RBI MPC Minutes: Staying the course in choppy waters

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Key takeaways: Minutes of RBI MPC meeting, August 2024

- At its bi-monthly meeting held in August 2024, the RBI MPC held the policy repo rate at 6.50%, and the stance at 'withdrawal of accommodation' with 4:2 majority vote. Two external members continued to vote for a change in stance to 'neutral' and a rate cut of 25bps, while the remaining members voted to maintain status quo in policy settings. The meeting marked the last one for the three external members, as they complete their term, with new appointments to be announced before the MPC meets again in October.
- The minutes of the August MPC meeting show concerns of MPC members around the persistence of food inflation, with risks of i) spill overs to other components of the CPI basket, ii) de-anchoring of households' inflation expectations, iii) the resultant delay in alignment of the headline print to the RBI target.
- The MPC members leaning towards policy changes versus the ones preferring status-quo mainly differ in their views regarding the economy's growth being above or below potential. The status quo-ists are sanguine about the economy's growth momentum and believe that it is providing the policy space needed to focus on the MPC's inflation mandate. On the other hand, members voting for changes to policy hold a cautious view and note the recent softening in consumer and business sentiments.
- What also differentiates the two camps within the MPC is the approach to policy making. The hawks focused on inflation seem to favor data dependent decision-making. On the other hand, the members voting for a rate cut appear inclined to the need to be forward-looking and base decisions on expected future outcomes.
- The US Federal Reserve is expected to start easing at its upcoming FOMC meeting in September. Among other factors, the Fed pivot could provide policy space to EM central banks to lower rates.
- Irrespective of global factors, domestic conditions could facilitate fine-tuning of policy, if food inflation eases more than expected. The MPC meeting in October would be too early to envisage changes to policy settings, as the committee members might prefer to gain more clarity on food price outcomes and move past the statistically-induced lower inflation expected in Q2-FY25.
- At the time of December meeting, the MPC will have information on CPI print for one month of Q3 (October), and Q2-GDP. In case of CPI, base effect is favorable for October, though momentum typically tends to be higher than in September. Depending on how these growth-inflation dynamics evolve, unless growth undershoots the MPC estimate of 7.2% for Q2-FY25, the MPC will mostly prefer to wait and watch. Actual changes seem more probable in February, when the expected rebound in Q3 CPI print is behind us.
- The upward revision to the economy's natural rate of interest, as per the central bank's latest update, indicates room for a shallow easing cycle of not more than 50bps, starting with a 25bp cut in February. Among other factors, risks to this view include changes to the MPC. Apart from the external members' term ending, Governor Das' and Dr. Patra's tenures also conclude in December and January, respectively.

Staying the course in choppy waters

At its bi-monthly meeting held in August 2024, the RBI MPC held the policy repo rate at 6.50% for the ninth straight meeting, and the stance at ‘withdrawal of accommodation’ with 4:2 majority vote. The voting pattern was unchanged from the previous meeting, with two external members – Prof. Jayanth R. Varma and Dr. Ashima Goyal continuing to vote for a change in stance to ‘neutral’ and a rate cut of 25bps. The remaining members of the MPC voted to maintain status quo for both stance and the policy rate. The meeting marked the last one for the three external members, as they complete their term, with new appointments to be announced before the MPC meets again in October.

Concerns over persistent food inflation: The minutes of the August MPC meeting show recurring concerns of MPC members around the persistence of food inflation, with probable risks of i) spill overs to other components of the CPI basket, ii) de-anchoring of households’ inflation expectations, and iii) the resultant delay in alignment of headline inflation to the RBI target. Where there is no evidence yet on spillovers to core inflation from food price spikes, urban households’ near-term and one-year ahead inflation expectations ticked up in the latest two rounds of the RBI surveys, This could be attributable to the fact that households tend to focus on food prices while evaluating inflation, as also stated by MPC member Dr. Ranjan, while explaining the rationale of the MPC’s mandate to target the headline and not simply core inflation. In an encouraging sign though, results from the latest RBI Survey of Professional Forecasters (SPF) show that median estimates for both core and headline inflation for FY25 were stable in the latest two rounds. Also, headline inflation forecasts from the RBI MPC and the SPF survey are aligned at 4.5%.

