GST restocking. The agricultural sector and services both decelerated in this quarter.

Although, growth in GFCF improved, private final consumption expenditure reduced to an eight quarter low in Q2.

2. **Agriculture and food inflation**

Crop sowing during the Rabi season remained weaker than the corresponding period in the last year, as did rainfall and sources of irrigation. This could result in inflationary pressures in later quarters. There was also an increase in housing inflation due to the roll out of the 7th Central Pay Commission.

3. **Fuel Inflation**

Fuel inflation has remained high due to a pickup in international oil prices, and subsequent effects on LPG, kerosene, coke and electricity prices.

4. **Surplus Liquidity**

Surplus liquidity in the system has been declining post demonetisation. The RBI has been relying on regular variable rate reverse repo auctions to absorb excess liquidity. The RBI conducted Rs 300 bn worth of auctions in the period of Oct-Nov '17. Total absorption for the financial year is Rs 1.9 tn of which $900bn in the form of OMO sales and $1tn in T-bills under the Market stabilization scheme. The RBI cancelled their last scheduled auction on the 23rd of November.

Assessment of Global Economy

1. **Global economic activity**

Global economic activity expanded due to growth among advanced economies. The United States remained resilient despite temporary shocks from hurricanes. The Eurozone and Japan both saw strong growth as well. In China growth was driven by a strong services sector, but remains limited due to weak real estate/construction activity. In Russia, growth moderated on account of lower industrial activity during the third quarter.

In the US, high private consumption, strong corporate earnings and robust exports led to the highest growth in Q3 in the past three years. In Europe, growth was a result of robust job gains and accommodative monetary policy.

2. **Global Oil prices**

Oil prices have remained high in recent months, driven by a increased global demand and OPEC negotiations to rebalance global supply. In its most recent meeting, OPEC decided to cut production by up to 1.8mn barrels a day until December 2018.

RBI's Outlook:

1. **Inflation:**

The RBI has increased the inflation projections from its earlier estimates in October'17 from 4.2-4.6% to 4.3- 4.7% in Q3 and Q4. Upside risks to inflation could emanate from:

- Increase in core inflation in Q2
- An Increase in the house rent allowances under 7th Central Pay Commission
- Rising crude oil prices and OPEC efforts to rebalance global supply

However, some factors that may ease inflationary pressures include:

- Expected seasonal moderation in food inflation during winter months
- Lowering of tax rates under GST for many retail goods and services
- Global financial and political risks

2. **GVA growth**

Outlook of GVA growth of 6.7% has been retained for FY18. This is expected to be 7.0% in Q3 and 7.8% in Q4. There has been an uptick in the credit market and recapitalization in the banking sector may result in further improvement in credit growth. However, an increase in international oil prices, reduction in kharif output and lower than expected Rabi sowing (by acreage) may pose downside risks to the GVA.

Policy Announcements

- **Rationalization of Merchant Discount Rate:**

The RBI has decided to rationalize the Merchant Discount Rate (MDR), the framework which applies to debit card transactions – to increase the use of debit cards and to improve sustainability of entities involved.

- **Overseas Indian Banks to Refinance ECBs**

Overseas branches/subsidiaries of Indian banks will be permitted to re-finance ECBs of AAA rated corporates and Navratna/Maharatna PSUs by raising new ECBs.

CARE Ratings' view:

Against projected inflation of 4.3-4.7% by March '18, ***we do expect the RBI to maintain status quo*** on interest rates as well as reserve requirements for the full year. Given the potential for inflation moving ahead, the RBI will remain watchful of developments in this space.

CORPORATE OFFICE:
CARE Ratings Limited (Formerly known as Credit Analysis & Research Ltd)
Corporate Office: 4th Floor, Godrej Coliseum, Somaiya Hospital Road, Off Eastern Express Highway, Sion (East), Mumbai - 400 022; CIN: L67190MH1993PLC071691
Tel: +91-22-6754 3456 I Fax: +91-22-6754 3457
E-mail: care@careratings.com I Website: www.careratings.com

Follow us on /company/CARE Ratings
/company/CARE Ratings