RBI MPC Minutes: A tug of war between proponents of growth versus inflation

June 27, 2024

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Key takeaways: Minutes of RBI MPC meeting, June 2024

At its bi-monthly monetary policy meeting held in June 2024, the RBI MPC held policy repo rate at 6.50% for the ninth straight meeting and kept policy stance unchanged at 'withdrawal of accommodation.' However, there was a change in the voting pattern, with an additional member voting for change in stance to 'neutral' and a policy rate cut of 25bps. The inflation forecast for FY25 was unchanged at 4.50%, while GDP growth forecast was raised to 7.2% from 7.0%. The minutes of the meeting suggest that the dissenters are worried that the current policy rate is restrictive and could entail growth sacrifice at some point. The members voting for status quo remain concerned about the 'disappointing' speed of easing of inflation, spillover of food inflation to other pockets of the inflation basket, and de-anchoring of inflation expectations. In some of the recent media events, the RBI Governor expressed his reservations on 'adventurism' on the monetary policy front and brushed off concerns regarding elevated rates impeding growth prospects. With majority of the MPC members preferring to maintain status quo, the central bank could continue to focus on use of liquidity management tools rather than explicit adjustments to policy stance and rates. The MPC could continue to wait and watch, at least till the point it gains confidence that the growth-inflation balance necessitates changes to policy. That could happen if either inflation or growth undershoot, the evidence on which could take time to manifest, so that fine-tuning of policy, if any, is more probable in H2-FY25. By that time, there would be more clarity on actual monsoon outturn, Union Budget and the fiscal math, and likely Fed policy pivot.

Change in voting pattern at June RBI MPC meet

Date	Change in repo rate	Repo	SDF	MSF	Voting pattern Policy rate	Policy stance	Voting pattern Policy stance
08-Feb-23	0.25	6.50	6.25	6.75	4:2#	WoA	4:2
06-Apr-23	0.00	6.50	6.25	6.75	6:0	WoA	5:1
08-Jun-23	0.00	6.50	6.25	6.75	6:0	WoA	5:1
10-Aug-23	0.00	6.50	6.25	6.75	6:0	WoA	5:1
06-Oct-23	0.00	6.50	6.25	6.75	6:0	WoA	5:1
08-Dec-23	0.00	6.50	6.25	6.75	6:0	WoA	5:1
08-Feb-24	0.00	6.50	6.25	6.75	5:1*	WoA	5:1
05-Apr-24	0.00	6.50	6.25	6.75	5:1	WoA	5:1
07-Jun-24	0.00	6.50	6.25	6.75	4:2**	WoA	4:2

WoA: Withdrawal of accommodation; # Two MPC members voted against hike
* One MPC member voted for 25bp cut; ** Two MPC members voted for 25bp cut

Increasing divide within members on inflation vs growth objective

At its bi-monthly monetary policy meeting held in June 2024, the RBI MPC held policy repo rate at 6.50% for the ninth straight meeting and kept policy stance unchanged at 'withdrawal of accommodation.' However, there was a change in the voting pattern within the committee to 4:2 from 5:1, with an additional member (Dr. Ashima Goyal) joining Professor Jayanth Varma in voting for change in stance to 'neutral' and a 25 basis point (bp) cut in the policy repo rate. Remaining four MPC members continued to vote for status quo on policy rate and stance.

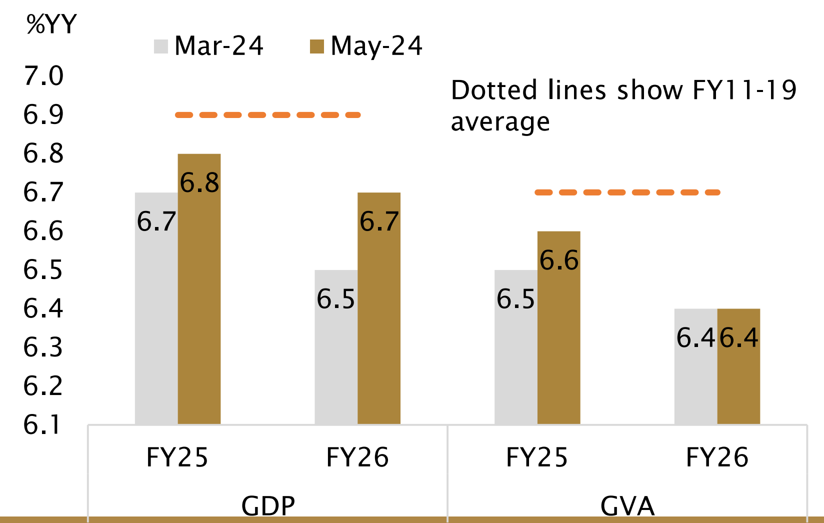
The change in voting pattern was unsurprising based on the assessment of previous MPC meeting minutes. While the MPC members voting for status quo remain unwaveringly focused on the objective of aligning inflation to the central bank's 4% target on a durable basis, the dissenters are inclined towards focusing on attaining a balance between the RBI's growth and inflation objectives. They are of the view that the current policy rate is restrictive, the real interest rate is above neutral, and that could hurt growth in the economy at some point.

