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RBI's Fifth Bi-Monthly Monetary Policy Review (2017-18)

6th December 2017

Maintains status quo...Neutral Stance

Repo Rate unchanged at 6.00%

Reverse Repo Rate stands at 5.75%

Marginal Standing Facility and Bank rate at 6.25%.

GVA growth projection for FY18 has been maintained at 6.70 percent.

RBI expects inflation trajectory to rise from current levels and has revised the inflation forecast for second half from 4.20%-4.60% previously to 4.30%-4.70%

The next meeting of the MPC is scheduled on 6th & 7th February, 2018.

The Reserve Bank of India (RBI), in its Fifth Bi-Monthly Monetary Policy Review (2017-18) , kept the policy **repo rate unchanged at 6.00 per cent**. Five of the six members of the Monetary Policy Committee (MPC) voted in favor of the rate decision, whereas one voted for a 25 bps cut.

Consequently, the reverse repo rate under the LAF remains at 5.75 per cent, and the marginal standing facility (MSF) rate and the Bank Rate at 6.25 per cent. The RBI left the **Cash Reserve Ratio (CRR) of scheduled Banks unchanged at 4 per cent of their net demand and time liability (NDTL).** The decision of the MPC is consistent with a **neutral stance of monetary policy** in consonance with the objective of **achieving the medium-term target** for consumer price index (CPI) inflation of **4 per cent within a band of +/- 2 per cent**, while supporting growth.

The move to keep the policy rates unchanged was much anticipated. According to a Bloomberg survey, 41 of the 46 economists expected RBI to leave the repurchase rate unchanged at 6%. The inflation had picked up towards the RBI's medium term target of 4 percent to 3.58% as per the latest reading and GDP also expanded to 6.30% in the second quarter of the fiscal after five quarters of continuous decline.

GDP Growth at three year low:

Showing some respite from low growth numbers, India's GDP (gross domestic product) growth for Q2 (July-September) of FY2017-18 came in at 6.3% YoY. Growth stood at 5.7% YoY in Q1 (January-March) of FY2017-18. GVA (gross value-added) growth for Q2 FY2017-18 has also been recovering. It came in at 6.1% YoY against 5.6% YoY in previous quarter.

During the quarter, industrial growth increased significantly to 5.8% YoY on account of sharp rise in manufacturing sector growth. However, services growth remained surprisingly resilient at near 9% YoY levels. During the quarter, capital formation showed some improvement. However, private consumption growth, which has been the key structure that has been supporting growth so far also registered weak number. Government expenditure too remained muted.

On the expenditure side, Government Final Consumption Expenditure (GFCE) grew by 4.1% YoY against 17.2% YoY registered in Q1 of FY2017-18. Private Final Consumption Expenditure (PFCE) growth came in at 6.5% YoY. On the other hand, growth in fixed capital formation improved to 4.7% YoY from 1.6% in Q1 of FY2017 -18.

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Industrial Output rises 3.8% in September:

India's Industrial Production growth remained steady in September 2017 as the key capital goods and consumer nondurables sectors reported a healthy performance, indicating some strength in laggard areas. Output, as measured by the Index of Industrial Production (IIP), rose 3.8% YoY in September, compared with an upward revised 4.5% YoY in August 2017. The preliminary estimate for August Industrial growth was 4.3% YoY. For the April-September FY2017-18, the Index was up 2.5% YoY compared with 5.8% YoY in the first half of FY2016-17.

Among the sectors, Mining output climbed 7.9% YoY, Electricity generation rose 3.4% YoY and Manufacturing increased 3.4% YoY in September 2017. Capital goods production rose 7.4% YoY, suggesting some traction in investment activity, while output of Consumer non-durables increased 10% YoY. However, production of Consumer Durable goods contracted 4.8% YoY during the month.

India's Trade Deficit near three-year high as Exports fall:

India's trade deficit in October 2017 widened significantly as exports fell for the first time in 15 months, while higher crude and metal prices inflated the import bill. Trade deficit stood at $14 billion in October compared with $8.9 billion in September. Exports in October fell 1.1% YoY to $23.1 billion. This was in stark contrast to the 26% YoY rise in exports to a six-year high in September. Gems and jewellery exports, typically the second largest contributor to the export bill, fell 24.5% over last year to $3.3 billion. Export of engineering goods in October, the largest contributor, went up 11.7% YoY to $5.9 billion, but moderated from September when they gone up 44.2% YoY. On the other hand, India's import bill increased 7.6% YoY to $37.1 billion in October. The value of oil imports rose 27.9% YoY to $9.2 billion. Gold imports fell for the second straight month to $2.9 billion, 16% lower than the same month last year.

