

RESEARCH
BOB Economics Research | August MPC Minutes

Rate cut cycle may be behind us

SUMMARY
India Economics: August MPC Minutes

While India's growth seems to have bottomed out in Q1FY21, growth trajectory still remains uncertain. Both consumption, apart from rural, and investment demand is likely to be weak. Even so, supply side inflation pressures may not allow MPC to reduce policy rate as inflation remains above upper end of tolerance band. MPC minutes suggest members are concerned about a broader generalisation of inflation despite weak demand. With inflation likely to be above RBI's target of 4% in H2FY21, we see no room for rate cuts as of now.

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TOP PICKS
LARGE-CAP IDEAS

Company	Rating	Target
Bajaj Finance	Buy	4,000
Cipla	Buy	850
GAIL	Buy	155
Petronet LNG	Buy	310
Tech Mahindra	Buy	780

MID-CAP IDEAS

Company	Rating	Target
Alkem Labs	Buy	3,600
Chola Investment	Buy	280
Laurus Labs	Buy	1,200
Transport Corp	Buy	270
Mahanagar Gas	Sell	750

Source: BOBCAPS Research

DAILY MACRO INDICATORS

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	0.68	1bps	7bps	(91bps)
India 10Y yield (%)	5.96	1bps	16bps	(61bps)
USD/INR	74.82	(0.1)	0.1	(4.6)
Brent Crude (US\$/bbl)	45.37	(0.2)	4.8	(24.8)
Dow	27,693	(0.3)	3.8	5.7
Shanghai	3,408	(1.2)	2.8	18.3
Sensex	38,615	0.2	3.2	4.2
India FII (US\$ mn)	18 Aug	MTD	CYTD	FYTD
FII-D	(22.5)	(107.8)	(14,635.4)	(4,875.9)
FII-E	140.5	5,374.1	4,085.9	10,688.8

Source: Bank of Baroda Economics Research

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AUGUST MPC MINUTES

20 August 2020

Rate cut cycle may be behind us

While India's growth seems to have bottomed out in Q1FY21, growth trajectory still remains uncertain. Both consumption, apart from rural, and investment demand is likely to be weak. Even so, supply side inflation pressures may not allow MPC to reduce policy rate as inflation remains above upper end of tolerance band. MPC minutes suggest members are concerned about a broader generalisation of inflation despite weak demand. With inflation likely to be above RBI's target of 4% in H2FY21, we see no room for rate cuts as of now.

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Growth trajectory likely to be weak: MPC members noted that while economic activity has recovered from the lows seen in Apr-May'20, the future growth trajectory remains uncertain and depends on the pandemic. Dr. Saggar and Dr. Ghate also cautioned against "hysteresis" which may impinge on growth recovery as there may be permanent damage to potential output. Dr. Patra stressed on sustained policy support to various sectors to resuscitate activity. RBI's assessment is that GDP is likely to shrink in H1 and GDP growth will be negative in the year, implying weak recovery in H2.

Inflation surprises negatively: Dr. Dholakia believes the economy is in a deep stagflation as supply shock is more pronounced than demand shock. Dr. Saggar pointed out that inflation may have upward bias and monetary factors may be contributing to elevated inflation. Dr. Patra cited inflation outcome can be on 2009-10 or 2016-17 experience depending upon policy action. In the near-term, we believe inflation is likely to move up further with vegetable prices in Aug'20 showing a further uptrend (17% MoM increase).

Rate cut cycle may be behind us: Dr. Patra said that MPC has signalled its concern in its stance by resolving to ensure that inflation remains within the target going forward. Dr. Dholakia believes that available space for policy space should now be used prudently. Dr. Dua said that data of few more months will be crucial and Dr. Ghate has been advocating a more cautious path for policy rate reductions. While MPC members will be regarding Apr'20 and May'20 prints as break in the series, the upward pressure on inflation is seen in most food items (as many as 8 out of 12 food and beverage items are reporting inflation in excess of 6%). While core inflation is driven by gold and higher taxes on petro products, the supply side pressures imply inflation is likely to average above 4% even in H2FY21 implying no room for rate cut as of now.

KEY HIGHLIGHTS

- MPC members worried about elevated inflation print.
- Growth trajectory uncertain.
- Further rate cuts seem difficult.



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BUY – Expected return >+15%

ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

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