Liquidity management to remain key as RBI MPC stays put on policy rate and stance

TRUST

In Partnership. With Trust.

April 6, 2024

Key takeaways: RBI MPC meeting, April 2024

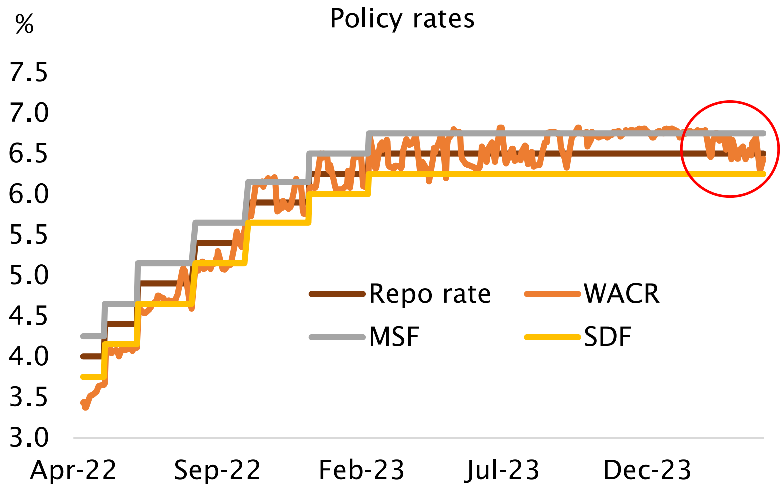
At its first bi-monthly meeting for FY24 held during April 3-5, the RBI MPC kept key policy rates (repo rate: 6.50%) and stance (withdrawal of accommodation) unchanged for the seventh consecutive time. The outcome was in line with market expectations, eliciting a stifled response from financial markets. Unlike the central bank's latest monthly bulletin, the MPC kept GDP growth and CPI inflation forecasts for FY25 unchanged from its previous meeting, though there were minor tweaks to quarterly numbers. The MPC stayed confident about domestic growth prospects, and took comfort from the higher probability of a soft landing for the global economy. However, it continued to sound caution over external risks emanating from geopolitical tensions and elevated debt levels in advanced economies. The MPC remained cautious regarding food price shocks in the domestic economy that continue to challenge the disinflation process amid climate-related uncertainties and the recent rise in crude oil prices. The MPC emphasized the need for policy to remain disinflationary, stating that its task was incomplete till inflation was aligned to the 4% target on a durable basis.

The last leg of the disinflation journey is turning out to be a protracted one across most major economies, so that the risk of de-anchoring inflation expectations is acting as a deterrence to explicit changes in policy stance or rates. Under this backdrop, the RBI has been and continues to resort to liquidity management tools to work its way through the operating target of the monetary policy, which is the weighted average call rate (WACR). Over the past two months, there has been a softening bias in the WACR, with its spread over the repo rate easing, a divergence from the trend seen in later part of 2023 after domestic inflation had spiked. With index inclusion-related inflows expected from June, liquidity management will continue to remain at the centre stage of monetary policy. The RBI MPC could be more willing to tinker the policy stance and rates post Q1-FY24, when there is more clarity on the monsoon outturn, general elections and the likely policy pivot by major central banks, including the Fed.

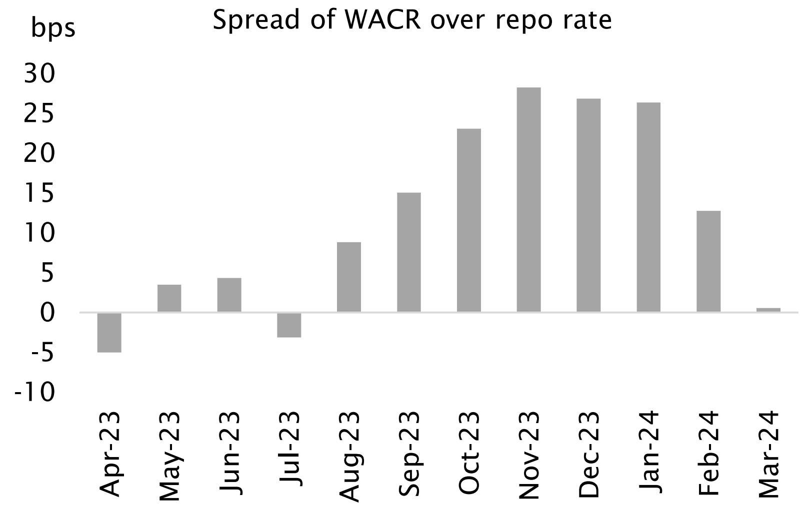
In the post policy conference, members of the MPC noted that the concerns regarding the impact of high real interest rates on domestic growth need to be assessed in the context of the gap between the level of inflation from the target, and the impact of a possible change in the economy's potential growth on the neutral rate of interest that the central bank would further assess in a study.

