

FEBRUARY MPC MINUTES

20 February 2020

Policy space to open in Q3FY21

MPC members noted that economic activity has slowed down since the last policy. While reduction in rates is the most optimal response to dip in growth, the elevated inflation levels imply RBI has to wait for inflation to fall below its target and accordingly reduce policy rate to close output gap. Given the uptick in non-vegetable food inflation, this window is likely to open up only in Q3FY21. In the interim, RBI is likely to take measures to improve transmission such as LTRO, CRR exemption, external linking of rates etc.

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Global slowdown continues: MPC members noted that slowdown persists. RBI Governor pointed out that economic activity has slowed since Dec'19. Some green shoots are visible in the form of rabi sowing and PMI data. Even credit flow to commercial sector is seeing an improvement, though lower than last year. However, capacity utilisation remains low and residential real estate inventory is high. The Budget has given a boost to consumption through tax cuts. External demand is likely to remain weak as impact of coronavirus plays out in the next few months. MPC members reiterated that focus needs to be on structural reforms to boost investments.

Inflation to ease in Q3FY21: The current inflation spike is not only limited to onions (vegetables) but is visible in cereals, pulses, milk, sugar etc. While vegetable prices may come off, the inflation in other non-vegetable food items is likely to taper-off with a lag. Global cereal prices are also inching up and have a high correlation with domestic prices. In addition, transport and communication has seen a surge to 4.8% on the back of increase in telecom tariffs. Despite elevated level of food inflation, muted elements of core (apart from gold) suggests, that CPI inflation is likely to fall below RBI's target of 4% in Q3FY21.

Policy space remains: Given the negative output gap, most MPC members pointed out that policy space for further accommodation remains. Dr Janak Raj pointed out that there is policy space which could be used once inflation outlook becomes clear. Dr Patra emphasised on improving transmission of cumulative 135bps rate reduction into lending rates. Transmission has been partial as of now and RBI's LTRO and CRR exemption to retail and MSME loans will improve transmission. We continue to see 40bps rate cut in Q3FY21 which is in-line with easing cycle seen in Asian Central Banks this year.



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