RBI MPC likely to remain in risk minimization mode and maintain policy status quo at its April meeting

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RBI MPC likely to maintain status quo in a risk minimization mode

- The RBI MPC meeting held in February was the sixth in a row when the committee kept policy stance and rates unchanged. However, two outcomes stood out: the cautious tone of the policy that caught financial markets off guard and a dissent vote with one member favoring a 25bp rate cut.

- Since its last meeting, Q3-FY24 real GDP growth numbers surprised on the upside amid upward revisions to previous quarters' growth rates, indicating a near-8% growth for the financial year. CPI inflation stayed within the central bank's tolerance band with core inflation continuing to slide, but food inflation remained a challenge to the disinflation process. Banking liquidity turned to surplus briefly in March, enabling lowering of money market rates and the yield curve. However, liquidity conditions tightened again in the past couple of weeks due to advance tax and GST payment outflows. The central bank conducted an appropriate mix of VRR and VRRR auctions to manage the volatility in liquidity conditions. There still remains room for policy transmission from the 250bp hike since May 2022, particularly in case of lending rates.

- Despite increased prospects of a soft landing, the global economy exudes mixed cues. Stubborn core price pressures continue to push back policy easing by systemic central banks. Geopolitical disruptions are adding to supply chain pressures that could impinge on the disinflation process across economies and impair global trade recovery.

- **Against this backdrop, the Indian economy is expected to sustain its ongoing growth momentum, as indicated by the recent high frequency indicators such as the PMI indices. As per the RBI's latest monthly bulletin, its in-house baseline forecasts indicate higher GDP in FY25 than suggested at its February MPC meeting. The forecasts for CPI inflation, while projected to be fractionally lower for the entire financial year, indicate scope for policy easing that could start in Q2-FY25 at the earliest, with likely delay into H2. The central bank authors emphasized the need for monetary policy to remain in a risk minimization mode, as it nudges inflation towards the target, while sustaining growth momentum. Accordingly, in its first meeting for FY25 to be concluded on April 5, the MPC is expected to maintain status quo with respect to policy rates and stance, though further changes in voting patterns cannot be ruled out.**

Latest RBI CPI forecasts show scope for policy easing in Q2:FY25

- As per the central bank's latest bulletin, its in-house baseline projections indicate higher growth and lower inflation across quarters for FY25, except for Q2, where the forecast is lower for GDP (higher for CPI) compared to the February MPC meeting.

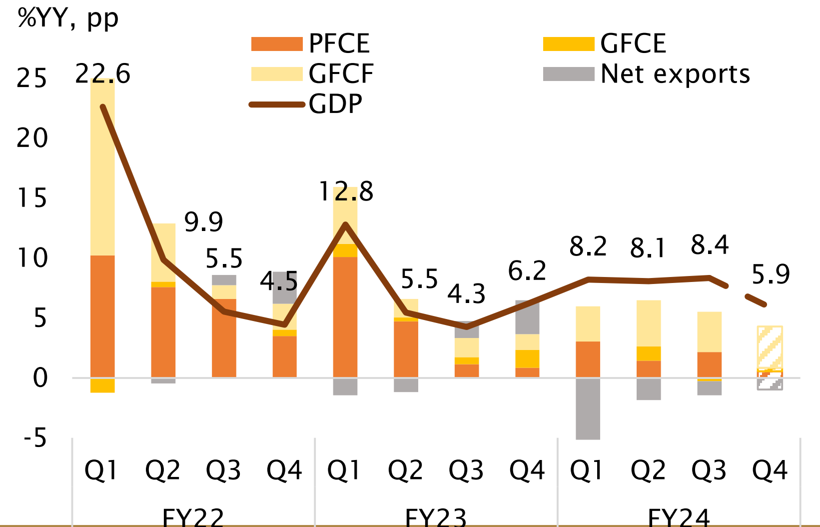
- **The latest forecasts suggest inflation to be low and stable in H2:FY25, and a continued downward trajectory for the fiscal year, which marks a difference from February MPC forecasts, and lends scope for policy easing that could start in Q2-FY25 at the earliest, with likely delay into H2.** The upward revisions in Q2-FY25 inflation forecasts probably account for the impact of the vagaries of the monsoon.