RBI MPC kept key policy rates and stance unchanged at Apr meet

Policy rates unchanged at April RBI MPC meeting



Softening bias in WACR in recent months



Policy rates and stance unchanged at April RBI MPC meeting

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
Cumulative (bps)	250						

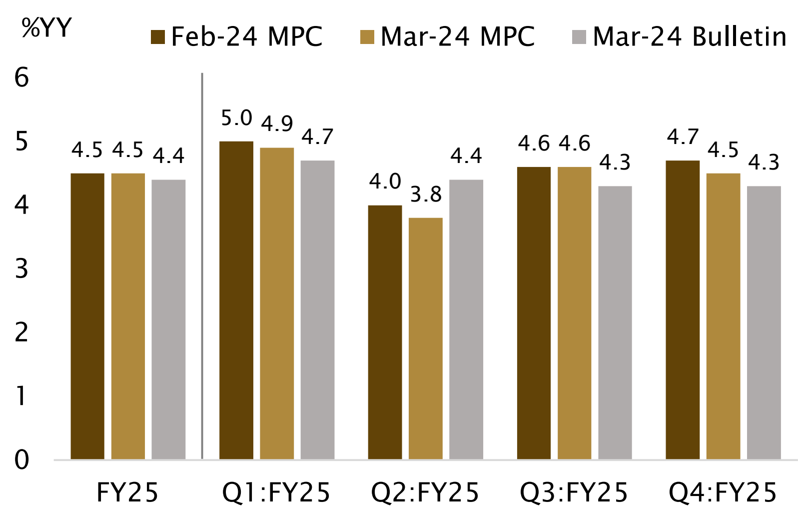
WoA: Withdrawal of accommodation; *** Two MPC members voted against hike, # one MPC member voted in favor of a 25bp rate cut.

RBI MPC projects inflation to align to its 4% target by FY26

- Compared to its previous meeting, the MPC left its CPI inflation forecast for FY25 unchanged at 4.5% amid minor tweaks to quarterly numbers. The changes to quarterly estimates indicate that the MPC expects inflation to moderate to 4.5% in Q4 after an uptick in Q3, instead of a continued rise forecasted earlier. In its monetary policy review published bi-annually, **the central bank has projected inflation to moderate to 4.0% in FY26, thereby aligning with its target.**

- For its projections, the central bank has assumed crude oil (Indian basket) at USD85/bbl for FY25, and noted that if prices rise 10% above its baseline assumption, domestic inflation could be higher by 30 bps, and moderate by an equivalent amount if prices fall 10% relative to baseline. Similarly, continued food price shocks due to climate changes could raise headline inflation by 100bps over baseline, and lower it by 50bps if food prices ease.

CPI inflation forecasts



Factors supporting disinflation	Risks to inflation outlook
1. Moderation in core inflation. 2. Continued deflation in fuel prices that could be further aided by cut in LPG prices in March, and in petrol and diesel prices in mid-March. 3. Early indication of a normal monsoon. 4. Benign global food prices.	1. Food price uncertainties due to increasing incidence of climate shocks including the prediction of heat waves in April-June and their impact on horticulture products, low reservoir levels, tight demand supply in certain pulses. 2. Increase in crude oil prices. 3. Cost push pressures faced by firms. 4. Impact of continuing geopolitical tensions on commodity prices and supply chains.

