RBI Bi-monthly MPC: Policy Rates kept Unchanged

6th February 2020

The MPC kept rates unchanged at 5.15% and policy stance to remain accommodative.

Consequently, the reverse repo rate under the LAF remains unchanged at 4.9%, and the marginal standing facility (MSF) rate and the Bank Rate at 5.4%.

RBI statement - These decisions are in consonance with the objective of achieving the medium-term target for consumer price index (CPI) inflation of 4% within a band of +/- 2%, while supporting growth.

RBI projects CPI inflation at 6.5% in Q4 FY20, 5-5.4% in H1 FY 21 and 3.2% in Q3 FY 21.

The baseline inflation outlook is likely to be influenced by several factors:

- Food inflation is likely to soften from the high levels of December and the decline is expected to become more pronounced during Q4 FY20 as onion prices fall rapidly in response to arrivals of late kharif and rabi harvests. Higher vegetables production, despite the early loss due to unseasonal rain, is also likely to have a salutary impact on food inflation. On the other hand, the recent pick-up in prices of non-vegetable food items, specifically in milk due to a rise in input costs, and in pulses due to a shortfall in kharif production, are all likely to sustain. These factors could impart some upward bias to overall food prices
- crude prices are likely to remain volatile due to unabating geo-political tensions in the Middle East on the one hand, and the uncertain global economic outlook on the other.
- There has been an increase in input costs for services, in recent months. However, subdued demand conditions, muted pricing power of corporates and the correction in energy prices since the last week of January may limit the pass-through to selling prices.
- Domestic financial markets remain volatile reflecting both global and domestic factors, which may have an influence on the inflation outlook.
- Base effects would turn favorable during Q3 FY21.
- Increase in customs duties on items of retail consumption in the budget may result in only a marginal one-time uptick in inflation.

GDP growth for 2019-20 projected at 6% vs 5% (5.5-6% in H1FY20) and 6.2% in Q3.

The growth outlook will be influenced by several factors:

- Private consumption, particularly in rural areas, is expected to recover on the back of improved rabi prospects. The recent rise in food prices has shifted the terms of trade in favour of agriculture, which will support rural incomes.
- The easing of global trade uncertainties should encourage exports and spur investment activity. The breakout of the coronavirus may, however, impact tourist arrivals and global trade.
- Monetary transmission in terms of a reduction in lending rates and financial flows to the commercial sector has progressed vis-à-vis the last policy, and this could spur both consumption and investment demand.
- The rationalisation of personal income tax rates in the Union Budget 2020-21 should support domestic demand along with measures to boost rural and infrastructure spending.