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RBI VOTES FOR *STATUS QUO*

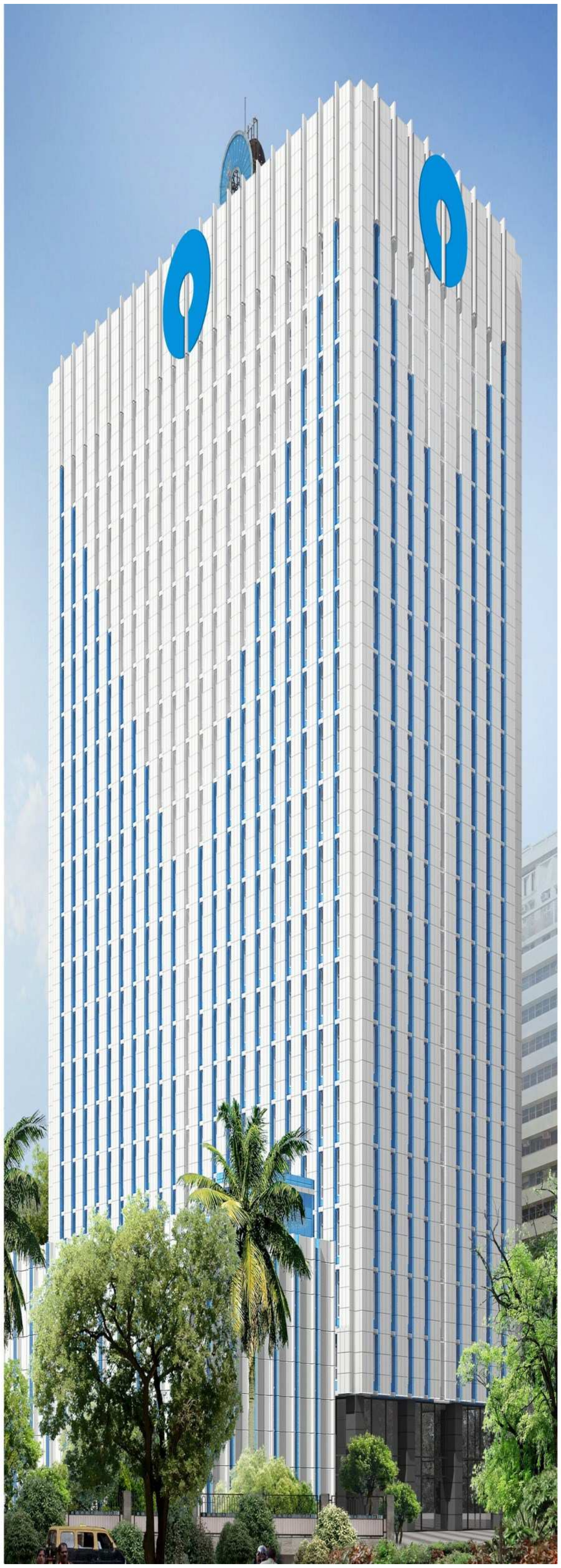
RBI's decision to keep the policy rates unchanged is well thought -out and on expected lines. Economic growth is gaining momentum on the back of revival in investment activity, improving global demand and better exports. Hence real GDP growth is projected to strengthen from 6.6% in 2017-18 to 7.4% in 2018-19. Even as the threat of full scale trade war looms, global growth is getting broad-based, which will complement the domestic conditions.

RBI revised downward its CPI inflation projection for 2018-19 to 4.7-5.1% in H1:2018-19 and 4.4% 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 4.4-4.7% in H1:2018-19 and 4.4% in H2. We have mentioned in our recent research report that RBI's CPI projections are overshot by at least 30 bps and hence this downward revision is most appropriate.

The Policy has many positives for the Banking sector. RBI has deferred the implementation of Ind AS by one year for the banks. RBI has decided not to activate the countercyclical capital buffer (CCCB) at this point of time. RBI has proposed to stipulate a minimum level of 'loan component' in fund based working capital finance to foster greater credit discipline among large borrowers.