RBI forecasts CPI inflation to be stable in H2:FY25

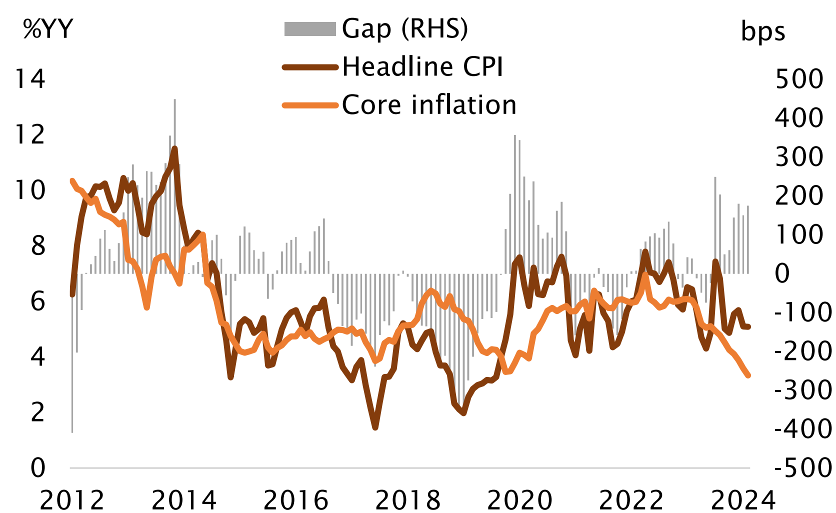
Real GDP %YY	Mar-24 Bulletin	Feb-24 MPC	Dec-23 MPC
Q1:FY25 F	8.1% (+0.9pp)	7.2 (+0.5pp)	6.7%
Q2:FY25 F	6.6% (-0.2pp)	6.8% (+0.3pp)	6.5%
Q3:FY25 F	8.0% (+1.0pp)	7.0% (+0.6pp)	6.4%
Q4:FY25 F	7.1% (+0.2pp)	6.9%	
FY25 F	7.4% (+0.4pp)	7.0%	

CPI %YY	Mar-24 Bulletin	Feb-24 MPC	Dec-23 MPC
Q1:FY25 F	4.7% (-0.3pp)	5.0% (-0.2pp)	5.2%
Q2:FY25 F	4.4% (+0.4pp)	4.0%	4.0%
Q3:FY25 F	4.3% (-0.3pp)	4.6% (-0.1pp)	4.7%
Q4:FY25 F	4.3% (-0.4pp)	4.7%	
FY25 F	4.4% (-0.1pp)	4.5%	

Real GDP growth likely to be closer to 8%YY in FY24



Core inflation below 4% for the third straight month in Feb



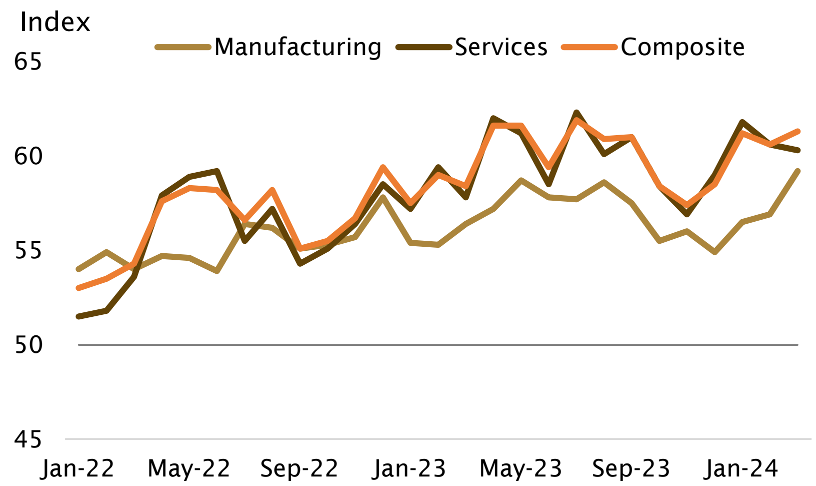
Continued policy vigilance required if food price shocks continue

- High frequency activity indicators such as the PMI remain buoyant, indicating continued growth momentum in Q4-FY24.

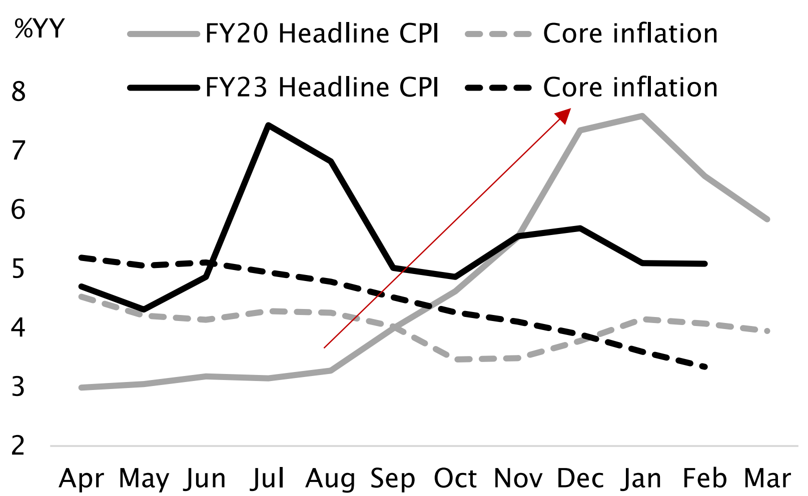
- However, inflation woes remain. In addition to elevated inflation in cereals, pulses and spices, lower seasonal easing in vegetable prices continued to impart pressure on food inflation in February.

