# Monetary Policy preview: Will the RBI cut interest rates tomorrow?

## Here is what top research houses and brokerages expect

The Reserve Bank of India (RBI) imposed a temporary cash reserve ratio (CRR) **over the weekend, on the incremental rise in bank deposits** following the government's demonetisation move. The measure, which will be reviewed on December 9 and was largely expected by analysts, aims to suck out excess liquidity in the system; though banks will not be able to earn any income on these deposits.

Given this development and the ongoing clampdown on black money via the demonetisation route, will the RBI cut interest rates in its upcoming monetary policy review tomorrow? Here is what top research houses and brokerages expect.

## ICRA

We expect a 25 bps reduction in the repo rate in the upcoming policy review in December 2016, followed by one more cut of a similar magnitude up to June 2017. Moreover, the Reserve Bank of India (RBI) is likely to outline measures to manage the systemic liquidity, which would be of interest to the banks, and provide some timeframe by which cash liquidity would increase, that would be of significance to the public.

## HSBC

With the CRR move, the RBI has bought itself room to suck out about Rs 10.2 trillion, or Rs 10.2 lakh crore (Rs 3.2-lakh crore via incremental CRR and Rs 7-lakh crore via using government bonds) from the banking system. As per our calculations, this should suffice for now, but if additional need arises, the RBI can resort to additional measures like issuing special bonds.

If the RBI believes than lending rates need to fall over time, in order to support growth and recovery, (especially given some growth drag following demonetisation), cutting the repo rate may provide a nudge. We are expecting a repo rate cut in the December 09 policy meeting.

## BANK OF AMERICA-MERRILL LYNCH

We expect the RBI to cut policy rates by 25 bps on December 7 (and April) as the conversion of black money into deposits should allow banks to cut lending rates even in October - March busy industrial season. In out view, the case for a rate cut grows more complelling. We see further 30bps risk each to our 7.4% FY17 and 7.6% FY18 groqth forecasts with demonetisation to hurt activity in December as well.

## CRISIL

The immediate impact hike in CRR will cause liquidity to tighten and send bond yields on a northward blip. However, more liquidity is expected to make way into the banking system in the coming days in the aftermath of demonetisation, which will ease the pressure on yields. Also, the move, as the RBI said, is 'purely temporary' and will be reviewed over the coming fortnight.

The other impact is on interest rate transmission. Banks could delay cutting their lending rates given that they have promised at least 3-4% interest rate to savings account depositors, but will be not be receiving any interest on the deposits impounded for CRR.

Since the last monetary policy review in October, the downside risks to growth have risen and that to inflation have subsided. The fall in the value of rupee could exert some upward pressure on the imported component of inflation. We believe the odds are in favour of a 25 bps repo rate cut to 6%.

**CARE RATINGS**

The expectation so far has been that the RBI will lower the repo rate aggressively in the December policy by 50 bps. This may be deferred till stability is achieved in the system. Depending on further RBI action or announcements in the period running up to the policy, our expectation on rates would be moulded.

**EDELWEISS RESEARCH**

We foresee a 25-50bps cut in repo rate in the forthcoming monetary policy review on December 07, 2016. We lean towards a 50bps cut for the simple reason that even before demonetisation we were seeing the rising possibility of 50bps cut spread over the next two - three policy reviews, given that the RBI had lowered its assessment of neutral real rate and inflation was expected to be lower than RBI's indicative trajectory. However, post demonetisation, near term risks to both inflation and growth are tilted towards the downside. Thus, we think, it makes sense to front-load the monetary easing to limit the downside from demonetisation.

**ICICI SECURITIES**

In terms of the monetary policy signals, we do not believe any strong inferences are to be drawn from a cut in CRR. After all, the RBI itself expects the recourse to this measure to be temporary. We retain our assumption that RBI will cut the benchmark repo rate by 25bps to 6%, while highlighting the downside risks to its growth projections. RBI is unlikely to force pedal to the metal thereafter in our view even as the scale and durability of the negative growth shock is still to be known.

Our underlying assumption is that Government is more likely to boost its expenditures, helped by the potential distribution of substantially higher dividend from the RBI, even as the quantum as well as the mechanics of distribution is far from certain at this stage.

*(Business Standard)*