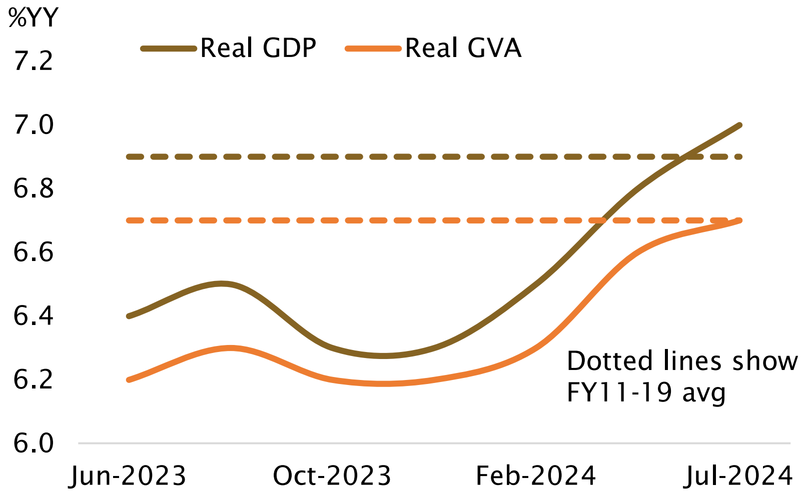
Hopes of moderation in food prices and the subsequent boost to rural consumption largely hinge on a favorable monsoon outturn. The progress in rains, Kharif sowing, and reservoir levels, so far, bode well for farm output prospects. However, the associated risks need to be watched out for in terms of the distribution of rainfall or any adverse climate events, particularly in a scenario where core inflation seems to have bottomed out. To deal with these uncertainties, the status-quo MPC members seem to be adopting a data-dependent approach, as they await the food-induced volatility in the headline print to abate. Latest quarterly forecasts from the MPC show expectations of CPI to resurge to 4.7% in Q3-FY25 after the statistically-induced easing in Q2, before moderating to 4.3% in Q4. The sub-4.5% print penciled in for the last quarter of the current fiscal, and (hopefully) receding food inflation risks could provide the MPC some scope to fine-tune policy settings, particularly in the backdrop of softening consumer and business confidence, as indicated in the latest RBI surveys.

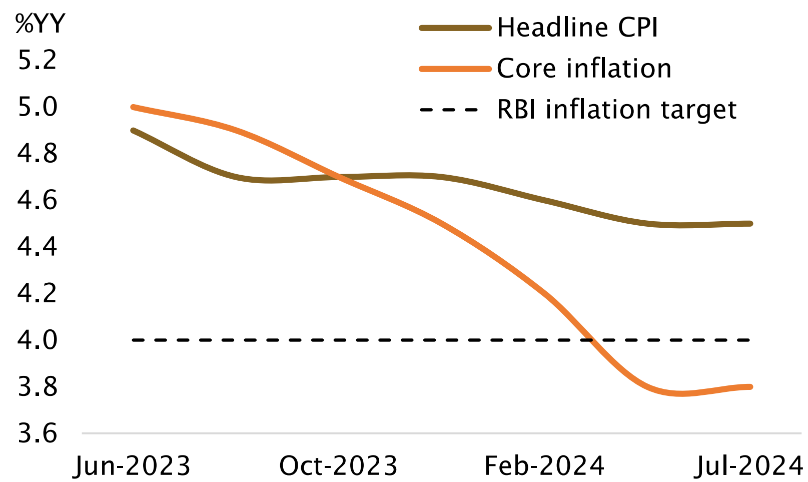
Concerns over stubborn food inflation, divergent views on growth

Divergent views on growth: The MPC members leaning towards policy changes versus the ones preferring status-quo mainly differ in their views regarding the economy's growth expected to be above or below potential. For instance, in the latest MPC minutes, Dr. Patra noted that the output gap had turned positive, implying that the actual output is above the economy's potential that could require vigil on aggregate demand conditions. However, in a recent television interview, the three external members of the MPC concurred that the current demand conditions in the economy might not be able to push growth beyond 7%. External member Dr. Bhide, while remaining in the status-quo camp and projecting a balanced view in the minutes, held 'cautious optimism' regarding the GDP growth estimate of around 7% for FY25. Dr. Goyal noted that low core inflation indicates that despite being strong, growth is below potential. Both Dr. Goyal and Prof. Varma pointed to softening signals for growth based on the latest central bank surveys, and the MPC's downgrade of GDP growth forecast for Q1-FY25.

On the other hand, the status quo-ists are sanguine about the growth momentum and believe that it is providing the policy space needed to focus on the MPC's inflation mandate. At its latest meeting, though the MPC cut Q1 growth estimate, it kept forecast for the fiscal year unchanged after raising it by 20bps to 7.2% in June. The median forecasts for FY25 real GDP growth in the SPF surveys have been on a upward trajectory, and in fact, in the latest round, touched the 7% mark for the first time since the survey for the fiscal year began in June 2023.

Median forecasts for FY25 from RBI's latest SPF surveys are above average for real GDP and stable for inflation





Differences in policy making: data dependent vs forward looking

Differences in approach to policy making: In addition to the divided views on growth, what also differentiates the two camps within the MPC is the approach to policy making, irrespective of their focus areas. While accounting for risks and forecasts, the hawks focused on inflation seem to be leaning towards cautious, data dependent decision-making. On the other hand, the members voting for a rate cut appear inclined towards the need to be forward-looking and base decisions on expected future outcomes. This was underscored in Dr. Goyal's views and also came up in Prof. Varma's assessment of the ex-ante real rate estimate.

