

By Invitation

Pause for now, rate hike later this year

If the CPI inflation remains elevated, there may be a rate hike in the second half of 2018

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In line with our expectations, the Monetary Policy Committee (MPC) voted 5:1 in the sixth bi-monthly policy statement to leave the repo rate unchanged at 6 per cent. It retained the neutral stance of Monetary Policy and reiterated the commitment toward achieving the medium-term inflation target of 4 per cent.

Inflation picture

The MPC highlighted various inflation risks, such as the revision in house rent allowance (HRA) by State governments, rising commodity prices and proposal to augment minimum support prices (MSPs) for various crops. Moreover, it remarked that fiscal concerns have begun to raise costs of borrowing, which may push up inflation.

Based on these factors, the MPC expects the CPI inflation to rise from 5.1 per cent in the last quarter of FY-18 to 5.1-5.6 per cent in the first half of FY-19, after which it would ease to 4.5-4.6 per cent in the later half of FY-19. Notably, these forecasts entail a considerable uptick in the average CPI inflation in FY-19 relative to FY-18. Accordingly, the Committee emphasised caution about

the evolving inflation scenario.

At the same time, it highlighted the presence of mitigating factors, such as muted capacity utilisation, moderate rural wage growth and the prospect of lower crude oil prices, which supported its decision to maintain *status quo* on the policy rate and the neutral stance of the Monetary Policy.

Additionally, the MPC expects GVA growth to improve from 6.6 per cent in FY-18 to 7.2 per cent in FY19, benefiting from factors such as the stabilisation of the economy after the transition to the Goods and Services Tax (GST) and the ongoing recapitalisation of public sector banks. However, the MPC cautioned that the deterioration in public finances might crowd out private financing and investment. In ICRA's view, a broad-based pick-up in investment activ-

ity may not emerge in the next two quarters. Accordingly, ICRA expects GVA growth of 7 per cent in FY-19, mildly lower than the MPC's forecast. Overall, the tone of the policy outlook was less hawkish than anticipated. In particular, the

emphasis on conducive and stable macro-financial management suggests that the MPC is unlikely to hike the repo rate in the immediate term. However, if the CPI inflation remains elevated, a rate hike may be forthcoming in the second half of 2018.

The MPC highlighted that systemic liquidity remains in surplus but is moving towards neutrality. Given the comment that liquidity injection will not be driven by the prices of long-term assets, the Reserve Bank of India (RBI) is unlikely to conduct open market operations to purchase Government securities in the near term, to arrest the recent fall in bond prices and dampen the rise in yields, in our view.

Rating relaxation

The Budget for FY-19 included a proposal related to relaxation of the rating threshold to A from AA, which would encourage domestic insurance companies and pension funds to invest in bond issuances from the infrastructure sector. However, given the likelihood of an increase in the repo rate in the second half of 2018, bond yields may remain elevated. As a result, the magnitude of issuance from entities rated below the AA cat-

egory may not immediately see much uptick.

Through a separate statement, the RBI has extended relief to the micro, small and medium enterprise (MSME) borrowers registered under the GST, with exposure of up to ₹250 million. The central bank has permitted the amount overdue as on September 1, 2017 and repayments due between September 1, 2017 and January 31, 2018, to be paid within 180 days. Additionally, banks have been permitted to maintain the asset classification, without a downgrade of such account, because of deferment of repayments.

This relaxation is likely to provide a temporary relief to banks or NBFCs as well as MSME borrowers, who have been facing cash flow pressures because of delays in payments from customers or GST refunds from the government.

In a similar vein, a deferment of loan repayment had been provided to micro finance borrowers and other small borrowers after demonetisation.

Although this had provided temporary relief to the banks or NBFCs in terms of their reported NPAs, it is worth recalling that their NPA levels had surged upon the expiry of the forbearance period.

The writer is a managing director and a group CEO, ICRA



Conclusions

- Pick-up in investment activity not anytime now
- Expect GVA growth at 7 per cent in FY-19
- MPC unlikely to hike repo rate in the immediate term

Monetary Policy

The tone of the policy outlook was less hawkish than anticipated



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