Development of interest rate derivative markets has received some attention in this policy. This is in the context of banks having relevant market tools to better manage the ALM risk in post MCLR regime. Notable measures in this respect include access to Non-residents into the IRS Market and introduction of Rupee Swaptions.

The rapid growth of digital payment and crypto currencies has drawn attention of Central banks across the world. Moving ahead from case by case advisory, RBI has decided to set up a group to study the desirability and feasibility to introduce a central bank digital currency in India. RBI has also proposed ring fencing of regulated entities from virtual currencies (VC) whereby no entity regulated by RBI can deal with or provide services to any individual or business entities dealing with or settling VCs. RBI has also directed payment system operators to ensure that data related to payment systems operated by them should be stored inside the country within a period of 6 months.



RBI MAINTAINS *STATUS QUO*

- As expected, the Monetary Policy Committee (MPC) decided to retain Repo rate at 6.0% by 5-1 vote. One member voted for 25 bps increase.
- In this policy, RBI gave projection for real GDP instead of real GVA. Real GDP growth is projected to strengthen from 6.6% in 2017-18 to 7.4% in 2018-19 (due to revival in investment activity, improving global demand and better exports). The break up for 7.4% is: 7.3-7.4% in H1 and 7.3-7.6% in H2 – with risks evenly balanced.
- RBI revised downward its CPI inflation projection for 2018-19 to 4.7-5.1% in H1:2018-19 and 4.4% in H2, including the HRA impact for central government employees, with risks tilted to the upside.

RBI Growth & Inflation Outlook for India

CPI Inflation (%)	Q4 FY18	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19
Apr'18 (1st Bi-monthly)	4.5	4.8	4.6	4.4	4.4
Feb'18 (6th Bi-monthly)	5.1	5.5	5.0	4.6	4.4
Dec'17 (5th Bi-monthly)	4.7	-	-	-	-
GVA Growth (%)	**Q4 FY18**	**Q1 FY19**	**Q2 FY19**	**Q3 FY19**	**Q4 FY19**
Apr'18 (1st Bi-monthly)*	7.0	7.2	7.4	7.2	7.5
Feb'18 (6th Bi-monthly)	7.8	7.4	7.3	7.1	7.2
Dec'17 (5th Bi-monthly)	7.7	-	-	-	-

Source: RBI, SBI Research; * Projections of Real GDP

- Excluding the impact of HRA revisions, CPI inflation is projected at 4.4-4.7% in H1:2018-19 and 4.4% in H2. We have mentioned in our recent research report that RBI's CPI projection are overshot by at least 30 bps. In this policy RBI revised downwards its projections in the range of 20-70 bps.

