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RBI's Sixth Bi-Monthly Monetary Policy Review (2016-17)

Status Quo..Neutral Stance

Repo Rate unchanged at 6.25 per cent

Reverse Repo Rate at 5.75%

Marginal Standing Facility and Bank rate at 6.75%.

GVA growth for 2016-17 lowered to 6.9 per cent from earlier target of 7.1 per cent. GVA growth for 2017-18 is projected at 7.4 per cent.

Notes in circulation at INR9.92 lakh crore including all notes as of January 2017.

Raised cash withdrawal limits from INR24000 to INR50000 wef 20th Feb and no limit on withdrawal wef 13th March 2017

The next meeting of the MPC is scheduled on 5th & 6th April, 2017 and resolution to be placed on 6th April 2017.

The Reserve Bank of India (RBI), in its Sixth Bi-Monthly Monetary Policy Review (2016-17) , **maintained status quo on the Policy Repo rate** yet again which stands at 6.25 per cent. The **decision was unanimous** with all the six members voting in favor of maintaining status quo.

Consequently, the **Reverse Repo Rate under the Liquidity Adjustment Facility (LAF) remains unchanged at 5.75 per cent and the Marginal Standing Facility (MSF) rate and the Bank Rate at 6.75 per cent.**

The RBI also left the **Cash Reserve Ratio (CRR) of scheduled Banks unchanged at 4% 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 **consumer price index (CPI) inflation at 5 per cent by Q4 of 2016-17** and the medium-term target of 4 per cent within a band of +/- 2 per cent, while supporting growth.

The move to keep the benchmark rates unchanged was correctly predicted by only 5 of 39 economists in a Bloomberg survey, while 34 expected a cut of 25 bps to 6 per cent. Hence **the decision was against the majority consensus.**

WPI Update

India's **WPI inflation accelerated to 3.39 percent in December from 3.15 percent in November**. Food articles inflation for the month was in negative, indicating a 0.7 percent fall in food prices in December as compared to 1.54 percent rise in the previous month. This is the first fall in wholesale food prices since August 2015. **Fuel and Power inflation also rose sharply to 8.65 percent in December from 7.07 percent in November** and **core inflation was up at 2.2 percent in December as compared to 1.6 percent in November.**

CPI Update

India's **CPI inflation eased further to nearly 3-year low of 3.41 percent in December 2016.** This is the lowest level since January 2014. Inflation stood at 3.63 per cent in November 2016. The **decline in inflation has been mainly on account of falling prices of vegetables and pulses.**

CA Harshit Mantri
Email: harshit.mantri@smifs.com

IIP

The index of Industrial Production **(IIP) rose to a 13-month high of 5.7 percent in November 2016 compared with a contraction of 1.8 percent in the month of October.** This sudden jump is mainly on account of base effect. **IIP in November last year was negative -3.4 percent.**

Key Notes

- The committee decided to **change the stance from accommodative to neutral** while keeping the policy rate on hold to assess how the transitory effects of demonetisation on inflation and the output gap play out.
- **GVA growth for 2016-17 is projected at 6.9 per cent** with risks evenly balanced around it. The earlier target was 7.1 per cent.
- **GVA growth for 2017-18 is projected at 7.4 per cent** with risks evenly balanced . The committee expects growth to recover sharply in 2017-18 as discretionary consumer demand held back by demonetisation is expected to bounce back, economic activity in cash-intensive sectors such as retail trade, hotels and restaurants, and transportation, as well as in the unorganised sector, is expected to be rapidly restored, reduced MCLRs is expected to spur a pick-up in both consumption and investment demand and lastly the Union Budget focus on increased capital expenditure, boost in rural economy and affordable housing should also contribute to growth.
- **Headline CPI inflation in Q4 of 2016-17 is likely to be below 5 per cent** and as growth picks up and the output gap narrows, it is expected to pick up momentum post Q1 of 2017-18. **Inflation is projected in the range of 4.0 to 4.5 per cent in the first half of the financial year and in the range of 4.5 to 5.0 per cent in the second half.**
- The Committee believes that the environment for timely transmission of policy rates to banks lending rates will be considerably improved if (i) the banking sector's nonperforming assets (NPAs) are resolved more quickly and efficiently; (ii) recapitalisation of the banking sector is hastened; and, (iii) the formula for adjustments in the interest rates on small savings schemes to changes in yields on government securities of corresponding maturity is fully implemented.
- The **Current Account Deficit is likely to remain muted and below 1 per cent of GDP in FY17**
- **Rising crude oil prices, volatility in the exchange rate on account of global financial market developments and fuller effects of the house rent allowances** under the 7th Central Pay Commission (CPC) award which have not been factored in the baseline inflation path **remain as the key risks.**
- During the review, **RBI has also relaxed cash withdrawal limits**. RBI has raised the cash withdrawal limits for savings account from the existing INR24,000 to INR50,000 per week, staring February 28. Further, all cash limits will be removed with effect from 13th March 2017.
- The next meeting of the MPC is scheduled on April 5 and 6, 2017