While an update to the central bank's assessment of neutral or natural rate of interest for the economy could provide guidance for assessment of future policy path, the fact is that RBI's in-house model estimates for real GDP growth in its latest monthly bulletin indicate moderation in growth in both FY25 and FY26 from 8%+ attainted in FY24. In fact, median forecasts on real growth from RBI's survey of professional forecasters (SPF) suggest growth in both fiscal years to remain below the pre-pandemic average in terms of both GDP and GVA. If these forecasts manifest, it would defy the RBI's assessment of the economy taking off on a higher growth trajectory post-pandemic.

Higher rates could constrain growth in FY26

Real GDP forecasts (%YY)	FY25	FY26
Monetary policy report (Apr)	7.0	7.0
Monetary policy committee (Jun)	7.2	-
RBI bulletin (Jun)	7.6	6.4
Survey of professional forecasters (May)	6.8	6.7
Pre-pandemic real GDP growth average (FY11-19): 6.9		

Forecasts from RBI's Survey of Professional Forecasters



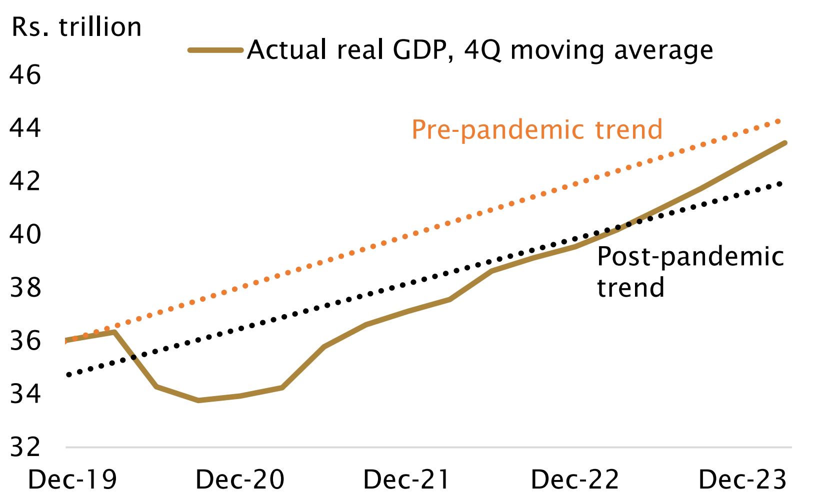
Growth likely to be lower than pre-pandemic average in FY25-26

As noted by some of the MPC members themselves, even at present, the economy is probably growing below potential as reflected by soft core inflation and low current account deficit despite high real GDP growth rates. In fact, in terms of levels, real GDP is still catching up with the pre-COVID trend. This lends credence to the dissenters' concerns that growth could underperform in the absence of fine- tuning of policy rates and stance.

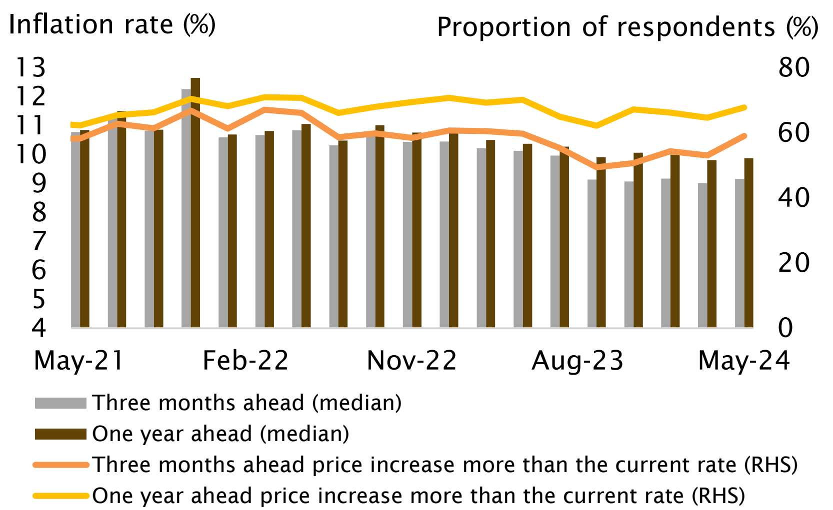
The MPC members focused on inflation reaching target on a sustainable basis expressed concerns along these lines: 1) recurring shocks to food inflation that could spill over to other components of CPI 2) resurgence of headline inflation above its 4% target in H2-FY25, post the soft statistical patch expected in Q2-FY25 3) de-anchoring of inflation expectations, which saw an uptick in the latest round of RBI's bi-monthly survey.

