

First Bi-monthly Monetary Policy Statement 2018

Introduction:

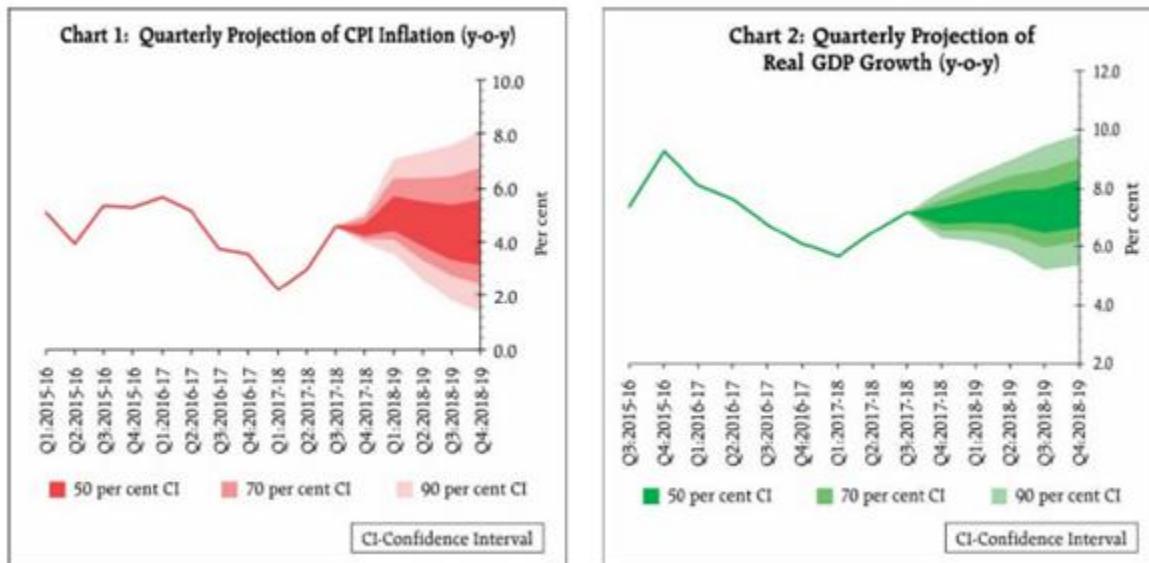
- The Reserve Bank of India (RBI) on April 5, 2018 released its First Bi-monthly Monetary Policy Statement 2018-19 (Monetary Policy Report - April 2018, Published under Section 45ZM of the Reserve Bank of India Act, 1934) Along with press release of 'Statement on Developmental and Regulatory Policies' and 'Resolution of the Monetary Policy Committee (MPC) of Reserve Bank of India'.

Highlights of Resolution of the Monetary Policy Committee are as follows;

1. Policy repo rate under the liquidity adjustment facility (LAF) unchanged at 6.0 percent. Consequently, the reverse repo rate under the LAF remains at 5.75 percent, and the marginal standing facility (MSF) rate and the Bank Rate at 6.25 percent.
 - **Note** – MSF rate is the rate at which Schedule banks can borrow funds from RBI overnight, against the approved government securities.
 - **Note** – This is fourth policy review in sequence in which the MPC has kept the Repo Rate unchanged. Monetary Policy Committee has kept its neutral stance unchanged.
 - **Further Note** - The decision* of the MPC to keep the repo rate unchanged was in accordance with the objective of achieving the medium-term target for Consumer Price Index (CPI) inflation of 4 percent within a band of +/- 2 percent while supporting growth.
 - * Decision was taken by 5 to 1 vote. Dr Chetan Ghate, Dr Pami Dua, Dr Ravindra H. Dholakia, Dr Viral V. Acharya and Dr Urjit R. Patel voted in favour of the keeping rate unchanged. Dr Michael Debabrata Patra voted for an increase in the policy rate of 25 basis points.
2. CPI inflation re-projected at 4.7%-5.1% for April-September (H1) and 4.4% for October-March (H2) of FY19 including estimated impact of an increase in the house rent allowances (HRA) for central government employees under the 7th central pay commission (CPC), with risks tilted to the upside (See Chart 1 on next page).
 - **Note** - Excluding the impact of HRA revisions, CPI inflation is projected at 4.4-4.7 percent in H1 of FY19 and 4.4 percent in H2 of FY19.
 - **Further Note** - The 6th bi-monthly resolution of 2017-18 in February 2018 projected CPI inflation in the range of 5.1-5.6 percent in H1:2018-19 and 4.5-4.6 percent in H2, including the HRA impact, with risks tilted to the upside.
3. CPI inflation in Q4 of FY18 is now re-projected at 4.5 percent from an earlier projection of 5.1 percent.
 - **Note** – Above projections are revised due to Retail inflation, measured by the year-on-year change in the CPI, fell from a high of 5.1 percent in January FY18 to 4.4 percent in February FY18 to a decline in inflation in food (decline of 120 basis points) and fuel.

4. Projected real GDP growth in FY19 seen at 7.4% as against 6.6% in FY18. (See Chart 2 below).

- **Note** – For FY19 Q1 GDP growth seen at 7.1%, and Q2 GDP growth seen at 7.4%.
- **Note** – RBI says models suggest FY20 real GDP growth will range from 7.4% to 7.9%.



