MARCH MPC MINUTES

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Growth concerns warranted a larger cut

Sameer Narang
Sonal Badhan | Aditi Gupta
chief.economist@bankofbaroda.com

MPC members voted unanimously to cut rates and keep an accommodative stance. Dr. Ghate and Dr. Dua voted for 50bps cut. Others 75bps. The larger cut was justified as RBI estimates inflation to fall to 2.6% in H2FY21. While Dr. Dholakia sees room for further rate cuts, the low base implies inflation will be near RBI's mandate in H2FY22. With no growth forecast put out by RBI, we believe further reduction in global and domestic growth impulses may call for a further rate cut. But overwhelming focus will be on financial stability.

KEY HIGHLIGHTS

- Inflation expected to remain below RBI's target in FY21.
- Risks to growth remain tilted to the downside.
- Focus will be on financial stability.

Out of turn cut to prioritise growth: MPC members believe a combination of fiscal and monetary measures are required to mitigate the economic impact arising from COVID-19. Dr. Ghate believes monetary policy should aim to minimise fall in aggregate demand. In a demand deficient economy a large rate cut is akin to pushing on a string. Hence, second fiscal stimulus will be helpful. While RBI has not given a growth forecast for FY21, Dr. Raj pointed out that growth is likely to be weak for three reasons: 1) lower discretionary spending, 2) low external demand and 3) delay in revival of investment activity.

Inflation to remain benign: In the MPR, RBI has projected CPI inflation to ease to 2.4% in Q4FY21 from a high of 4.8% in Q1FY21. This is predicated on 1) oil prices at US$ 35/bbl, 2) contraction of global growth in 2020, 3) INR at 75 to US$ and 4) normal monsoon. The decline in inflation is also contingent on pass-through of lower oil international prices. While lower domestic demand implies inflation, in particular, core should see downside pressures some near-term fluctuations due to supply side disruptions are not ruled out. For FY21, RBI's new inflation projection is 3.6% which is 60bps lower than projections by professional forecasters.

Is there space for more: Dr. Dholakia emphasised that there is room for further rate cuts to support growth as inflation is likely to be under control. The current projection of CPI inflation by RBI for H2FY21 is at 2.6% compared with 4.6% in H1FY21. Correspondingly, low base effect implies inflation will rise in H2FY22 closer to RBI's mandate unless global oil prices or aggregate demand falls from current levels. Thus we believe focus of RBI in the next few policies will be 1) financial stability, 2) provision of adequate liquidity, 3) implementation of RBI's forbearance norms, and 4) transmission of earlier rate cuts.

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For further details about this publication, please contact:

Economics Research Department

Bank of Baroda

chief.economist@bankofbaroda.com