This brings back into focus the debate on the neutral rate of interest for the economy. Dr. Patra noted that the RBI's latest study showing an increase in the natural rate indicated that the current monetary policy settings were appropriate, requiring no further tweaks. Governor Das reiterated that policy changes cannot be based on the concept of equilibrium natural interest rate that is 'an abstract, theoretical and model specific construct which is unobservable and time varying.' However, the two external members voting for changes to policy remained emphatic that the current settings were restrictive and could hold back the economy from attaining higher growth. The two members also concurred that focusing on the growth objective was relevant in the context of tapping into the economy's demographic dividend.

Outlook: The MPC members noted the divergences in monetary policies across the globe, with some central banks starting to ease amid growth concerns, while others opting to wait for inflation to glide to their respective targets. There are also central banks that are tightening or remain hawkish as price pressures remain stubborn. The financial market pricing of policy moves remains volatile and sensitive to incoming data.

Even as central banks in advanced economies have started to ease, the pace and extent remains uncertain and data dependent. In a key pivot, the US Federal Reserve is expected to ease at its upcoming FOMC meeting outcome due on September 18. In the post-policy conference held in July, Chair Powell indicated that September rate cut was on the table, and this was also reiterated in the FOMC meeting minutes and at the Jackson Hole Symposium held last week. The start of easing by the Fed could provide policy space to central banks in the emerging markets to lower rates.

Irrespective of global factors, domestic conditions could facilitate fine-tuning of policy. In minutes of the latest MPC meeting, Dr. Ranjan noted that more than expected easing in food inflation 'could open up the window for monetary policy to change its course.' But as indicated by Prof. Varma, who voted for a rate cut, it

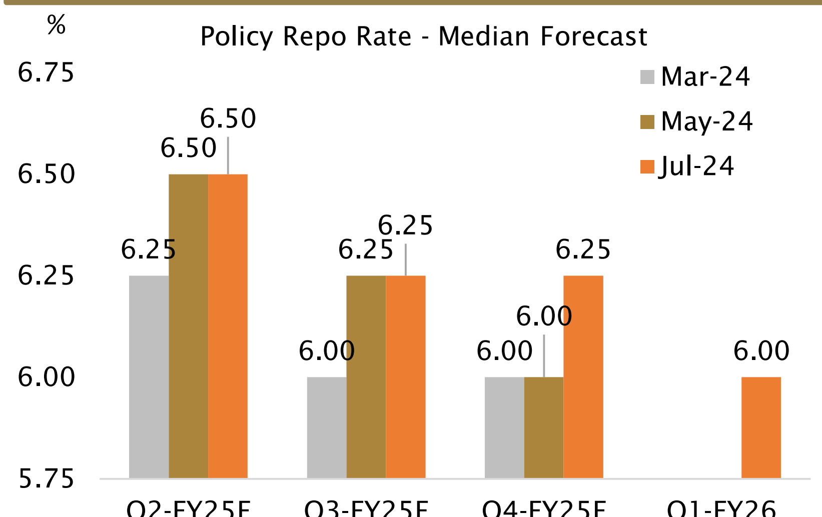
RBI MPC likely to fine-tune policy but with caution

would be prudent to move cautiously in the direction of easing.

The RBI MPC might prefer to adopt a wait and watch approach before tweaking policy, as it awaits clarity on the monsoon outturn and the subsequent developments in food prices. The core inflation trajectory warrants monitoring, as it is expected to gradually firm up in the remainder of the fiscal year. As per the MPC estimates, headline CPI is expected to ease to 4.3% in Q4-FY25, following by a mild uptick to 4.4% in Q1-FY26. The sub-4.5% prints could provide the MPC some headroom to fine-tune the policy rate. The SPF survey shows expectations of a 25bp cut in Q3-FY25, which is unchanged from the previous round. However, the median forecast of the next 25bp cut has been pushed back a quarter to Q1-FY26 in the latest round.

It could be a cautious balancing act for the MPC, if it needs to cushion against any downside risks to growth. The recent signs of weakness in consumer and business sentiments, as indicated by the RBI surveys, need to be watched out for, but so do households' rising inflation expectations. The meeting in October would be too early to envisage changes to policy settings, as the MPC might prefer to get clarity on food inflation outcomes and move past the statistically-induced easing in inflation expected in Q2-FY25. At the time of its meeting in December, the MPC will have information on CPI print for one month of Q3 (October)), and also Q2 GDP. In case of CPI, base effect is favorable for October, though momentum typically tends to be higher than in September. Depending on how these growth-inflation dynamics evolve, unless growth undershoots the MPC estimate of 7.2% in Q2-FY25, the MPC will mostly prefer to wait and watch. Actual changes seem more probable in February, when the expected rebound in Q3 CPI print is behind us. The upward revision to the economy's natural rate of interest, as per the RBI's latest update, indicate room for a shallow easing cycle of not more than 50bps, starting with a 25bp cut in February. Risks to this outlook include changes to the MPC committee. In addition to the external members' term ending, Governor Das' and Dr. Patra's tenures also conclude in December and January, respectively.

RBI SPF survey shows shallow, protracted rate cut cycle



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