SHANKAR IAS PARLIAMENT
Information is Empowering

RBI Repo Rate Cut - October 2019

Why in news?

The six-member Monetary Policy Committee (MPC) of the Reserve Bank of India (RBI) slashed the short-term lending rate, repo rate, by 25 basis points to 5.15%.

How is the rate cut trend?

- There was an unconventional 35 basis points cut in interest rates by the RBI in August 2019.
- The RBI has now returned to a normal 25 basis points cut.
- With this, the central bank has pruned rates by 135 basis points in just 7 months since the rate cut cycle started in February 2019.
- Of this, until August, banks had passed on just 29 basis points to borrowers.
- But, major banks recently shifted to an external benchmark mostly linked to the repo rate.
- So, the transmission of benefits to borrowers could be quicker from here onwards.

What is the change in growth projections?

- The RBI has sharply marked down the GDP growth projections for the current fiscal to 6.1%.
- This is down from the 6.9% that it had projected in the August policy.
- The downgrade was inevitable after the shocking 5% growth reported in the first quarter.
- However, even the revised estimate is a bit too optimistic.
- If the projection of 6.1% for 2019-20 is to be met, the economy has to grow by about 7% in the second half, which does not look very likely.
- Given this, the basis for RBI's optimism appears unclear at this moment.

How does the future look?

- The central bank has been taking a liberal stance in making repo rate cuts in the last few months.
- Given this, monetary policy may well be nearing its limits in so far as its ability to influence growth prospects is concerned.
- Inflation is well within the target giving space to the RBI to focus on growth.
- Crude oil prices are back in the comfort zone, retreating from the spike in

mid-September 2019.

- Food prices are projected to remain soft on the back of a good monsoon.
- The monetary policy statement is unambiguous that the RBI will continue with its accommodative stance "as long as it is necessary to revive growth".

Why is fiscal policy measure crucial now?

- The problem is that the central bank can only facilitate lower rates and push banks to lend.
- It cannot force borrowers to borrow and this is evident from the soft trends in credit offtake in the last few months.
- As per latest available data, bank credit is growing at just 10.3%.
- The onus, therefore, is on fiscal policy which alone can boost borrowing and investment.

What lies ahead?

- To be fair, the government has been engaging the levers, and the recent corporate tax cut measure is a major move to get private investment going.
- However, the Rs.1.45 lakh crore giveaway has set off fears in the market of a fiscal slippage and higher borrowings by the government.
- These concerns also explain the unenthusiastic response of the stock and bond markets to the current rate cut.
- The ongoing festival season consumption holds the key to revival of the economy this fiscal.

Source: The Hindu