- **Earlier experience from FY20 indicates such food price shocks could continue to roil CPI inflation despite easing core inflation.** In FY20, surge in onion prices drove headline inflation higher, necessitating policy vigilance and supply side intervention.

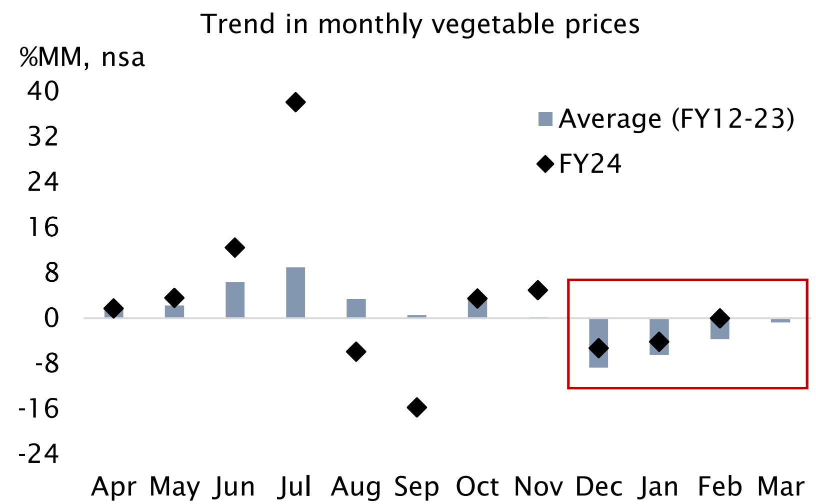
Economic activity indicators remain robust in Q4:FY24



Policy vigilance required despite easing core inflation



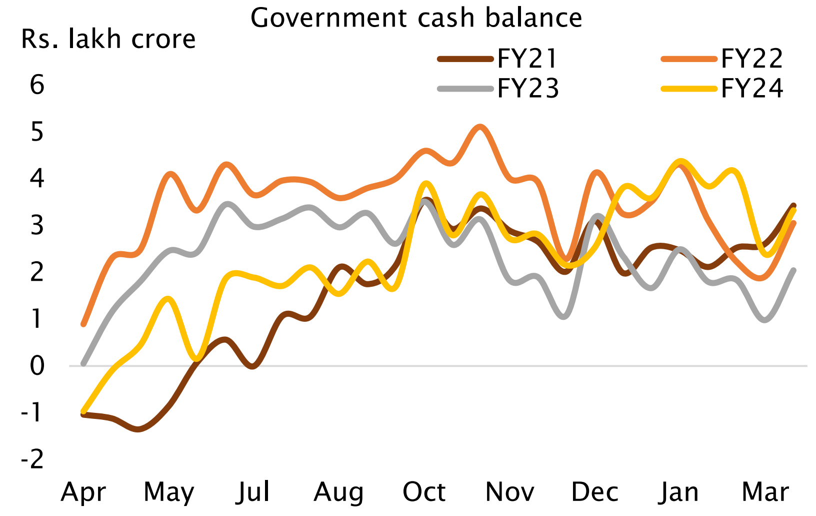
Seasonal easing in vegetable prices was lower in FY24



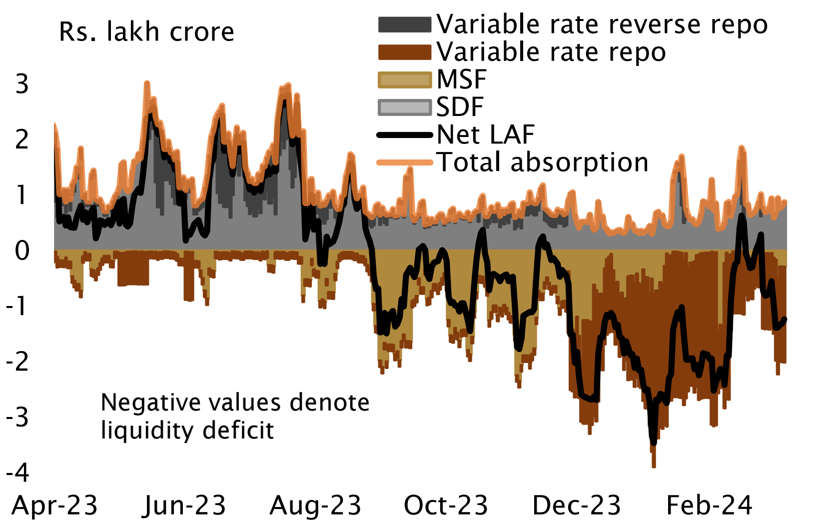
Liquidity back in deficit mode after briefly easing in March

- In March, liquidity conditions eased after almost three months, aided by year-end government spending. In its latest bulletin, the central bank noted that the return-leg of its USD-INR sell buy swap auction for USD5bn on March 8, 2022 also injected liquidity amounting to Rs. 42,800 crore on March 11, 2024. However, in the past couple of weeks, liquidity tightened again due to advance tax and GST payment outflows.
- The RBI conducted a mix of VRR and VRRR auctions to manage changes in liquidity requirements.
- Despite the volatility in system liquidity, core liquidity, net of government cash balances, continued to remain in surplus.