DEVELOPMENTAL AND REGULATORY MEASURES

- RBI has deferred the implementation of Ind AS by one year for the banks, as necessary legislative amendments to make the format of financial statements, prescribed in the 3rd Schedule of Banking Regulation Act 1949 are still under consideration of the Government. This is an welcome step and banks will get enough time to prepare themselves for the Ind AS roll-out.
- Based on the empirical review and testing, RBI has decided not to activate the countercyclical capital buffer (CCCB) at this point of time.
- To promote greater credit discipline among the large borrowers, RBI has proposed to stipulate a minimum level of 'loan component' in fund based working capital finance. This will help the banks in planning their asset liability management. Further, it will help the corporates as the interest rate burden will be reduced.
- RBI has also announced that payment system operators should ensure that data related to payment systems operated by them should be stored inside the country within a period of 6 months. This will ensure unfettered access to all payment data for supervisory purposes.
- Other major developments announced include setting up of a group to study the desirability and feasibility to introduce a central bank digital currency in India. RBI has proposed ring fencing of regulated entities from virtual currencies whereby no entity regulated by RBI can deal with or provide services to any individual or business entities dealing with or settling VCs and the ones already providing such services shall exit the relationship within a specified time.
- RBI has also announced the setting up of a Data Science Lab to gainfully harness the power of Big Data analytics. This will ensure employment of relevant data and application of the right filters for improving its forecasting, nowcasting, surveillance and early-warning detection abilities that all aid policy formulation.
- To promote market development and improve liquidity and coverage of the various sections of financial markets, RBI has proposed access to Non-residents into the IRS Market, introduction of Rupee Swaptions, a review of Separate Trading of Registered Interest and Principal Securities (STRIPS) directions.
- In the Addendum to the Report of the Internal Study Group to Review the Working of the Marginal Cost of Funds Based Lending Rate System, the point that banks are currently not in a position to hedge interest rate risk given the absence of a developed Interest Rate Swap (IRS) market was mentioned. In the absence of such a market, either their profitability will come under pressure or spreads will be higher than necessary as a compensation for interest rate risk. The Interest Rate Swap market has not witnessed much action since its inception in India. Allowing non-residents access to the Rupee Interest Rate Swap market in India is a step in the right direction as it will lead to wider participation and may also pave the way for other players' entry in the market as well.

- Introduction of Rupee Swaptions will enable better timing flexibility for those seeking to hedge interest rate risk. STRIPS has also not seen much traction since its inception. The guidelines for these are awaited and the interest that these instruments will generate will depend on how the guidelines are formed.
- The other measures pertaining to financial markets include Legal Entity Identifier (LEI) for Non-individual Market Participants, Introduction of Single Master Form for Reporting of Foreign Direct Investment in India and Reporting by Authorised Dealers, are aimed at improving transparency and availability of data in a consolidated manner in the system. This will help in better regulation and risk management.
- In line with the recommendations of the Usha Thorat Committee, RBI is revamping the Lead Bank scheme for the banks. This will meet the credit needs of the rural economy and further financial inclusion in the country with a coordinated approach between the various stake holders.

MARKET EXPECTATIONS VS. MPC DECISIONS

- The last one year track of MPC decisions indicates that they perfectly mimicked the market expectations. In this policy all the 42 economists predicted that there will be no rate cut and the RBI decision also confirmed the same.
- Almost all the market expectations (as well as MPC members' views) are one-sided except during 3rd bi-monthly policy. It was an interesting case where out of total 57 votes, 41 voted for cut and 16 voted for hold. Even within RBI for first time (the only instance till now), MPC decided the Repo cut with 4-2 votes in the 3rd policy.

RBI's Monetary Policy Rate Decisions vs. Market Expectations

Repo Rate Movement	2017-18						2018-19
	1st	2nd	3rd	4th	5th	6th	1st
Pre-Policy Rate/RBI Decision	6.25/Hold	6.25/Hold	6.25/Cut 25 bps	6.0/Hold	6.0/Hold	6.0/Hold	6.0/Hold
MPC Members Vote	6-0	5-0	4-2	5-1	5-1	5-1	5-1
Total Number of Economists & their Views:	52	50	57	32	48	33	42
6.25	52	48	16	-	-	1	-
6.00	-	2	41	31	42	32	42
5.75	-	-	-	1	6	-	-

Source: RBI, Bloomberg, SBI Research   Note: Number of Economists Expectations in Repo Rate Movement

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ABOUT US

The Economic Research Department (ERD) in SBI Corporate Centre is the successor to the Economic and Statistical Research Department (E&SRD). The latter came into being in 1956, immediately after the State Bank of India was formed, with the objective of "tendering technical advice to the management on economic and financial problems in which the Bank has interest and which required expert analysis".

After the first reorganization of the Bank, when specialized departments like Management Science, Management Information Systems, Planning and Market Segment Departments took over the statistical work of E&SRD, the Department was renamed as ERD.

However, with the ERD team now taking on multidimensional functionalities in the area of risk management, corporate analytics, strategy and so on, who knows, the time may have come to rename it again!

DISCLAIMER

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