ASSOCHAM IN THE NEWS

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RBI opts for flexibility to 'move in either direction'

Bond yields climb after debt market participants are surprised by central bank's shift to 'neutral' monetary stance

SPECIAL CORRESPONDENT

MUMBAI: The Monetary Policy Committee of the Reserve Bank of India (RBI) on Wednesday decided to keep the key policy rate, the repo rate, unchanged at 6.25% citing uncertainties caused by demonetisation, which it said had 'discoloured' an objective assessment of inflation pressures.

More significantly, the RBI, in its last bimonthly review of the current financial year, changed the policy stance – dispensing with its accommodative position and switching to neutral – meaning interest rates could hereafter move in either direction.

"In this policy review a clear assessment of the evolving macroeconomic configuration, at least in the short run, remains clouded by the transitory effects of demonetisation," RBI Governor Urjit Patel said in the post-policy interaction with the media.

"It [Monetary Policy Committee] decided to shift the stance from accommodative to neutral to give us sufficient flexibility to move in either direction," Dr. Patel said. All six members of the MPC voted to hold interest rates.

The move surprised debt market participants, with most expecting a 25 basis points (bps) rate cut. The yield on the benchmark 10-year government bond shot up by 32 bps to close the day at 6.75%. A hundred basis points make one percentage point.

The benchmark Sensex on the BSE also dropped 45.24 points, to 28,289.92, as equity investors sold bank stocks.

Banking majors like Axis Bank, ICICI Bank, State Bank of India and HDFC Bank all lost ground on Wednesday.

"On the inflation front, transient factors including anecdotal evidence on fire sales of perishables have discoloured an objective assessment on inflation pressures," Dr. Patel said, adding that retail inflation for December, which was 3.41%, could have ended up 140 bps higher if vegetable prices had been excluded.

Many economists had anticipated a further reduction in the repo rate as retail inflation had slowed well below the RBI's March end goal of 5%.

The central bank on Wednesday projected retail inflation in the first half of the next financial year would be in the range of 4% to 4.5% and accelerate to a 4.5% to 5% pace in the second half.

HOPES BELIED: Many economists had anticipated a further reduction in the repo rate as retail inflation had slowed well below the RBI's March-end goal of 5%. – FILE PHOTO

The RBI said while favourable base effects and lagged effects of demand compression would possibly mute headline inflation in the first quarter of 2017-18, price gains were expected to pick up momentum, especially as growth strengthened and the output gap narrowed. Moreover, base effects would reverse and turn adverse during the third and fourth quarters of the next fiscal, it said.

Nomura economist Sonal Verma said there appeared little likelihood of further reductions in policy rates.

"Looking ahead, we expect inflation to average above its target (at approximately 5% in FY18) and thus expect policy rates to remain unchanged at 6.25% throughout 2017 against our earlier expectations of a 6% terminal rate," Ms. Verma wrote in a note to clients. The real rate (repo rate minus inflation) that RBI looks at, is 1.25%.

However, banks still have room to lower interest rates further, according to Dr. Patel.

"There is still scope for lending rates to come down because our policy rates came down by 175 bps and the weighted average lending rate has come down at most by 85-90 bps," Dr. Patel said.

Banks had cut their marginal cost of funds based lending rate (MCLR) by 45-90 bps after their cost of funds declined due to higher savings and current account deposits following demonetisation.

The RBI also cited 'risks' to its inflation outlook: hardening global crude prices, exchange rate volatility, and fuller effects of house rent allowances under the seventh pay commission.

RBI to set up in-house enforcement cell

SPECIAL CORRESPONDENT

MUMBAI: The Reserve Bank of India has decided to set up an enforcement department to speed up regulatory compliance.

The department, to be operational from the next financial year, will mainly deal with the penalties imposed on banks for violation of norms. Currently, the penalties are decided by the banking and non-banking supervision departments.

"With a view to developing a sound framework and process for enforcement action, it has been decided to establish a separate Enforcement Department," RBI said in a statement. "Necessary steps have been initiated in this regard and the new department will start functioning from April 1, 2017," the statement said.

"Enforcement is an integral part of the supervisory process. We do take enforcement action even now. But we believe focussed attention will increase the regulatory compliance," RBI deputy governor N.S. Vishwanathan said at a post-policy media interaction.

The central bank said enforcement deals with cases of non-compliance with regulations were noticed either through the surveillance process or otherwise.

