Monetary policy review: RBI leaves key rates unchanged

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The RBI has decided to maintain status quo and keep its key interest rate, the repo rate, unchanged at 6 per cent. It had last cut rates by 25 bps two months earlier in its August review. The pause was on expected lines as market consensus had predicted a pause in its cutting cycle.

The six member monetary policy committee voted on the basis of a majority for a pause. Dr. Chetan Ghate, Dr. Pami Dua, Dr. Viral V. Acharya, Dir Michael Patra and Dr. Urjit R. Patel were in favour of status quo while Dr. Ravindra H. Dholakia voted for a policy rate reduction of 25 basis points.

The Sensex and Nifty continued to trade higher by nearly 0.5 per cent as the RBI's decision to keep repo rate unchanged at 6.0 per cent was in line with market expectations. At 2.31 p.m., the 30-share BSE index Sensex was up 155.47 points or 0.49 per cent at 31,652.85 and the 50-share NSE index Nifty was up 53.6 points or 0.54 per cent at 9,913.10.

Cuts GDP estimate

The monetary policy committee of the RBI has cut its GDP forecast, revising it down to 6.7% this year as against 7.3% per cent projected earlier in August.

GDP growth had fallen to 5.7% in the first quarter and has been coming down continuously over the past five quarters.

On inflation, the committee felt that it has broadly moved on expected lines. It has projected that inflation will move in the 4.2 per cent to 4.6 per cent range over the next half year.

Upside risks to inflation

The RBI noted that just like in the August policy, there are factors that continue to impart upside risks to this baseline inflation trajectory. These were : " (a) implementation of farm loan waivers by States may result in possible fiscal slippages and undermine the quality of public spending, thereby exerting pressure on prices; and (b) States' implementation of the salary and allowances award is not yet considered in the baseline projection; an increase by States similar to that by the Centre could push up headline inflation by about 100 basis points above the baseline over 18-24 months, a statistical effect that could have potential second round effects." The RBI, however, hedged its bets saying that adequate food stocks and effective supply management by the Government may keep food inflation more benign than assumed in the baseline.

Rationale for cutting GDP estimates

Explaining its rationale for revising downwards GDP estimates from 7.3% to 6.7%, the RBI noted that the loss of momentum in Q1 of 2017-18 and the first advance estimates of kharif foodgrains production are early setbacks that impart a downside to the outlook.

It said, "The implementation of the GST so far also appears to have had an adverse impact, rendering prospects for the manufacturing sector uncertain in the short term. This may further delay the revival of investment activity, which is already hampered by stressed balance sheets of banks and corporates."

Consumer confidence and overall business assessment of the manufacturing and services sectors surveyed by the Reserve Bank weakened in Q2 of 2017-18; on the positive side, firms expect a significant improvement in business sentiment in Q3, the RBI noted.

Policy stance neutral

The MPC also decided to keep the policy stance neutral and monitor incoming data closely. The MPC said that it remains committed to keeping headline inflation close to 4 per cent on a durable basis.

The MPC was of the view that various structural reforms introduced in the recent period will likely be growth augmenting over the medium - to long-term by improving the business environment, enhancing transparency and increasing formalisation of the economy.

The Reserve Bank continues to work towards the resolution of stressed corporate exposures in bank balance sheets which should start yielding dividends for the economy over the medium term, the announcement said.

The MPC called for recapitalising public sector banks adequately to ensure that credit flows to the productive sectors are not impeded and growth impulses not restrained.

Steps to boost growth

It suggested the following measures could be undertaken to support growth and achieve a faster closure of the output gap:

a concerted drive to close the severe infrastructure gap;

restarting stalled investment projects, particularly in the public sector;

enhancing ease of doing business, including by further simplification of the GST; and

ensuring faster rollout of the affordable housing program with time-bound single-window clearances and rationalisation of excessively high stamp duties by States.