In the latest round of survey on households' inflation expectations in May, there was an uptick in three-month and one-year ahead inflation expectations. The maximum increase in the percent of respondents expecting higher inflation three months ahead was in case of food products. Similarly, in the latest round of consumer confidence survey, there was an increase in the percent of respondents indicating an increase in current and one-year ahead spending on essential items.

Real GDP level yet to catch up to pre-pandemic trend



RBI's inflation expectations survey of households

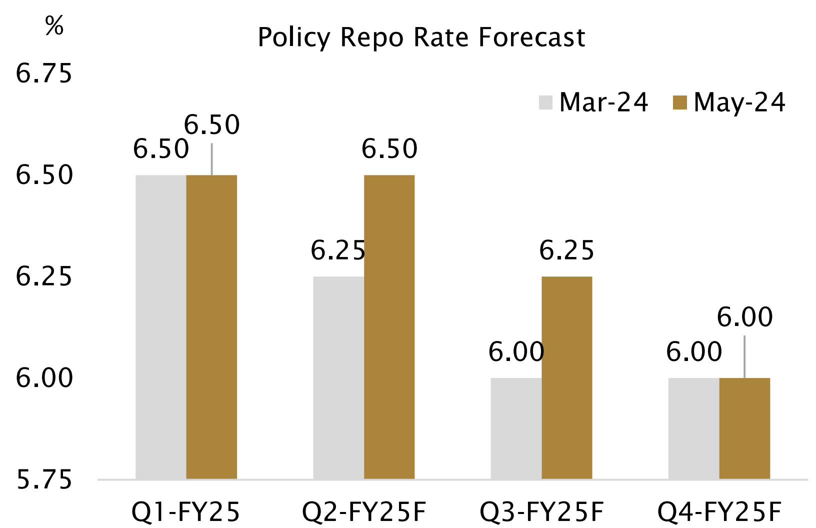


Inflation undershoot in FY25 could give room to fine-tune policy

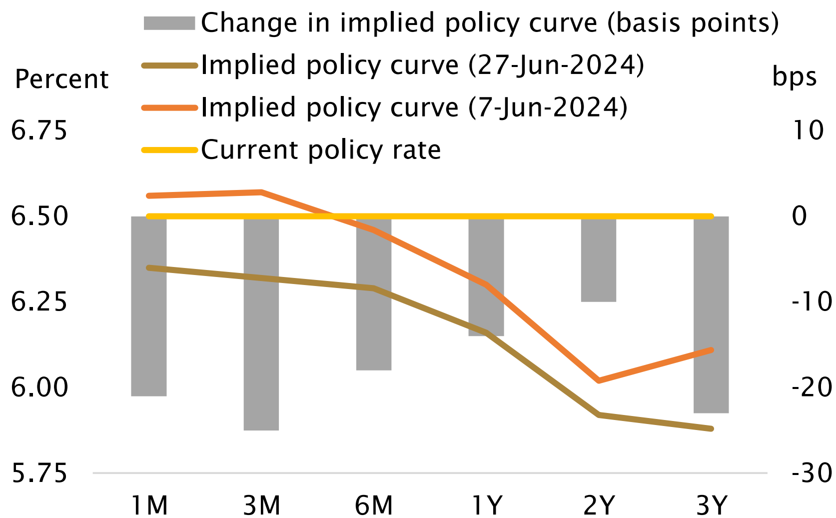
The RBI MPC expects inflation to average 4.5% in FY25. However, the central bank's in-house model estimates, published in both March and June bulletin, indicate inflation to undershoot at 4.4%. Latest actual inflation data for the months of April and May indicate a possibility of inflation undershoot in Q1 as well. While some members of the MPC have expressed concerns regarding inflation resurging post the 'statistical soft patch' in Q2, an undershoot for the full year could give the committee some leeway to fine-tune policy stance and rates that support growth in FY26.