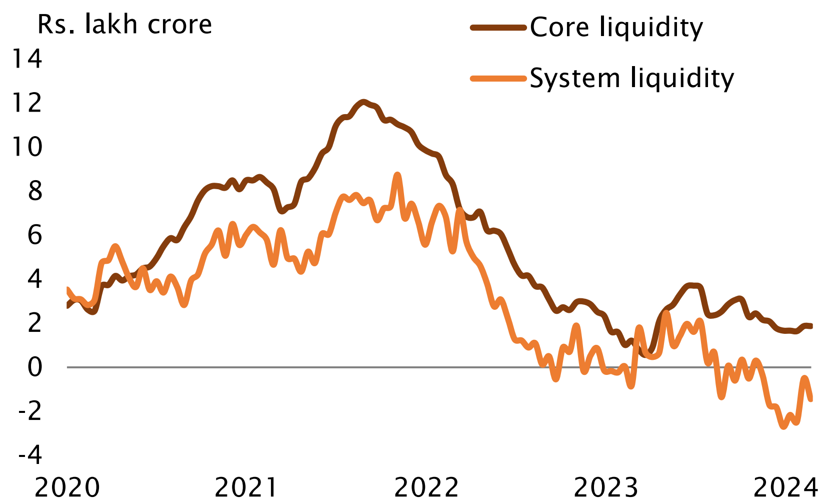
Government cash balances up again due to tax payments



System liquidity back in deficit mode after easing in March



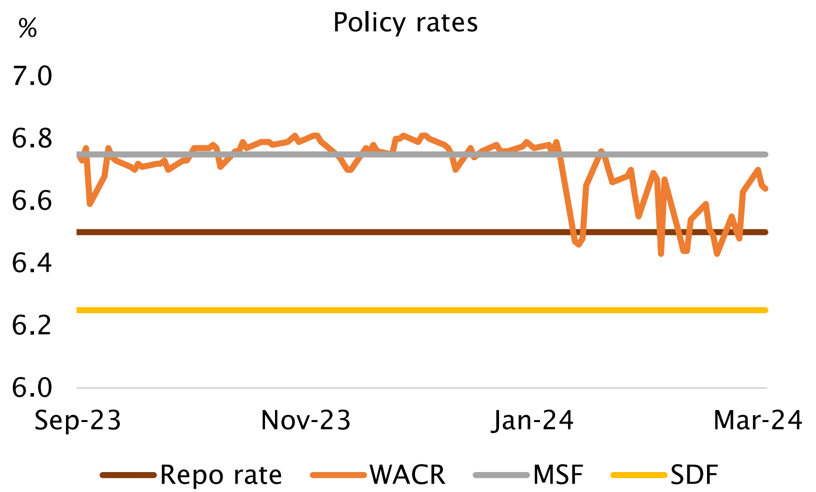
Core liquidity remains in surplus



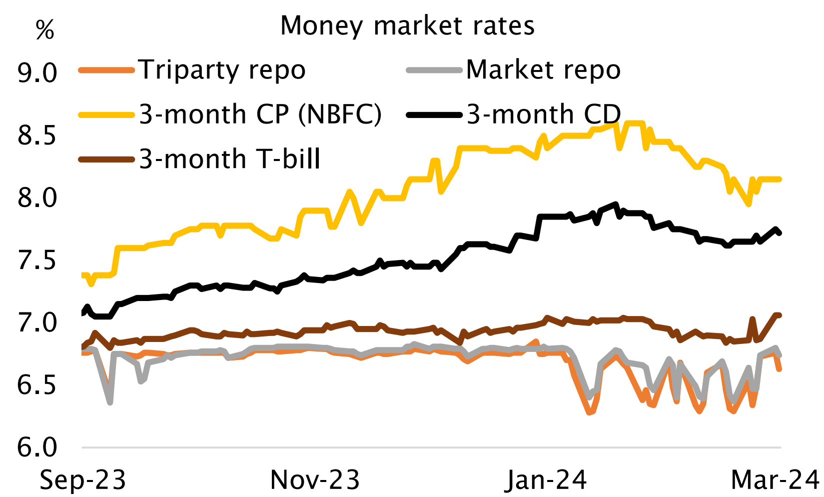
Interest rates softened in March due to easing liquidity conditions

- Reflecting the softening bias in liquidity conditions, interest rates eased in March, particularly at the front end of the yield curve.
- The spread of the WACR over the policy repo rate narrowed compared to February.
- In the term money segment, yields on 3-month CP eased in March before rising again towards the end of the month. Yields on 3-month CD were relatively firm.

