GS-III: A welcome move, but it’s unlikely to spur demand

News

With the 25 basis points (bps) rate cut, RBI returned to the conventional wisdom of a rate change in multiples of 25bps.

RBI statement

- MPC decided to continue with an accommodative stance as long as it is necessary to revive growth while ensuring that inflation remains within the target.
- RBI’s decision to increase the household income limit for borrowers of NBFCs and MFIs is welcome. It will enhance credit delivery to a larger customer base at the bottom of the pyramid.
- There is an attempt to boost the domestic forex derivatives market. RBI has decided to allow domestic banks to offer foreign exchange prices to non-residents on a 24-hour basis.

Efficacy of rate cuts:

- This may push the debt markets to take a cue from the second-generation policy signals and yields may soften from the current level.
- Efficacy of rate cuts is questionable against elevated household leverage, deteriorating company fundamentals, and weak demand.
- The number of downgrades in H1FY20 grew by 66% vis-à-vis a 20% de-growth for the number of upgrades. The pace of downgrades has been increasing.
- Financial flows to the commercial sector in H1FY20 are significantly lower due to a decline in funding from banks and non-bank sources.
- Despite a rising interest scenario, credit had expanded by over ₹1.65 trillion but contracted by ₹93,700 crores even as we are in an aggressive rate cut cycle. This indicates credit risk aversion continues to play center stage for the non-bank sector.

Fiscal policy:

- Centre has done a remarkable job in maintaining fiscal consolidation.
- We are increasingly concerned about the fiscal position of the states.

Way ahead

More clarity is needed to crystallize the KYC requirements for off-shore entities as also their tax implications.

In the current context, an only monetary policy rate cut would not work in isolation. It must be complemented by fiscal expansion.