

RBI MAINTAINS STATUS QUO ON INTEREST RATES

SLR TO BE REDUCED BY 25BPS EVERY QUARTER FROM JANUARY 2019 TILL IT REACHES 18%

Monetary policy: No surprises this time!!!

The RBI, as expected, kept the key policy rates unchanged. The monetary policy meeting was a non-event, given that the recent correction in oil prices and improving currency exchange rate laid the path for a dovish stance. The repo rate has been kept unchanged at 6.5% and, keeping in view the corridor of 25bps, the reverse repo stands at 6.25%. The MSF rate is at 6.75%. The only change the RBI has affected is the automatic reduction in the SLR every calendar quarter by 25bps from 19.5% currently till it reaches 18%, beginning January 2019. As stated in our morning market commentary as well, the RBI seems to have drawn comfort from the soft food prices and the recent drop in oil prices. In fact, the RBI has revised its inflation projection for the second half to 2.7%–3.2%, markedly lower from the earlier projection of 3.8%–4.5%. The monetary policy committee (MPC) has maintained its stance of “calibrated tightening”.

The key highlights of the policy are:

-  Key rates kept unchanged
-  SLR to be cut by 25bps every quarter till it reaches 18%, starting January 2019
-  On inflation
 - Inflation projection revised downward for H2:2018–19 to 2.7%–3.2%
 - Food group experiencing deflationary pressures
 - Weakening of food prices imparts downward bias to headline CPI
 - Non-food inflation on the rise
 - Effect of central pay commission’s HRA increase has been waning on expected lines
 - Several items in food basket remain at low levels, which could pose risk in case of sudden reversals
 - MSP impact muted so far
 - Uncertainty on oil prices and fiscal slippages remain a concern
 - Medium-term inflation projection remains unchanged
-  On economic growth
 - GDP growth estimate has been retained at 7.4%
 - Lower *rabi* sowing may adversely affect agriculture and, hence, rural demand
 - Slowing global demand and rising trade tensions pose negative risk to exports
 - Decline in oil price a big positive
 - Increased capacity utilization in manufacturing sector augurs well for future capex
 - Signs of acceleration in investment activity
-  On liquidity
 - Significant expansion in currency in October and November
 - Currency in circulation contracted in past three weeks
 - RBI injected ₹36,000cr in October and ₹50,000cr in November through OMO
 - Total injection of durable liquidity for 2018–19: ₹1,36,000cr
 - RBI expected to continue with its path of OMOs and long-term repos to manage liquidity

View:

Keeping in view the fluidity of global factors and domestic macros being affected by it, the RBI is expected to maintain a wait-and-watch approach. The MPC sticking to its

stance of “calibrated tightening” highlights the fact that the durability of significant reduction in inflation needs to be watched out for. Given this stance, the overall needle of rate direction in the medium term still tilts toward tightening. The real element that could alter the stance would be the trend of global oil prices and domestic food prices.

Nevertheless, the tone of the policy has turned clearly dovish in the past two months. At this juncture, we recommend investors to invest in good quality short to medium duration debt funds. Investors willing to deploy for a longer horizon may invest in FMPs at staggered intervals to lock in higher returns. Also, considering the resolve of the RBI to replenish liquidity gaps in the banking system through durable measures, investors looking to invest for 3-6 months may consider ultra short term and low duration funds.

Disclaimer: This document is STRICTLY for authorised recipients only and is prepared for information purposes only. The information provided herein, we believe, is from reliable sources. IndiaNivesh is not liable for the accuracy of the source data as well as the results of the calculations based on the same. We do not claim that the data provided herein is accurate and complete in all respects. This is not an offer or solicitation of any offer to buy or sell securities. No action is intended to be taken by the recipients based on this document. The recipients may take their decisions based on their own judgement and independent advice that they may receive before making any investment or disinvestment decisions. The recipients are advised not to take any decision only on the basis of this document. No portion of this document should be printed, reprinted, redistributed, reproduced, duplicated or sold.