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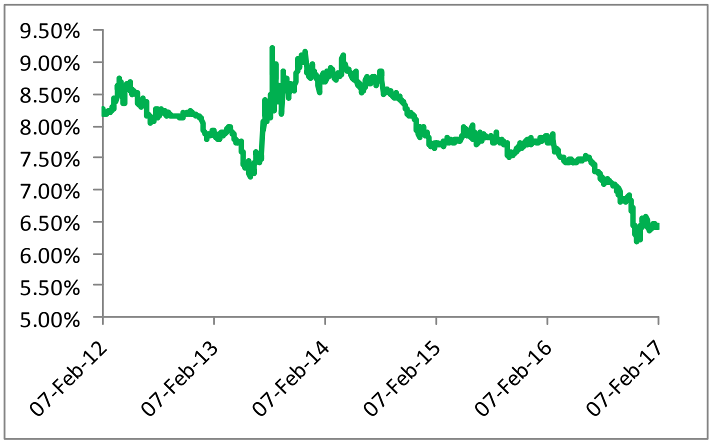
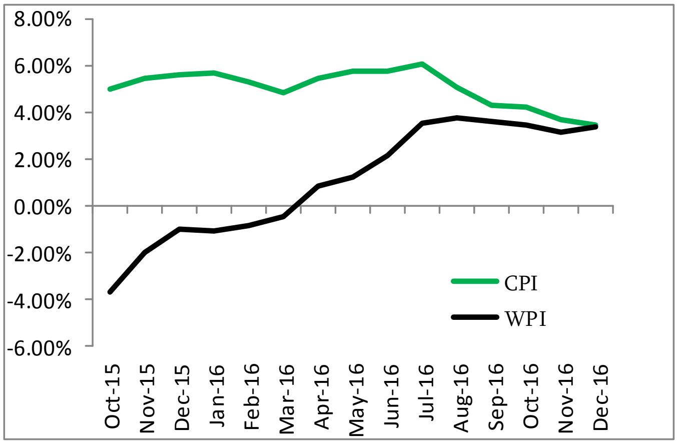
Indian Government 10 Year Bond Yield