Given the general environment of uncertainty both domestically and abroad, the RBI decision to maintain status quo was on expected lines. The RBI's view is right, that monetary policy transmission will improve further if NPAs are resolved, capital position of banks improve and small savings rates are more market-driven

– **ARUNDHATI BHATTACHARYA**, Chairman, SBI

The decision to keep the rate unchanged and the change in stance from accommodative to neutral is based on a judicious assessment of risks. The MPC has highlighted concerns around the global policy environment, impact of rising global commodity prices and domestic inflation. The policy reflects the need to balance inflation and growth dynamics that will provide long-term stability

– **CHANDA KOCHHAR**, MD and CEO, ICICI Bank

While the change in stance to neutral and focus on bringing CPI inflation to 4% lent a hawkish tinge to the policy, verbal comments emphasised flexibility

– **NARESH TAKKAR**, MD and Group CEO, ICRA

The shift in stance to neutral with a status quo on policy rates should allow RBI the flexibility to ease rates to push for stronger growth, amidst the Govt.'s fiscal rectitude

– **RANA KAPOOR**, Yes Bank MD & CEO

The RBI has put the ball in the court of the government for softening of interest rates which, it said, would depend on how soon the problems of the banks, non-performing assets, recapitalisation of the lenders and re-calibrating of small savings, are resolved. We urge the government to address these issues

– **SUNIL KANORIA**, Assocham President

Business Standard 9 February, 2017

RBI'S BI-MONTHLY MONETARY POLICY REVIEW

WE URGE THE GOVERNMENT TO TAKE SIGNALS FROM RBI. THERE IS A STRONG CASE FOR FISCAL SUPPORT... TO GENERATE CONSUMER DEMAND

Sunil Kanoria, Assocham President

The Tribune 9 February, 2017

India Inc unhappy, voices concerns

NEW DELHI, FEBRUARY 8

Disappointed with the RBI's decision to leave key policy rates unchanged, India Inc today said a rate cut was needed to revive demand hit by the cash crunch post-demonetisation.

Industry bodies also expressed concern over the apex bank shifting the stance of the monetary policy from 'accommodative' to 'neutral'.

"A cut in the repo rate would have boded well for the economy. Giving a push to demand which has taken a hit in the demonetisation process is critical as also the need to incentivise domestic private investment in the country which remains lackadaisical," Ficci president Pankaj Patel said.

Assocham said more worrying is the RBI putting an end to the 'accommodative' stance. "The RBI, in a way, has put the ball in the court of the government for softening of the interest rates which, it said, would depend on how soon the problems of the bank non-performing assets (NPAs), recapitalisation of the lenders and recalibrating of the small saving, are resolved.

"We urge the government to take signals from the RBI seriously and address these issues. There is a strong case for fiscal support, besides the monetary measures, to generate the consumer demand and revive the investment cycle," Assocham president Sunil Kanoria said.

He said while inflation targeting remains an important mandate of the RBI's Monetary Policy Committee, subdued growth should also weigh on the policymakers.

"We do take cognisance of the fact that banks have moved forward to revise down their lending rates over the last month. However, a more sustained effort would be required to bring a turnaround in domestic private capex cycle," Patel said.

❝A cut in the repo rate would have boded well for the economy. Giving a push to demand which has taken a hit in the demonetisation process is critical as also the need to incentivise domestic private investment in the country which remains lackadaisical❞

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❝The RBI, in a way, has put the ball in the court of the government for softening of the interest rates. We urge the government to take signals from the RBI seriously and address these issues. There is a strong case for fiscal support, besides the monetary measures, to generate the consumer demand and revive the investment cycle❞

– **Sunil Kanoria,** ASSOCHAM PRESIDENT

"With compelling reasons for both sides of the debate, the monetary policy committee was left with an unenviable task.

What finally weighed on their minds were uncertainties about sticky core inflation, commodity prices and possible Fed rate hikes," Mahindra Group CFO VS Parthasarathy said.

Naresh Takkar, MD and Group CEO of rating agency ICRA, said, "While the change in the stance to neutral from accommodative and focus on bringing CPI inflation to 4% in a durable manner lent a rather hawkish tinge to the policy document, the verbal comments emphasised flexibility." For the second time in a row, the Reserve bank today opted for a status quo in its key rates but shifted the stance of the monetary policy from 'accommodative' to 'neutral'. — PTI

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India Inc disappointed

PRESS TRUST OF INDIA
NEW DELHI, FEBRUARY 8

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—Sunil Kanoria, president, Assocham