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.