AUGUST MPC MINUTES

21 August 2019

Focus on growth to continue

With economic activity continuing to decelerate since June policy meeting, RBI reduced policy rate by 35bps. MPC has kept room open for more reduction depending upon incoming data. A benign inflation outlook favours lower real rates. Given the backdrop of current cyclical slowdown, we believe there is room for another 40bps reduction in policy rates. However, focus will move to transmission, in particular, for new loans with external benchmark linked products ensuring lower lending rates to incentivize consumers/ firms to invest.

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KEY HIGHLIGHTS

- Downside risks to growth persists.
- Inflation to remain benign.
- Room remains for 40bps rate cut.

Growth momentum waning: MPC members pointed out that economic activity has slowed down since the June policy meeting. Exports, investment and consumption are decelerating and output gap is widening. As a result, four MPC members voted to reduce policy rate by 35bps. Outlook on consumption is not that positive with consumer surveys conducted by RBI showing drop in consumer confidence. Dr Patra said the consumption slowdown is attributable to fading of fiscal stimulus from 7th Pay Commission and OROP. Dr. Dua spoke about promoting investments through structural reforms and fiscal policy which lowers interest rates.

Inflation to remain well anchored: MPC members reiterated that inflation outlook would remain benign. While food inflation has inched up, core inflation has come-off. Dr Patra attributed this to intrinsic link between inflation and output gap (Phillips curve). Hence, negative output gap is likely to put downside pressure on core inflation. While Kharif sowing is lower than last year and some seasonal uptick in food prices is possible, adequate soil moisture bodes well for Rabi sowing. So does more than adequate food stocks—domestic and global. We expect, inflation to be well below RBI's 4% target at 3.3% and 3.5% in FY20 and 21 respectively.

Room to reduce rates: While RBI has lowered its growth projection for FY20, actual growth is likely to be lower than current estimate of 6.9%. With inflation well below 4%, it opens up room for further rate cuts (our view another 40bps). The real rate then should stabilize between 1.5%-2% and gives adequate policy room to move either ways depending upon incoming data. More importantly, the focus should be on transmission. External benchmark (market interest rates) linked loan rate may lead to faster transmission for new loans and thus incentivize consumers/ firms to invest.

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