5. Turning to the growth outlook, several factors are expected to accelerate the pace of economic activity in 2018-19.

- There are now clearer signs of revival, in investment activity as reflected in the sustained expansion in capital goods production and still rising imports.
- Global demand has been improving, which should encourage exports and boost fresh investment.

6. There are several uncertainties surrounding the baseline inflation path. These are:

- The revised formula for MSP as announced in the Union Budget 2018-19 for Kharif crops may have an impact on inflation.
- The staggering impact of HRA revisions by various state governments may push headline inflation up.
- In case there is any further fiscal slippage from the Union Budget estimates for 2018-19 or the medium-term path, it could adversely impact the outlook on inflation.
- The monsoon turns deficient temporally and/or spatially, it may have a significant bearing on food inflation.
- Firms polled in the Reserve Bank's Industrial Outlook Survey expect input and output prices to rise, going forward.
- Volatility in crude prices has imparted considerable uncertainty to the near-term outlook.

7. **Additional Note** – Impact of First Bi-monthly Monetary Policy Statement, 2018-19 on the Stock market;

- PSU Bank stocks are now trading 3-10% higher, clearly having received the policy quite positively.
- The 10-year benchmark bond yield is now trading at 7.18%, down 11 basis points from its previous close.

Highlights of Statement on Developmental and Regulatory Policies are as follows;

Regulation and Supervision

1. It is proposed to stipulate a minimum level of 'loan component' in fund based working capital finance for larger borrowers.
2. IND-AS (Indian Accounting Standards) for banks has been postponed by one year.
 - **Note** - Scheduled Commercial Banks (SCBs), excluding Regional Rural Banks (RRBs), were required to implement Indian Accounting Standards (Ind AS) from April 1, 2018, vide our Circular dated February 11, 2016.
 - **Further Note** – Reasons for same are;
 - **Necessary legislative amendments** – to make the format of financial statements, prescribed in the Third Schedule to Banking Regulation Act 1949, compatible with accounts under Ind AS – are under consideration of the Government.
 - The level of preparedness of many banks is not as expected.
 - In recent times, the payment ecosystem in India has expanded considerably with the emergence of new payment systems, players and platforms. To reduce the risks it has been decided that all payment system operators will ensure that data related to payment systems operated by them are stored only inside the country within a period of 6 months.

Financial Markets

- Access for Non-residents into the IRS Market.
- **Introduction of Rupee Swaptions** - In December 2016, RBI introduced Rupee Interest Rate Options (IRO) Only plain vanilla Interest Rate Options were allowed initially. Subsequently, market participants including corporates have expressed the need for swaptions to effectively manage interest rate risk.
- **Introduction of Single Master Form** for Reporting of Foreign Direct Investment in India.

Currency Management

- **Central Bank Digital Currency** - Rapid changes in the landscape of the payments industry along with factors such as the emergence of private digital tokens and the rising costs of managing fiat paper/metallic money have led central banks around the world to explore the option of introducing fiat digital currencies. While many central banks are still engaged in the debate, an inter-departmental group has been constituted by the Reserve Bank to study and provide guidance on the desirability and feasibility to introduce a central bank digital currency. The Report will be submitted by end-June 2018.

Financial Inclusion and Literacy

- **Revamping of the Lead Bank Scheme** - Reserve Bank of India had constituted a “Committee of Executive Directors” of the Bank to study the efficacy of the Scheme and suggest measures for its improvement. The committee has since submitted its recommendations and it has been decided to realign the Lead Bank Scheme based on the recommendations to make it more relevant. Instructions on the revised scheme would be issued to the banks within 15 days.

Data Management

- Creation of RBI Data Sciences Lab - it has been decided to gainfully harness the power of Big Data analytics. It is envisaged that the unit will become operational by December 2018.

Expected Questions:

Question No. 1

Currently (6th April 2018) Marginal standing facility (MSF) rate and the Bank Rate is ____%

- a. 6.5
- b. 6.25
- c. 6
- d. 5.75
- e. 5.5

Correct Answer – b. 6.25

Question No. 2

Projected real GDP growth for FY19 according to RBI's First Bi-monthly Monetary Policy Statement, 2018-19 is _____%

- a. 6.6
- b. 6.9
- c. 7.1
- d. 7.4
- e. None of these

Correct Answer – d. 7.4

Question No. 3

According to RBI's First Bi-monthly Monetary Policy Statement, 2018-19 which of following are uncertainties surrounding the baseline inflation;

- a. The revised formula for MSP as announced in the Union Budget 2018-19 for Kharif crops may have an impact on inflation
- b. The staggering impact of HRA revisions by various state governments may push headline inflation up.
- c. In case there is any further fiscal slippage from the Union Budget estimates for 2018-19 or the medium-term path, it could adversely impact the outlook on inflation.
- d. The monsoon turns deficient temporally and/or spatially, it may have a significant bearing on food inflation.
- e. All of the above

Correct Answer – e. All of the above

Question No. 4

CPI fell from a high of 5.1 percent in January of FY18 to 4.4 percent in February of FY18 due to decline in an inflation rate of

- a. Food and fuel
- b. Dairy products
- c. FMCG products

d. Infrastructural good

e. None of the above

Correct Answer – a. Food and fuel

Question No. 5

Schedule Commercial Banks shall comply with the Indian Accounting Standards (Ind AS) for financial statements for accounting periods beginning from _____

a. April 1, 2016

b. April 1, 2017

c. April 1, 2018

d. April 1, 2019

e. None of these

Correct Answer – d. April 1, 2019