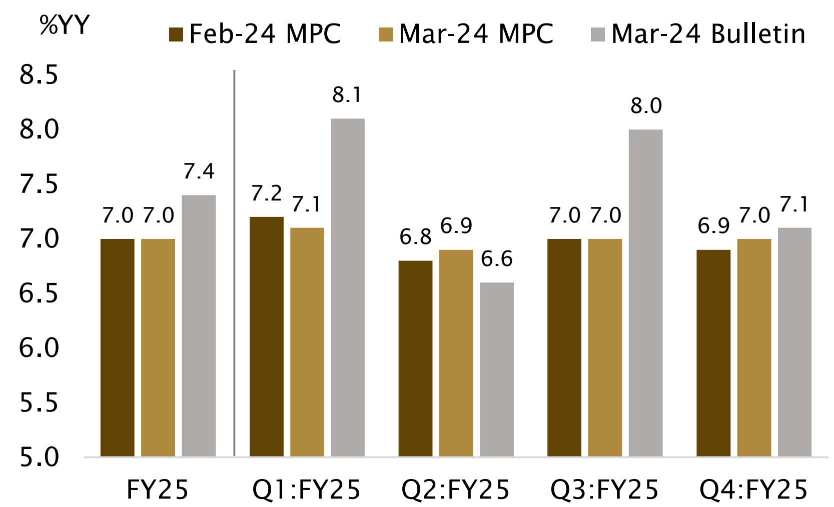
RBI MPC expects GDP growth to be stable at 7% in FY25 and FY26

- The MPC left its real GDP growth forecast for FY25 unchanged from its February meeting at 7.0%. The minor changes to quarterly numbers suggest that the MPC expects growth to remain stable at 7.0% in H2-FY25, instead of a moderation in Q4 projected earlier. In its bi-annual monetary policy review report, the central bank has projected growth to remain stable at 7% in both FY25 and FY26.

- **In a nutshell, the MPC expects growth to be stable at 7.0% by the end of FY25 and inflation to moderate to 4.5%.**

- In its assessment of alternative scenarios, the central bank expects growth to weaken by 15bps relative to baseline if crude oil prices rise 10% above its assumption, and improve by an equivalent amount in the opposite scenario.

Real GDP forecasts



Factors supporting growth	Risks to growth
1. Support to consumption from recovery in rural demand amid normal monsoon forecast, buoyancy in urban demand, moderating inflationary pressures, improving employment conditions and consumer confidence. 2. Boost to investment from upturn in private capex cycle becoming more broad-based, continued thrust on public capex, rising capacity utilization, healthy balance sheets of banks and corporates, improving business sentiments. 3. Improving global growth and trade prospects, rising integration in global supply chains.	1. Impact on external demand from protracted geopolitical tensions and disruptions in trade routes. 2. Uncertainty in start of monetary policy easing by major central banks and the subsequent impact from higher-for-longer policy rates and volatility in global financial markets.

DISCLAIMER:

We are committed to providing completely independent views to help our clients reach a better decision. This document is provided for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. Nothing in this document should be construed as investment or financial advice, and nothing in this document should be construed as an advice to buy or sell or solicitation to buy or sell the securities of companies referred to in this document. The intent of this document is not in recommendary nature. The recipient of this document should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved), and should consult its own advisors to determine the merits and risks of such an investment. The investment discussed or views expressed may not be suitable for all investors. Trust Group has not independently verified all the information given in this document. Accordingly, no representation or warranty, express or implied, is made as to the accuracy, completeness or fairness of the information and opinions contained in this document. The Company reserves the right to make modifications and alternations to this statement as may be required from time to time without any prior approval. Trust Group, its affiliates, their directors and the employees may from time to time, effect or have effected an own account transaction in, or deal as principal or agent in or for the securities mentioned in this document. They may perform or seek to perform investment banking or other services for, or solicit investment banking or other business from, any company referred to in this report. Each of these entities functions as a separate, distinct and independent of each other. The recipient should take this into account before interpreting the document. This report has been prepared on the basis of information, which is already available in publicly accessible media or developed through analysis of Trust Group. The views expressed are those of analyst and the Company may or may not subscribe to all the views expressed therein. Neither the Firm, not its directors, employees, agents or representatives shall be liable for any damages whether direct or indirect, incidental, special or consequential including lost revenue or lost profits that may arise from or in connection with the use of the information. This document is being supplied to you solely for your information and may not be reproduced, redistributed or passed on, directly or indirectly, to any other person or published, copied, in whole or in part, for any purpose.

Trust Group

1101, Naman Centre, Bandra Kurla Complex, Bandra (E), Mumbai -400 051, Maharashtra.

Ph: +91 22 4084 5000 • Fax: +91 22 4084 5052 • www.trustgroup.co.in