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On hold

Monetary Policy Review

December 6, 2017

- The Reserve Bank of India's (RBI), Monetary Policy Committee (MPC) made no change in the policy rates on Wednesday – leaving the repo rate at 6%, the reverse repo at 5.75%, and the marginal standing facility rate at 6.25%. Five of the six members of the committee were in favour of the decision, while one voted for a 25 basis points (bps) cut. So far in the easing cycle, which began in January 2015, the repo rate has been reduced by 200 basis points (bps), with the last rate cut in August 2017.
- The MPC maintained its neutral monetary policy stance, but raised concern on the trajectory of inflation, which has risen of late. The inflation forecast was upped about 10 bps for the second half of this fiscal. The MPC forecasts CPI inflation to average ~3.6% (actual inflation at 2.6% in the first half and forecast at 4.3-4.7% in Q3 and Q4) after including the impact of house rent allowance. It reiterated focus on maintaining medium-term inflation at 4%, within a band of +/- 2%, while supporting growth. The forecast for gross value added (GVA) growth in fiscal 2018 was retained at 6.7%.
- The latest suite of data sends mixed signals for monetary policy. Growth has caught up in the second quarter of this fiscal, but downside risks remains. Similarly, some upside risks to inflation emerge from hardening global oil prices, recent firming up of housing inflation, some shortfall in the rabi crop sowing so far, and possible impact of farm loan waivers on inflation. Still, if GDP growth surprises on the downside, so could inflation on the back of weak domestic demand conditions. In this backdrop, the MPC chose to maintain status quo on rates, but will stay vigilant on inflationary developments.

Our view

The MPC's stance is on expected lines. To be sure, GDP growth has seen a mild pick-up in the second quarter of fiscal 2018 and the RBI's GVA forecast for the full fiscal suggests growth in the second half could rise to 7.6% from 5.8% in the first half.

However, we believe there are risks to growth. Administrative issues related to tax refunds under goods and services tax (GST) and repeated changes being made to the tax structure/ rates cause uncertainty for businesses and can weigh on growth in the road ahead, particularly for small scale units. Also, a possible cut in capex due to rise in fiscal stress can limit the upside to growth. If growth sulks down further, it can potentially bring down core inflation, which will tamp down overall inflation.

Inflationary pressures are again in the spotlight with CPI inflation climbing rapidly to 3.6% in October – over 200 bps higher than the lowest point of 1.5% seen in June. While overall food inflation will stay benign, mild pressures could arise due to some shortfall in rabi sowing so far (especially oilseeds and wheat) and the mild recent upturn in global food prices. Of bigger concern is the firming up of housing inflation (due to award of higher house rent allowances), the sharp and sustained rise in global oil prices and impact of fiscal spending (especially farm loan waivers) on inflation. On the downside, items of mass consumption could see softer prices if the recent downward revision in GST rates on some items is passed on to consumers. The interplay among factors will therefore determine the pressures on inflation. ***CRISIL maintains its inflation forecast for fiscal 2018 at an average of 4%.***

That said, there could be room for a rate cut if the downside risks to growth materialise, and inflation undershoots the MPC's growth forecast for the second half. The base case scenario is of MPC staying on hold this fiscal.

Banking sector view

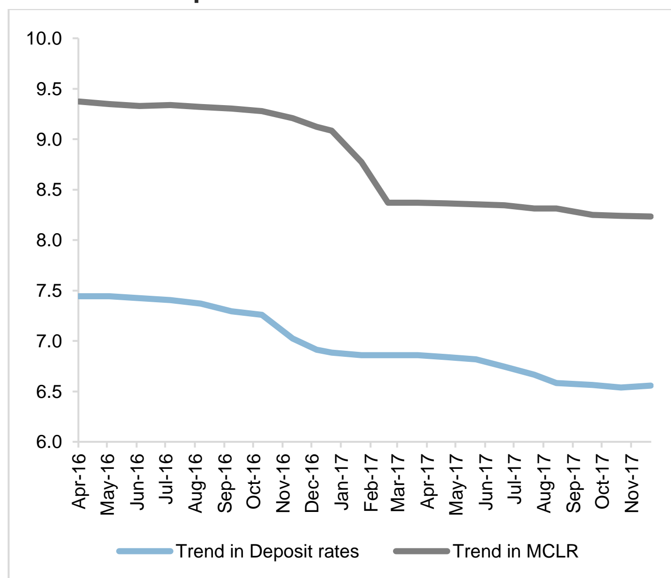
Credit growth ticking up

As of November 10, 2017, credit growth was 8.2%, showing some signs of a recovery from the aftereffects of the note ban. As of October 2017, industrial credit (which accounts for 37% of gross bank credit) declined 0.2%, while the services sector (which accounts for 24% of gross bank credit) registered good growth of more than 9%.

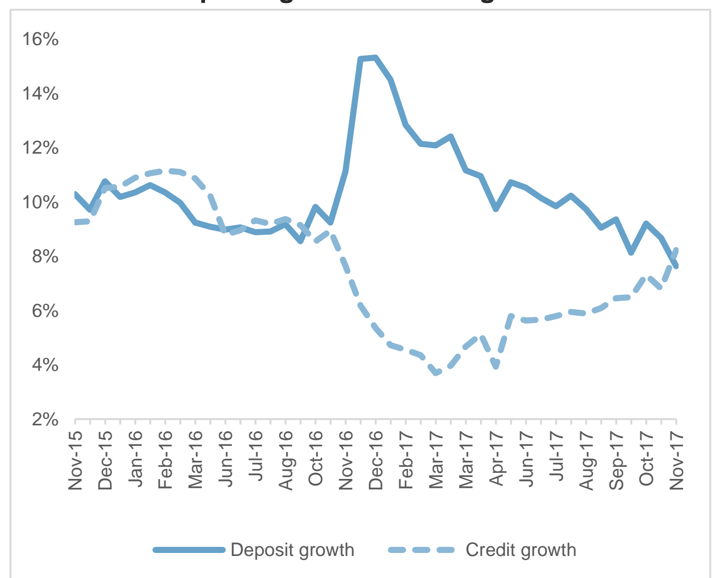
Thus, credit growth was mainly supported by the retail segment (which accounts for 25% of gross bank credit), clocking a double-digit increase of 16%. Deposit growth decelerated to 7.6% as of November 10, 2017, and is now much lower than the peak of 15.3% in December 2016, as the impact of demonetisation is tapering off.

CRISIL Research expects banking credit to grow 7-9% this fiscal, supported by an improvement in economic growth and domestic demand, and deposit growth to moderate at 7-9%.

MCLR and deposit rates of banks



Credit and deposit growth converge



Note: Average of one-year MCLRs of 10 banks considered. Deposit rate is the average of 1-2 year maturity, considered for 10 banks.

Source: RBI, CRISIL Research

GNPAs to remain high

Gross non-performing assets (GNPA) of the banking system has increased to ~9.6% as on March 31, 2017, from 7.5% as on March 31, 2016. The asset quality of banks further deteriorated in the first two quarters of this fiscal, as a result of which the GNPA is estimated to be at ~10% as of September 2017. We expect slippages to be lower this fiscal, compared with the previous two. Nevertheless, GNPA is expected to remain elevated and touch 10.5% of gross advances by March 31, 2018, due to slower recoveries.

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