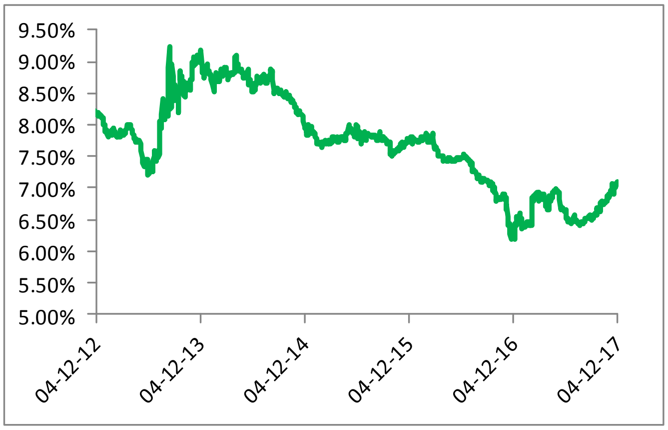
India's CPI Inflation at 7 month high:

India's Consumer Price Index (CPI) based inflation accelerated to a seven-month high in October 2017. Inflation stood at 3.5% YoY in October against 3.28% YoY in September. Higher inflation during the month was mainly driven by higher prices of vegetables, housing and fuel. During the month food inflation increased to 1.9% YoY from 1.25% YoY in September and 1.52% YoY in August. The price of food shot up mainly due to unexpected rains, which destroyed crops. Major indicators of CPI food & beverages stood at 2.26% YoY, pan, tobacco & intoxicants was at 6.91% YoY, clothing & footwear stood at 4.76% YoY, housing was at 6.68 YoY, fuel & light was at 6.36% and miscellaneous came in at 3.48% YoY. Rising commodity prices globally and a new pay revision for Government employees may have led to the rise in inflation further. However, Government's decision to slash tax rates on 178 items such as chocolates and detergent powders to 18% from 28% could have some marginal positive impact on inflation.

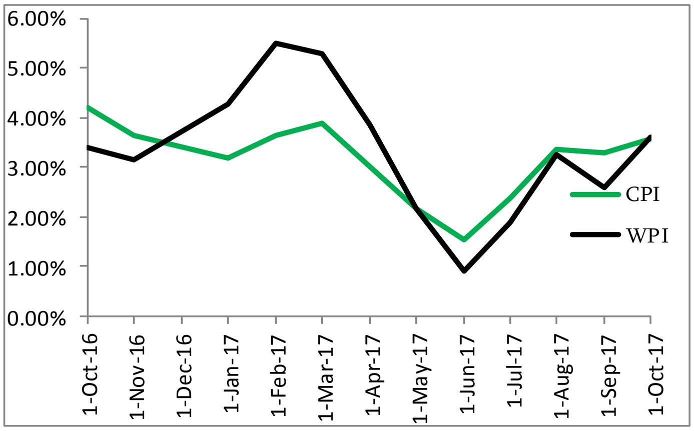
India's WPI Inflation touches 6-month high:

India's Wholesale Price Index (WPI) based inflation rose to a six-month high of 3.59% YoY in October from 2.6% YoY in September as food items and fuel became more expensive. WPI inflation was much lower at 1.27% YoY in October 2016. Wholesale food prices in October rose 3.23% YoY compared with a 1.99% YoY rise a month earlier, However, WPI inflation in manufactured items eased marginally to 2.62% YoY in October from 2.72% YoY a month ago. In the fuel and power segment, inflation rose to 10.52% YoY against 9.01% YoY in September. Fuel inflation has remained high for the past three months as petrol and diesel prices continued to rule high, tracking global crude oil rates. Power tariffs shot through the roof on lower domestic production. The final print of August WPI inflation remained unchanged at 3.24% YoY.

Indian Government 10 Year Bond Yield (%)



India's CPI and WPI Trend (%)



Key Highlights

The MPC statement highlighted that moderation in inflation excluding food and fuel has reversed and recent rise in oil prices may sustain on account of the OPEC's decision to maintain production cuts through next year. In addition to this, the impact of Housing Rent Allowance is expected to peak in December. All these factors may have upside risk on inflation.