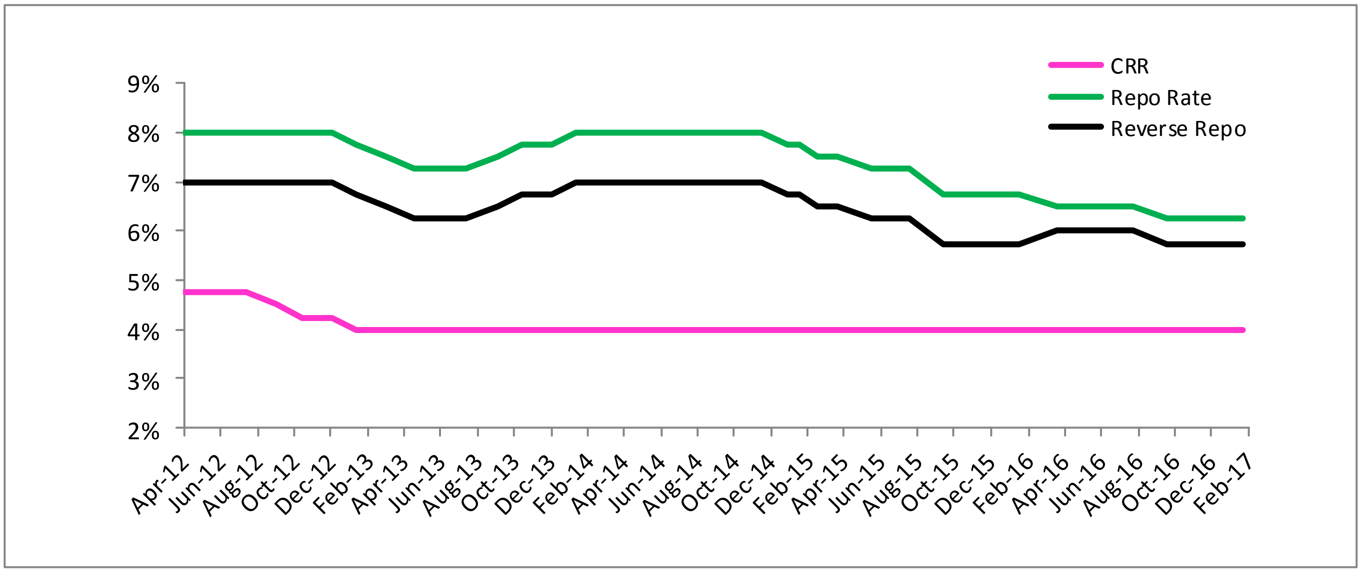
India's CPI and WPI Trend



Key Quotes by MPC

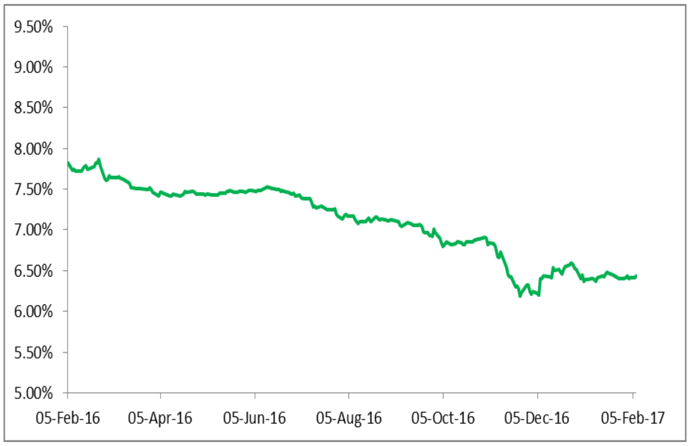
- *Remonetisation and balanced budget should aid narrowing output gap.*
- *RBI awaits clearer assessment of inflation and demonetization.*
- *They see some pressure on Net Profit of Banks to continue and few banks may be required to raise additional capital. However, bad loan ratios have come down in few banks and NPA reduction shows level of provisioning is adequate*
- *Believe that there is still scope for banks' lending rates to come down.*
- *Notes in circulation at INR9.92 lakh crore including all notes as of January 2017.*