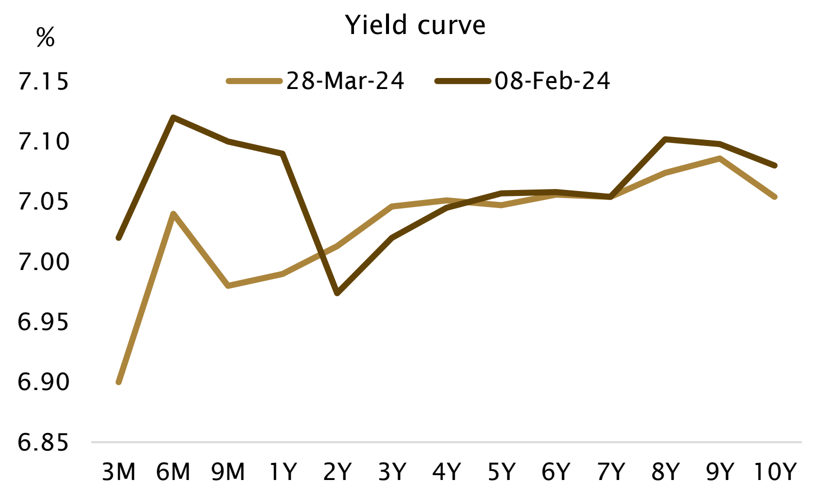
Weighted average call rate eased near the policy repo rate



Money market rates softened, reflecting liquidity conditions



Notable easing in front end of the curve since last MPC meet

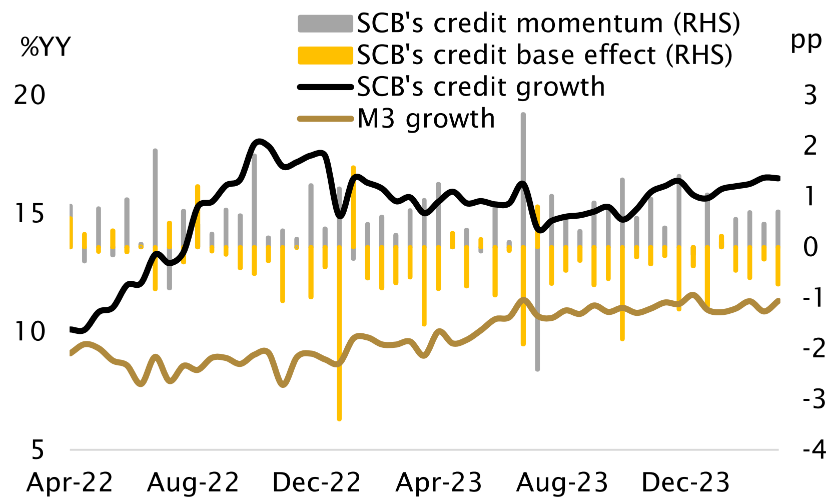


Credit growth continued to exceed aggregate deposits growth

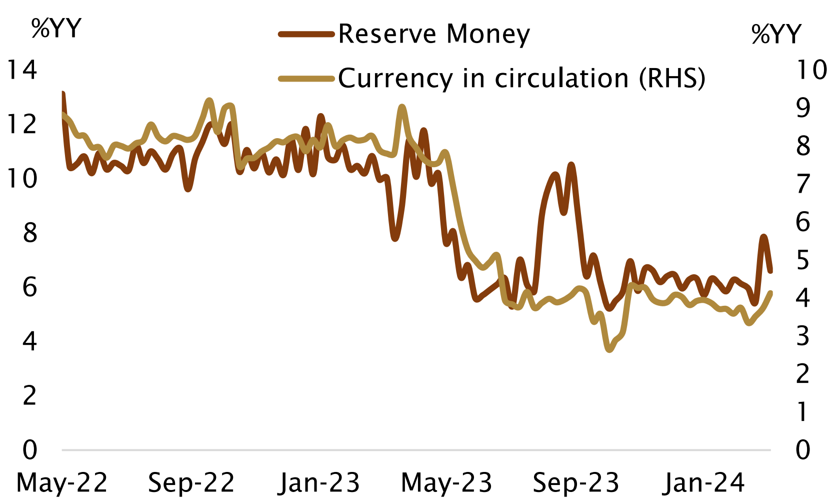
- As on March 22, 2024, reserve money recorded a growth of 6.6%YY (10.0% a year ago)..Growth in currency in circulation (CiC), the largest component of reserve money, eased to 4.1% from 7.8% a year ago, reflecting the withdrawal of Rs.2000 banknotes.

- As on March 8, 2024, money supply (M3) rose by 11.3%YY (9.6% a year ago). Scheduled commercial banks' (SCBs') credit growth stood at 16.5% (15.7% a year ago). Aggregate deposits with banks, the largest component of M3, increased by 13.7% (8.8% a year ago). SCBs' deposit growth (excluding the impact of the merger) remained in double digits in March 2024.

