RBI MPC delivers status quo policy with a slightly hawkish undertone

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Key takeaways: RBI MPC meeting, August 2024

The policy meeting held in Aug-2024 marked the ninth successive meeting of the RBI MPC where the committee maintained the policy repo rate at 6.50% and the stance of ‘withdrawal of accommodation’. The voting pattern of 4:2 was unchanged from the previous meeting for both the policy rate and stance, with Dr. Ashima Goyal and Prof. Jayanth R. Varma continuing to vote for a change in stance to ‘neutral’ and reducing the policy repo rate by 25 basis points.

The emphasis on the MPC’s focus on headline inflation, and not just the core component, as suggested by Ministry of Finance’s latest Economic Survey, added a slightly hawkish undertone to the policy statement.

The MPC kept the full year FY25 forecasts for growth and inflation unchanged at 7.2% and 4.5%, respectively, but with tweaks to quarterly projections. Forecasts for Q1-FY26 were introduced at 7.2% for real GDP growth and 4.4% for CPI inflation. In terms of quarterly estimates for FY25, the MPC raised Q2 and Q3 CPI inflation forecasts by 60bps and 10bps, respectively, while Q4 projection was trimmed by 20bps. In case of GDP, Q1 forecast was lowered by 20bps.

In the post policy conference, the Governor noted the improved resilience of the domestic economy in the context of potential external risks such as a slowdown in the US economy, and the fact that many multilateral organizations expected global trade to improve in 2024, which could act as a tailwind for the domestic economy.

Another highlight of the meeting was that even as the MPC reiterated the overall stability of the financial system, it also noted potential risks and challenges. Among these were 1) the persistent gap between credit and deposit growth that could create structural liquidity issues for banks, 2) continued high growth in certain segments of personal loans despite regulatory measures announced in Nov-2023, 3) misuse of top-up loans on housing and other collateralized loans 4) risks emanating from IT, cyber security, or third-party outsourcing arrangements for technology solutions.

FY25 outlook unchanged amid quarterly revisions

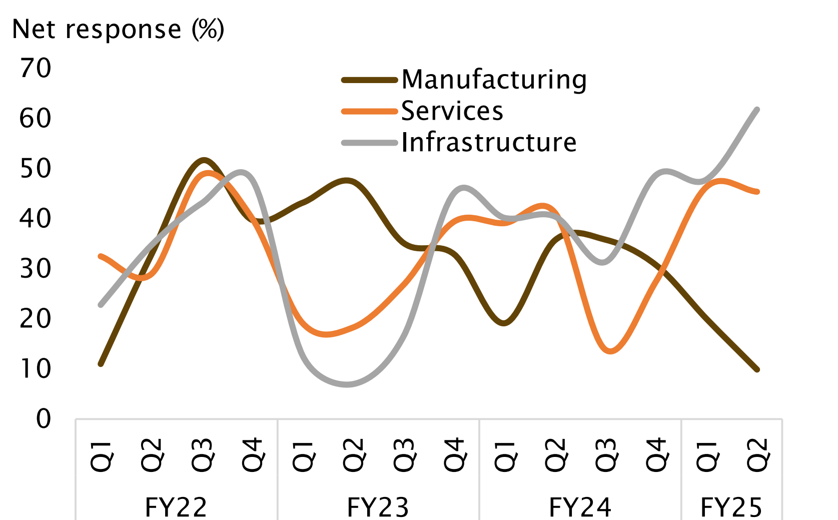
Real GDP %YY	Apr-24	Jun-24	Aug-24
Q1:FY25 F	7.1	7.3	7.1
Q2:FY25 F	6.9	7.2	7.2
Q3:FY25 F	7.0	7.3	7.3
Q4:FY25 F	7.0	7.2	7.2
FY25 F	7.0	7.2	7.2
Q1:FY26 F			7.2

CPI %YY	Apr-24	Jun-24	Aug-24
Q2:FY25 F	3.8	3.8	4.4
Q3:FY25 F	4.6	4.6	4.7
Q4:FY25 F	4.5	4.5	4.3
FY25 F	4.5	4.5	4.5
Q1:FY26 F			4.4

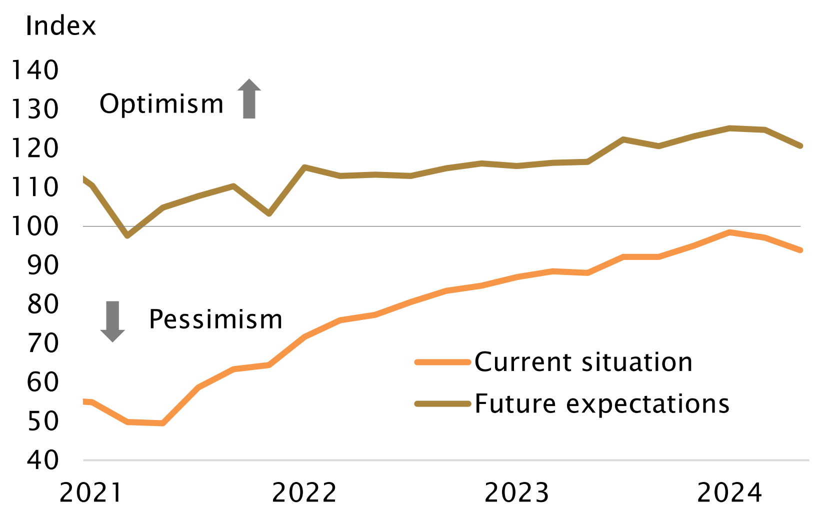
Slight moderation in growth outlook for Q1-FY25