RBI's Monetary Policy Stance

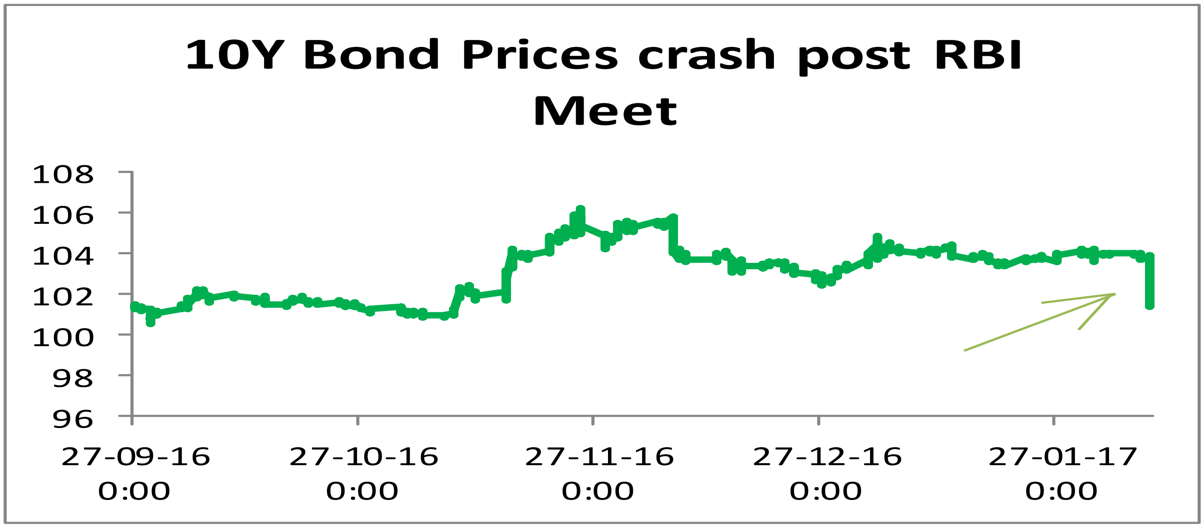


Impact On Market post RBI Policy Meet

Indian Government 10 Year Bond Yield (One Year Trend)



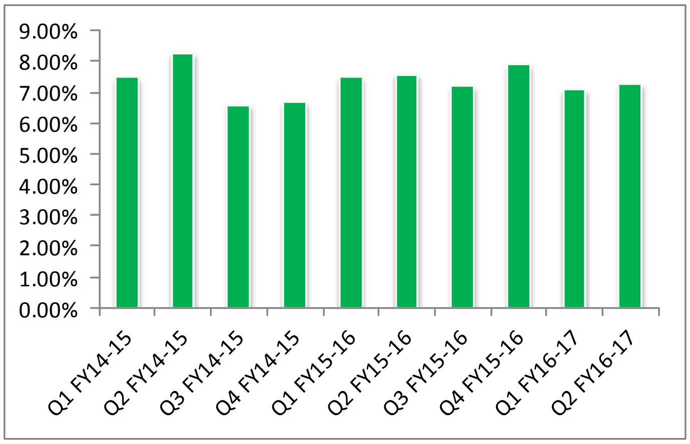
Nifty Bank Index Intraday Chart



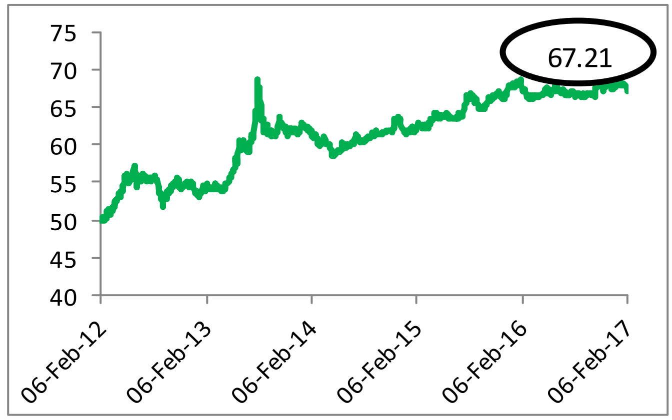
Yet again an unexpected decision by RBI to keep the benchmark rate unchanged for second straight meeting and changing its stance from accommodative to neutral lead to crash in 10 Year Indian Government Bond prices. The Indian sovereign bonds headed for their biggest loss since 2013. Foreign holdings of rupee denominated government and corporate notes have fallen for four consecutive months which is the longest stretch since 2013.

The 10 Year bond yields due 2026 surged 25 bps to 6.68 per cent post RBI meet, the biggest jump in 10 year bonds since Sept 2013. The rupee rose 0.2 per cent to 67.3075 per dollar.