In RBI's survey of professional forecasters (SPF) conducted in March, economists had penciled in two 25bp cuts in FY25, one each in Q2 and Q3. In the latest round in May, while the number and extent of rate cuts was unchanged, there was a push back in timing by one quarter to Q3 and Q4 of the current fiscal year. In terms of market expectations, there has been a softening bias since the latest MPC meeting. However, pricing remains hawkish relative to SPF survey of around 20bp rate cut six months ahead and less than 50bp one year ahead.

Forecasts from RBI's Survey of Professional Forecasters



Market implied policy curve

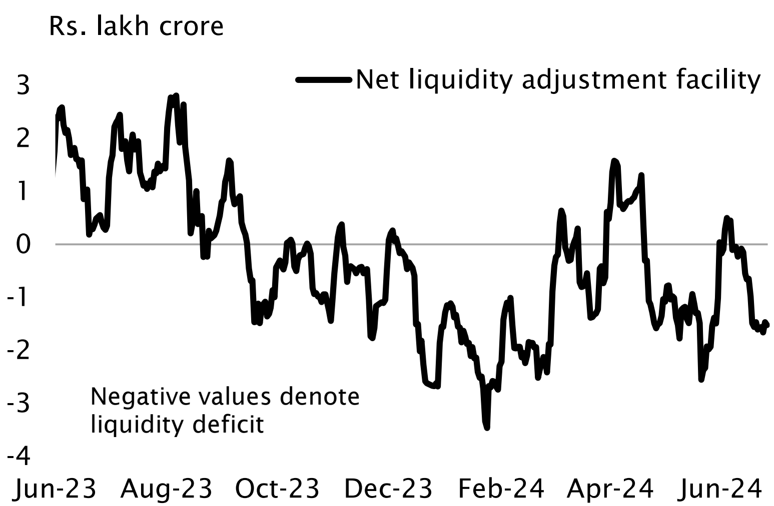


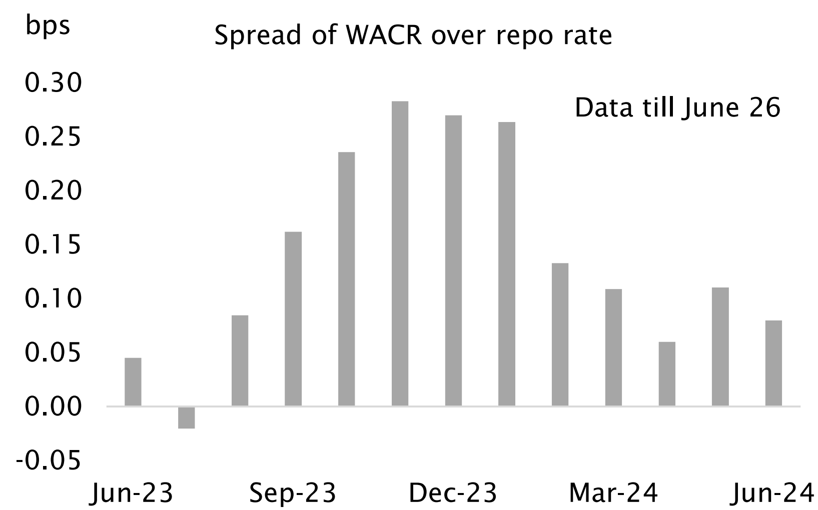
Outlook and policy implications

The majority of MPC members remain inclined to maintain status quo, as the current growth momentum in the economy gives space to the central bank to focus on aligning inflation to target. While addressing media in some recent events, RBI Governor Shaktikanta Das, stated that it would be too premature to change policy stance and noted that concerns of elevated interest rates impeding growth are misplaced.

In the MPC minutes, one of the members (Dr. Rajiv Ranjan) noted that "even though the repo rate has been kept unchanged since February 2023, several policy actions on liquidity, transmission and communication have played out to stabilise the economy further". This does reflect in data, and in the central bank's two-way operations to manage liquidity. The spread of weighted average call rate (WACR), which is the operating target of monetary policy, over the repo rate continues to remain low relative to the levels in Q2 and Q3 of FY24, when headline CPI inflation was on an uptrend. This indicates that the central bank might prefer to continue fine-tuning policy via liquidity management tools, rather than explicit changes to stance and rates, at least till the point it gains confidence that the growth-inflation balance necessitates changes to policy. That could happen either if inflation or growth undershoot, the evidence on which could take time to manifest, so that changes to policy, if any, is more probable in H2-FY25. By that time, there would be more clarity on actual monsoon outturn, Union Budget and the fiscal math, and likely Fed policy pivot.

RBI could continue to focus on liquidity management tools for fine-tuning policy





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