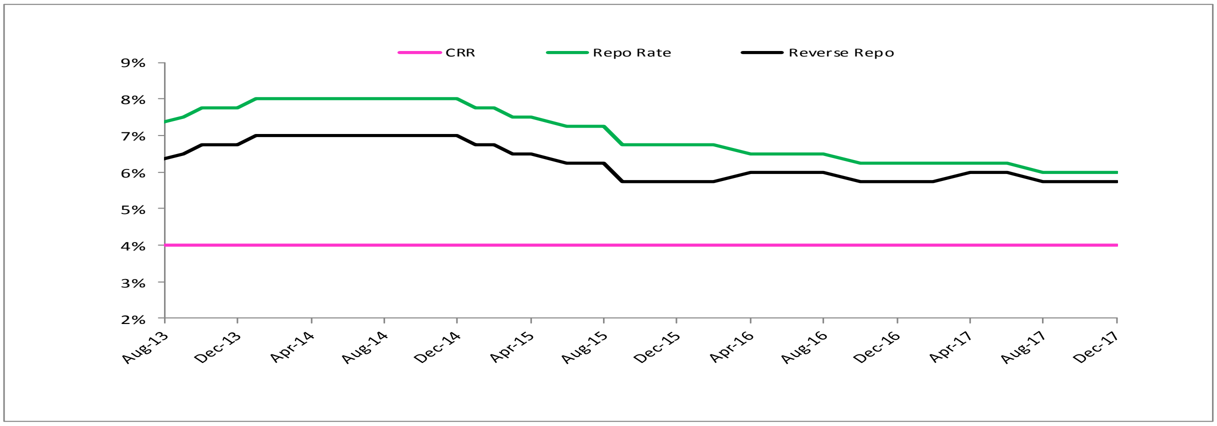
Governor Urjit Patel said that the RBI is in discussions with the government to finalize recapitalization amount for each bank and that the plan will also be a reform process for the banks. The banks with the best of balance sheet will receive the credit growth capital as well in addition to provision capital and the recapitalization plan will help improve credit flows.

The central bank will consider open market operation to manage liquidity on a durable basis and the committee expect there will be marginal surplus liquidity in the banking sector by the end of the financial year.

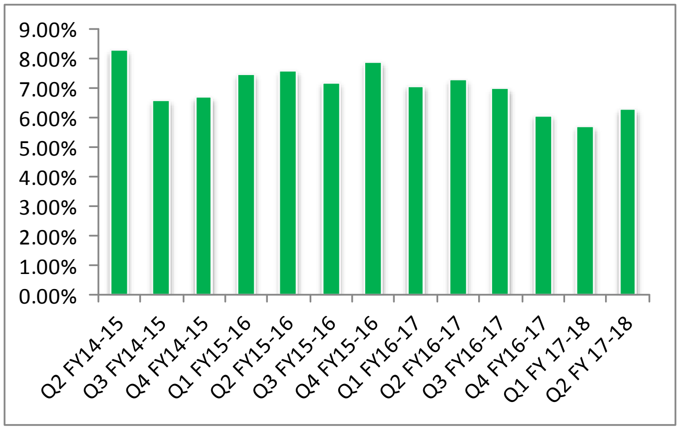
The equity index was down 0.40 percent after the decision and the bond yields declined by 2 bps to 7.04 percent. The rupee traded 0.10 percent lower at 64.4175 a dollar.

Going forward, RBI will assess the further macro readings and hence maintained a neutral stance.