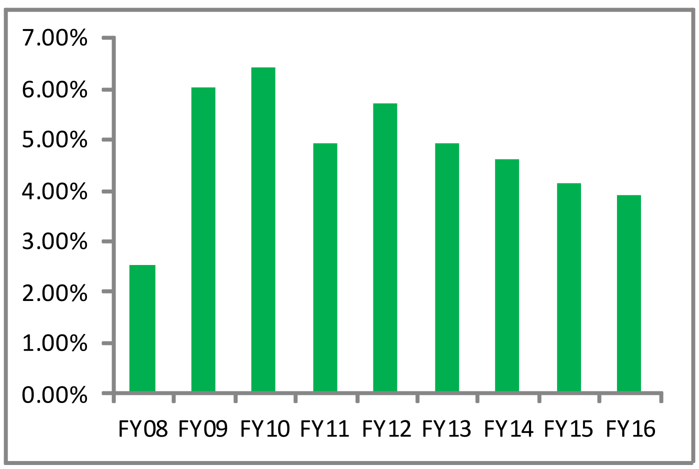
India's GDP Growth Trend



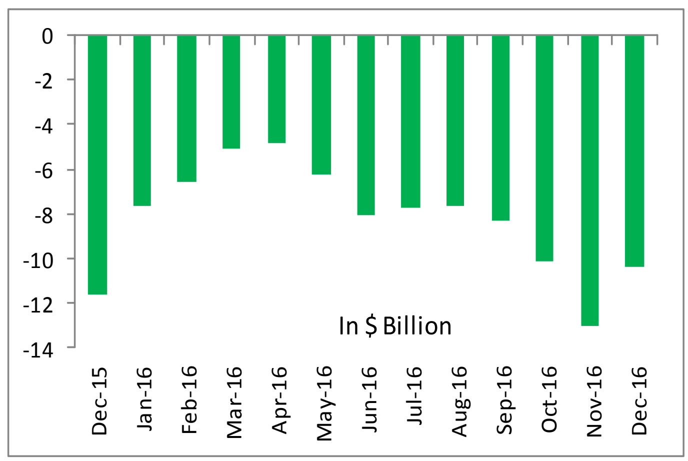
INR Vs US Dollar



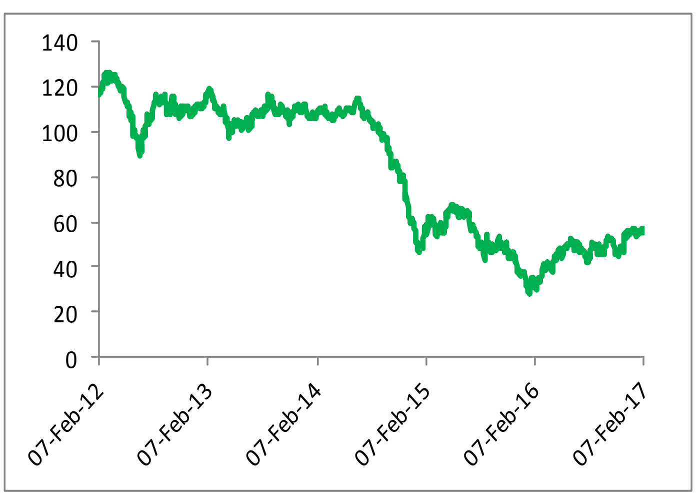
India's Fiscal Deficit Trend



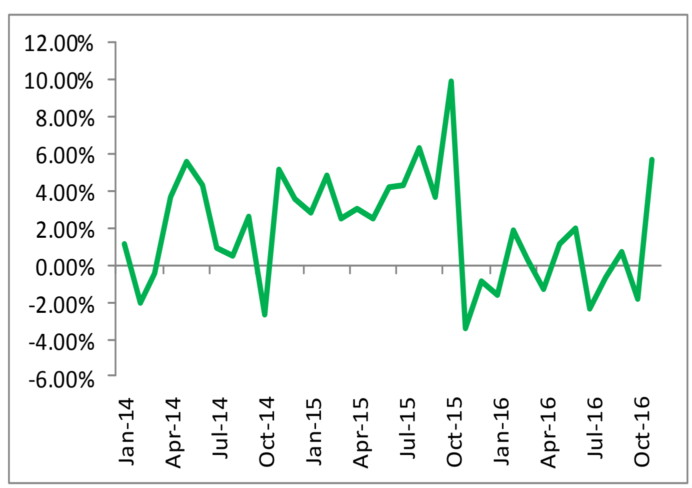
India's Trade Deficit Trend



Brent Crude Price Trend (In $/bbl)



India's Industrial Production Trend



Source: RBI, Bloomberg, SMIFS Research

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Research & Development Strategies

Mr. Ajay Jaiswal
President: Strategies and Head Research
ajaiswal@smifs.com
+91 33 30515408 / 40115408
Mobile: +91 9836966900

Mr. Ashiwini Kumar Tripathi
Director
aswin.tripathi@smifs.com
+91 33 30515415 / 40115415
Mobile: +91 9831155058