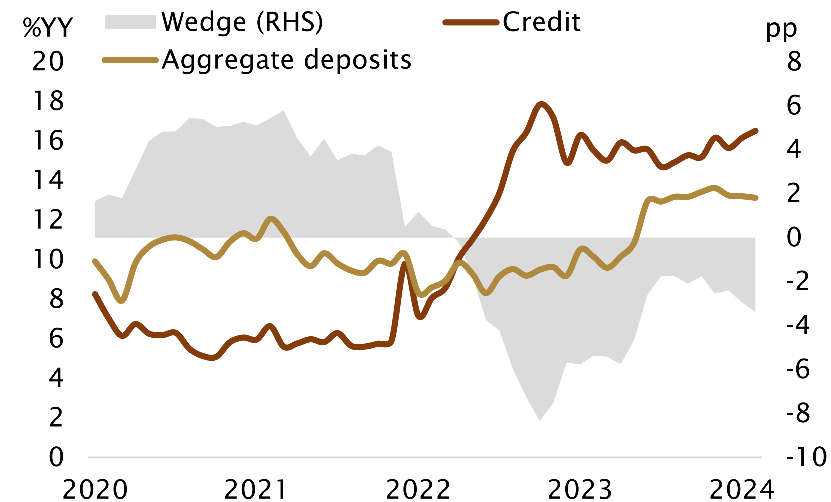
SCB's credit growth remained higher than a year ago



CiC continued to reflect impact of currency note withdrawal



Credit growth continued to exceed deposits growth in March



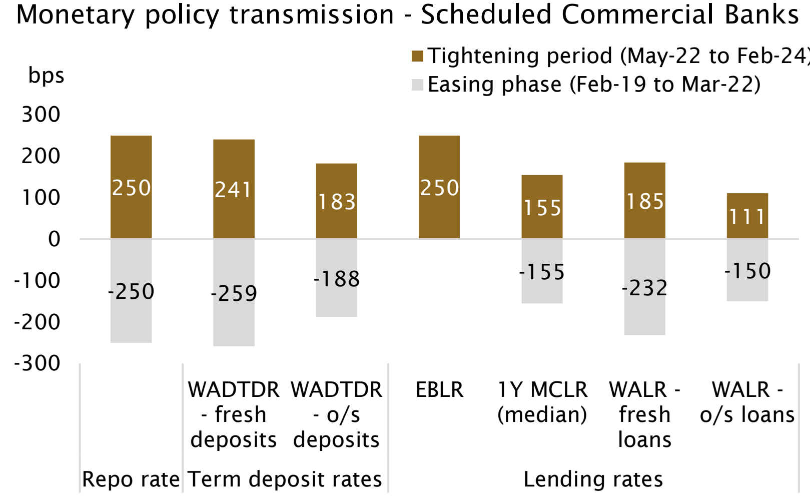
Scope remains for further transmission of previous rate hikes

- One of the reasons cited by the central bank MPC to maintain policy status quo at its previous meeting was the incomplete transmission of the 250bp rate hikes undertaken since May 2022.

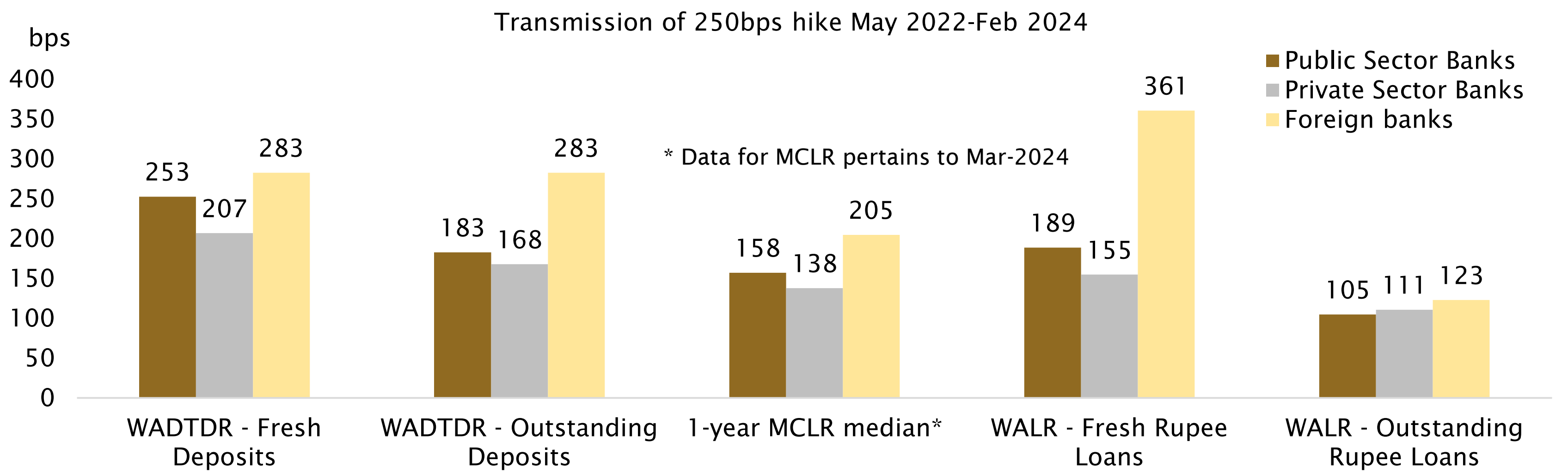
- While the transmission to deposit rates is relatively higher and comparable to an earlier equivalent easing cycle, there is scope for further transmission to lending rates, particularly outstanding loans.