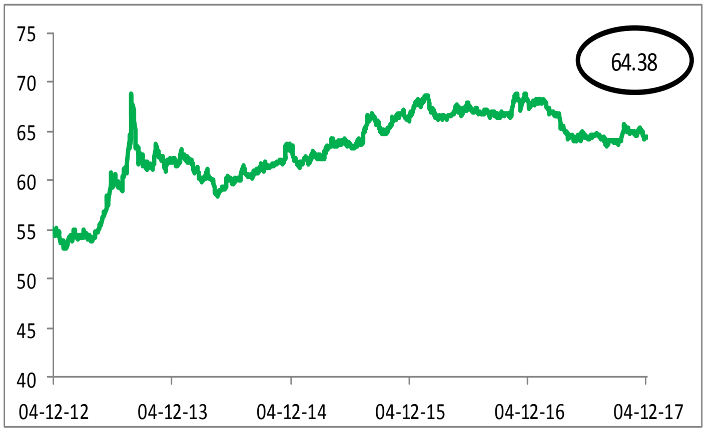
RBI's Monetary Policy Stance



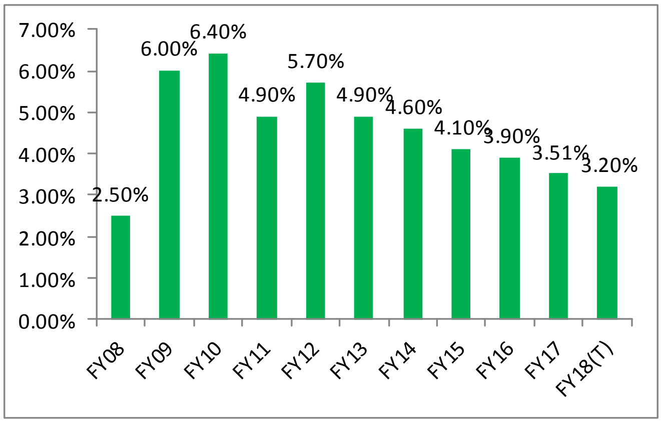
India's GDP Growth Trend



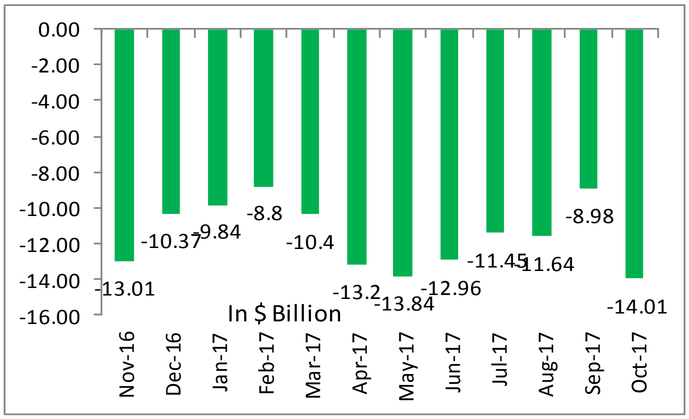
INR Vs US Dollar



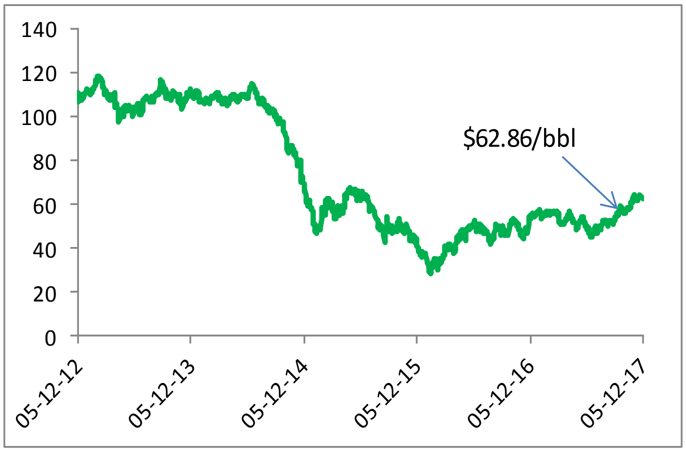
India's Fiscal Deficit Trend



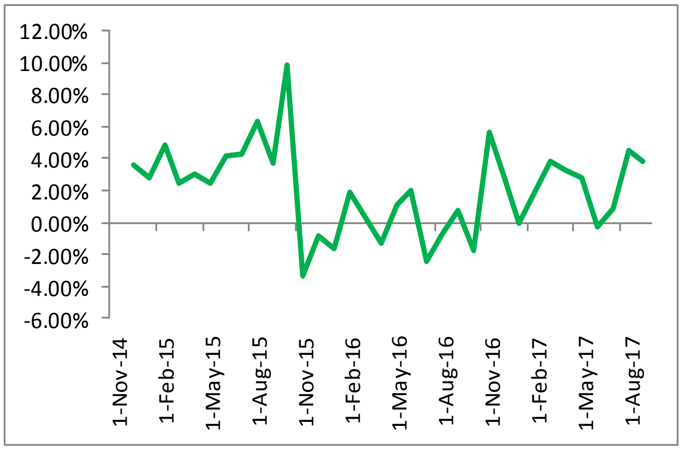
India's Trade Deficit Trend



Brent Crude Price Trend (In $/bbl)



India's Industrial Production Trend



Source: RBI, Bloomberg, SMIFS Research

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Stock Recommendation	Expected absolute returns (%) over 12 months
Strong Buy	>20%
Buy	between 10% and 20%
Hold	between 0% and 10%
Sell	0 to <-10%
Neutral	No Rating

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