Mr. Vishal Prabhakar
VP – Investors Relations & BDM
vishal.prabhakar@smifs.com
+91 33 30515400 / 40115400
Mobile: +91 9831554477

Fundamental Research

Mr. Saurabh Ginodia
Senior Research Analyst
saurabh.ginodia@smifs.com
+91 33 30515407

Mr. Dipanjan Basuthakur
Research Analyst
dipanjan.basuthakur@smifs.com
+91 33 30515486

Mr. Harshit Mantri
Research Analyst
BFSI/IT/Media
harshit.mantri@smifs.com
+91 33 30515433 / 30515468

Ms. Sutapa Biswas
Research Analyst
Economy
sutapa.biswas@smifs.com
+91 9836020612

Mr. Jeet Ranjan Ghosh
Research Analyst
Auto Ancillary/Engineering/Oil and Gas
jeet.ghosh@smifs.com
+91 33 30515433 / 30515468

Ms. Mononita Mitra
Research Analyst
Agro Chemicals/Diversified
m.mitra@smifs.com
+91 33 30515468

Mr. Abhishek Roy
Research Analyst
FMCG/ Capital Goods/Textiles
abhishek.roy@smifs.com
+91 33 30515468

Mr. Kapil Joshi
Research Analyst
Building Products/Infrastructure
kapil.joshi@smifs.com
+91 33 30515468

Technical Research

Mr. Jaydeb Dey
Technical Analyst Equities
jaydeb.dey@smifs.com
+91 33 30515433

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

Investor Relations and Data Support

Mr. Sandipan Chatterjee
Officer – Business Development
sandipan.chatterjee@smifs.com
+91 33 30515461

Ms. Debjani Sen
Officer – Investor Relations
debjani.sen@smifs.com
+91 33 30515401

Ms. Sulagna Mukherjee
Executive – Customer Care
sulagna.mukherjee@smifs.com
+91 33 30515436

Mr. Manish Kumar Sharma
Research Data Support
manish.sharma@smifs.com
+91 33 30515436

Bloomberg Ticker for Stewart & Mackertich Research: SMIF<Enter>

Contact Details

Registered Office Address:
Vaibhav, 4 Lee Road,
Kolkata 700020, India.
Phone: +91 33 30515400 / 40115400
Fax No: +91 33 22893401

Hyderabad Office:
Ms.Vaishnavi
3-6-198, Vasavi Shreemukh Complex 4A,
Ground Floor, Himayath Nagar,
Hyderabad – 500 029, India.
Phone: +91 40 69000032/31

Mumbai Office:
Mr.Vaibhav P. Wadke
922, 9th Floor, P.J. Towers,
Dalal Street, Fort,
Mumbai – 400 021, India.
Phone: +91 22 42005555 / 66159442 / 9619427174

New Delhi Office:
Mr.Prakash Srivastav
487, G. T. Road, 3rd Floor,
Dilshad Garden,
New Delhi – 110 095, India.
Phone: +91 11 43504705 / 9910497783

Bangalore Office:
Mr.S. Srikanth
No.153, 2nd Floor, Sheela Arcade, 7th Block
Koramangala, (Opp.—Sai Baba Mandir)
Bangalore - 560095, India.
Phone: +91 9845020017

Chennai Office:
Mr.K.K.Raja Gopalan
New No.4/2, Bajaj Apartments,
Seethamal Colony, 1st Cross Corner, Alwarpet,
Chennai – 600018, India.
Phone: +91 9383931590

Port Blair Office:
Mr.Gulam Hassan
24, S.J.Lane, 8/3, Sahajeevan Housing,
Co-operative, P.O. Haddo,
Port Blair 744102, India.
Phone: 233-175 Mobile No. 9932081381/9933236406

Website: www.smifs.com | Email: investors@smifs.com

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Stewart & Mackertich Wealth Management Ltd.
Vaibhav, 4 Lee Road, Kolkata 700020, West Bengal, India.
Tel.: +91 33 3051 5408 /, Fax: 91 33 22893401

Website: www.smifs.com

For queries related to compliance of the report, please contact:
- Sudipto Datta, Compliance Officer
Contact No.: +91 33 30515414 / 4011 5414
Email Id.: compliance@smifs.com / sudipta@smifs.com