- Transmission of policy rate hikes to lending and deposit rates in the current cycle has been the strongest in case of foreign banks, followed by public and private sector banks.

Transmission to lending rates lower than the previous cycle



Transmission of policy rate hikes remains the largest in case of foreign banks



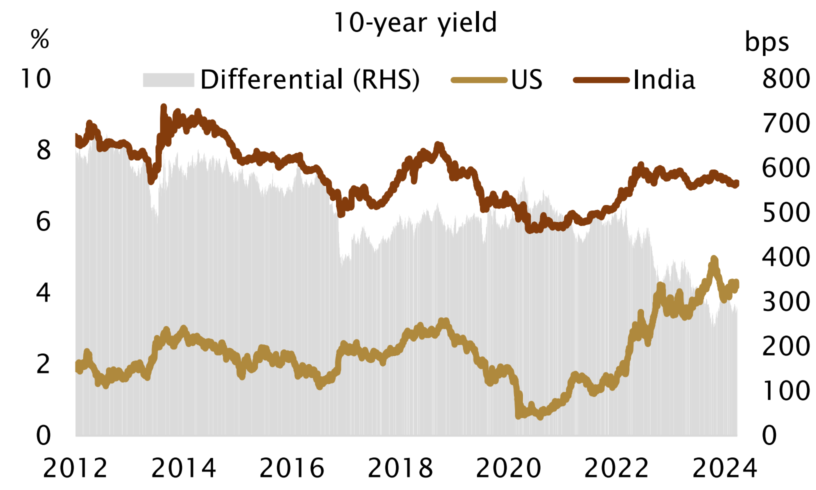
Major central banks remain cautious about start of policy easing

- While several central banks in Latin America already embarked on an easing path towards end-2023, most major central banks, particularly in advanced economies, remain cautious regarding an early start of an easing cycle amid relatively resilient economic data prints and still-elevated core inflation.

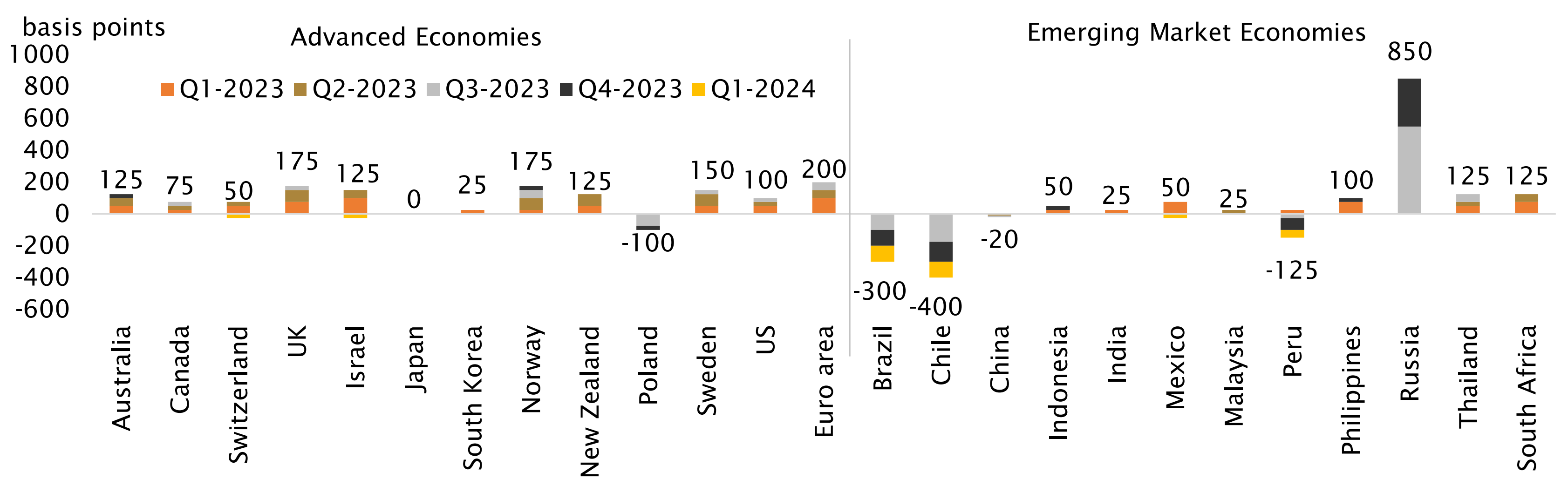
- There are exceptions though. Bank of Japan ended its negative interest rate cycle, while policy easing continues in China to support economic activity. In a surprise move in March, the Swiss National Bank cut its policy rate for the first time since June 2022.

