

DECEMBER MPC MINUTES

19 December 2019

Room for further easing remains

MPC members voted unanimously to keep policy rate and stance unchanged. MPC members believe further monetary space exists. However, members would like to see if vegetable inflation transmits into other food prices and persists. Moreover, fiscal policy and Budget is keenly awaited to see how growth evolves in the future. While growth is likely to improve next year to 6.1%, it will be below potential and thus calls for further policy easing once inflation projections turn favourable well below target of 4% from Jun'20.

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Monetary, fiscal policy to revive growth: While delving into current slowdown, MPC members believed that sharp deceleration in capacity utilisation and investment demand requires a co-ordinated policy response. RBI has reduced policy rates but 135bps and government has announced a number of measures. FDI/FPI inflows have also improved. MPC members await the Budget and see further policy response from government to boost growth. In addition, monetary transmission will improve as seen in 9bps reduction in WATDR in Oct'19 compared with overall reduction of 16bps since Feb'19.

How persistent will food inflation be: MPC members unanimously agreed that vegetable prices will subside. However, Dr. Patra said that it remains to be seen if rise in non-vegetable food inflation into milk and pulses will subside or persist. At the same time, drop in core inflation to 3.4% shows slack in the economy. Notably, Dr Pami Dua did point out private sector GVA increased by 3.1% in Q2 implying weak demand conditions. Dr. Ghate, however suggested that muted core inflation may not sustain as it is more supply constrained and may pick up. Hence, given the recent upturn in headline CPI, members wanted to see trajectory of inflation before reducing rates any further.

Further rate cuts on the table: MPC is not averse to further rate cuts as growth is far below potential. RBI Governor himself pointed out that there is policy space which needs to be appropriately timed. However, the current pause is a result of sharp acceleration in food inflation. Members are also awaiting fiscal response in the Budget. Dr. Dholakia believes any cut in government spending at this point will be counter cyclical. In our view, room for further rate cuts will open up once inflation falls below RBI's target of 4%, as per RBI's current projection in Q2FY21. However, policy response may be seen in Jun'20 as 12-month forward inflation trajectory will be sub-4% by then.

KEY HIGHLIGHTS

- MPC members await the Union Budget.
- Inflation projections will turn favourable below 4% target from Q1FY21.
- Space remains for further rate cuts.



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