- The moderation in MPC's Q1-FY25 GDP growth forecast was based on updated information from high frequency indicators that showed lower corporate profitability, general government expenditure and core industries output. Government expenditure was likely muted ahead of the general elections and is expected to pickup in the remainder of FY25. However, the RBI's latest round of surveys show mixed results regarding profit margins even in Q2, with muted expectations particularly in the manufacturing sector.
- After growing at a slower-than-expected pace in FY24, private consumption is expected to contribute more to growth in FY25. Even as urban spending is holding up and rural consumption is expected to improve, the RBI's consumer confidence indicators eased for the second straight round of survey in July. In the latest round, the only sub-category of the confidence indicators where sentiment deteriorated in case of both the current and future expectations pertained to the price level in the economy.
- However, as also noted in the policy statement, the ongoing progress in monsoon and Kharif sowing augurs well for rural demand. Investment activity is expected to pick up on the back of high capacity utilization, healthy balance sheets of banks and corporates, and the government's continued thrust on infrastructure spending. Improved global trade prospects is expected to support external demand.
- Escalation of geopolitical tensions, volatility in international commodity prices, geo-economic fragmentation would continue to pose risks to growth outlook.

Firms' expectations: profit margin



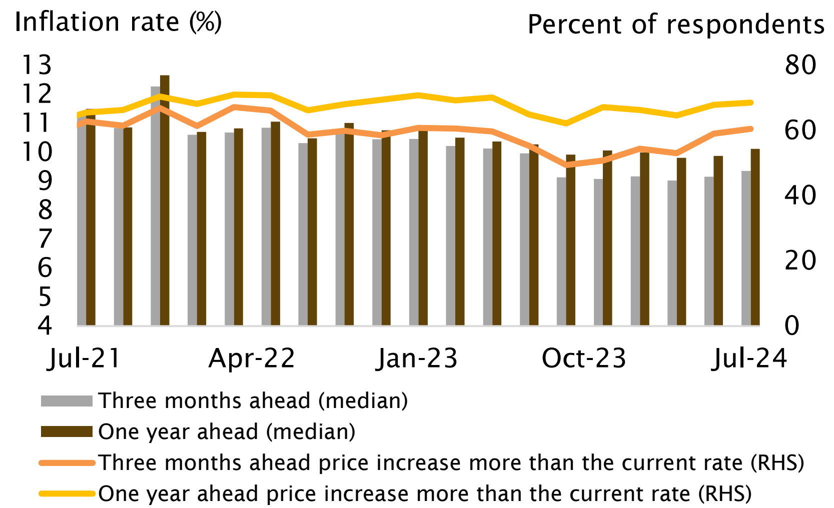
Consumer confidence survey



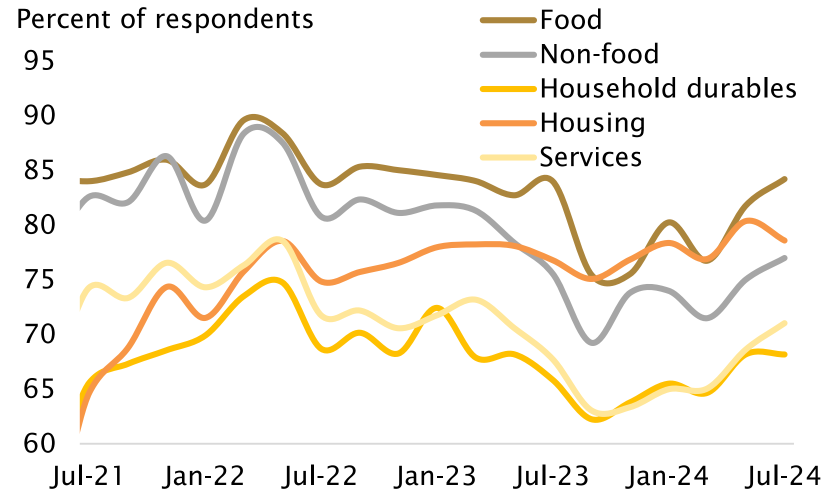
Inflation forecasts raised for Q2 and Q3-FY25, lowered for Q4

- The MPC raised inflation forecast for Q2-FY25 by 60bps, penciling in shallower softening despite favorable base effects, due to higher-than-expected price momentum, particularly in case of food items. The policy statement noted that there were indications of core inflation bottoming out, and that the revision in mobile tariff rates could lead to an increase in core inflation.
- The MPC stated that it could not afford to be complacent because of the fall in core inflation, as persistently high food inflation had raised households' inflation expectations, particularly in case of food items. This could have second round effects or spillovers to core inflation through increase in wages on cost-of-living considerations. Higher wages could, in turn, prompt firms to raise prices of goods and services, so that overall inflation could become sticky even if food prices decline.
- The uneven and slow progress in disinflation has prompted the RBI MPC to focus on its price stability goal, particularly when strong growth continues to provide the policy space to do so. Food inflation is expected to soften with the progress in monsoon and Kharif sowing, adequate buffer stocks of food grains, easing global food prices; even as adverse climate events and volatile commodity prices remain upside risks. Also, one of the latest RBI surveys shows higher selling prices in Q2-FY25 by services and infrastructure firms.
- However, as per the RBI's latest monetary policy report, alignment of headline inflation to its target in FY26 could provide RBI with some policy space for a shallow easing cycle that is expected to start in H2-FY25.

Households' inflation expectations



Expectations of price increase by category (3-month ahead)



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