- At its March meeting, the US Fed kept its policy unchanged, while continuing to pencil in three rate cuts in 2024 and raising GDP growth forecast.

US-India 10Y yield differential continues to narrow



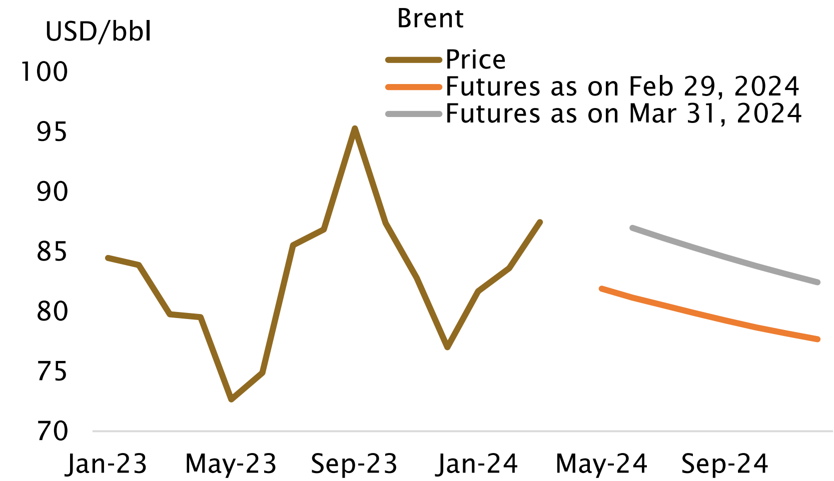
Central banks in most major advanced economies have held rates in recent months



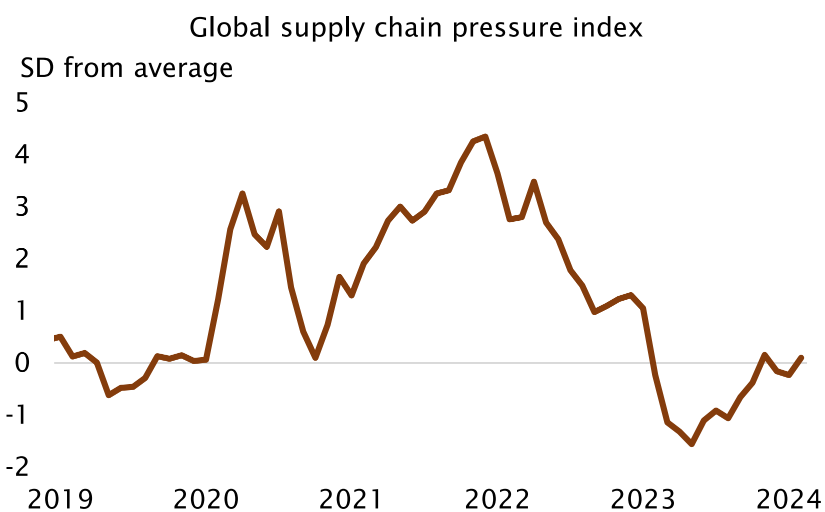
Geopolitical tensions add to central bank woes

- Geopolitical tensions in the Middle-East and extension of oil production cuts by OPEC+ to end-June have driven crude oil prices higher.
- The global supply chain pressure index also rose above its historical average levels in February, reflecting the impact of disruptions at the Red Sea. Continued geopolitical disruptions and/or further escalations could impair global trade recovery and derail the disinflation process across economies, thereby adding to central bank woes.

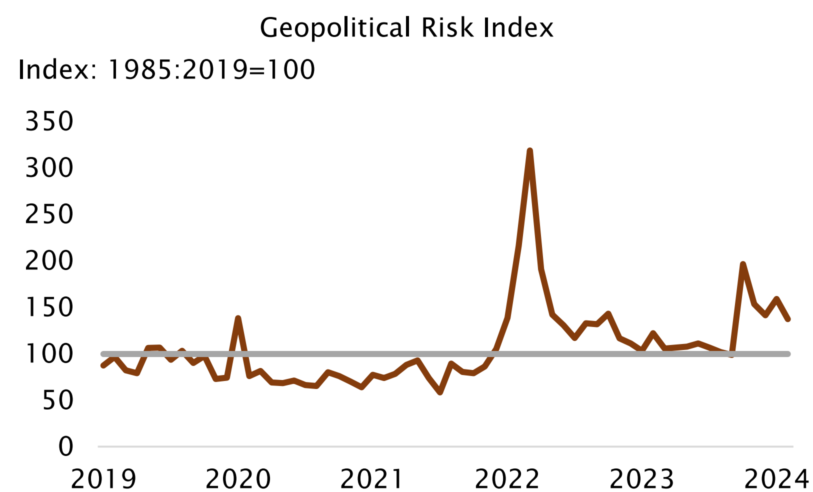
Crude oil prices continued to rise in March



Global supply chain pressures increased in February



Geopolitical risk stays elevated relative to historical average



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