RBI's MPC maintains status quo but tones down hawkishness to seek a balance

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December 6-8, 2023

Key takeaways: RBI MPC meeting, December 2023

At its bi-monthly meeting held during December 6-8, the RBI MPC held its policy rate(s) and stance for the fifth consecutive meeting. The policy repo rate was unanimously unchanged at 6.5%, and the policy stance was maintained at 'withdrawal of accommodation' by a vote of 5:1. The policy outcome was in line with market expectations, though the tone of the statement came across as less hawkish compared to the previous two meetings. The MPC remained optimistic about domestic growth prospects and raised its forecasts for FY24, while keeping inflation projections unchanged. The MPC reiterated that policy would remain actively disinflationary to enable better transmission of earlier tightening and to anchor inflation expectations. The MPC statement noted that the evolution of liquidity conditions was in line with policy stance. The central bank's focus on financial stability remains intact, with regulatory frameworks to be introduced for connected lending and for web-aggregation of loan products. The future course of action for the MPC would probably be a balancing act – to avoid complacency due to a few months of good data and to be mindful of the risks of overtightening.

Date	Change in repo rate	Repo	SDF	MSF	Voting pattern Policy rate	Policy stance	Voting pattern Policy stance
10-Feb-22		4.00	-	4.25	6:0	Accommodative	5:1
08-Apr-22	0.00	4.00	3.75	4.25	6:0	Accommodative: focus on WoA	6:0
04-May-22	0.40	4.40	4.15	4.65	6:0	Accommodative: focus on WoA	6:0
08-Jun-22	0.50	4.90	4.65	5.15	6:0	WoA	6:0
05-Aug-22	0.50	5.40	5.15	5.65	6:0	WoA	5:1
30-Sep-22	0.50	5.90	5.65	6.15	5:1*	WoA	5:1
07-Dec-22	0.35	6.25	6.00	6.50	5:1**	WoA	4:2
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
Cumulative	250.00						

WoA: Withdrawal of accommodation; * One MPC member voted for hike by 35bps; ** One MPC member voted against hike; *** Two MPC members voted against hike
Effective April 2022, floor of the LAF corridor was changed to SDF from reverse repo

Highlights: RBI MPC meeting, December 2023

- The RBI MPC kept both policy rates and stance unchanged for the fifth straight meeting, with the objective of durable alignment of headline inflation to the target of 4%, while supporting growth.
- **The MPC maintained the policy repo rate at 6.50%.** Accordingly, the standing deposit facility (SDF) was unchanged at 6.25%, and the marginal standing facility (MSF) and the bank rate at 6.75%.
- The MPC also **maintained the policy stance of 'withdrawal of accommodation'** by a vote of 5:1. Prof. Jayanth R. Varma maintained his reservations on the policy stance.

- However, the policy statement sounded **less hawkish compared to the previous two meetings, with no negative surprises on liquidity management.** In August, the central bank had introduced i-CRR to absorb excess liquidity in the system due to the withdrawal of Rs. 2000 notes, while in its October meeting, the MPC expressed willingness to conduct OMO sales to keep liquidity in check.
  - In its December meeting, the RBI decided to **allow reversal of liquidity facilities under both SDF and MSF during weekends and holidays**, effective December 30, 2023, to address the skewed distribution of liquidity, signaled by simultaneous high utilisation of both MSF and SDF by the banks,

- The MPC remained optimistic regarding domestic growth prospects. In the backdrop of better-than-expected GDP growth in Q2-FY23, **the committee raised FY24 GDP growth forecasts, while holding its CPI inflation projections.**

- **Focus intact on financial stability**: To address potential risks in the financial sector, the central bank, in November, increased the risk weights on unsecured consumer credit exposures of banks and NBFCs (including credit card receivables) as well as bank lending to NBFCs.
  - Some of the additional measures announced at its December MPC meeting – such as decisions to introduce regulatory frameworks for connected lending and for web-aggregation of loan products – indicated the central bank's continued focus on the area of financial stability.

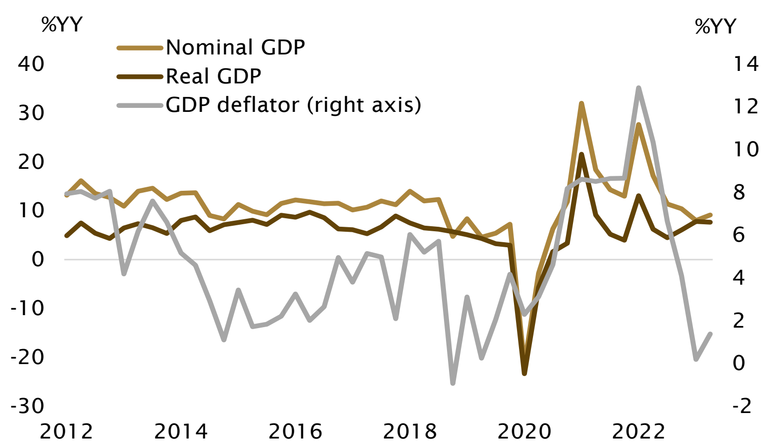
- View on global economy and inflation – The MPC noted that despite resolution of supply chain issues, **global growth is slowing** amid risks emanating from high debt levels, lingering geopolitical tensions, and extreme weather conditions. On the bright side, **easing of headline inflation in advanced economies was strengthening the view of an end to the rate hike cycle**, lifting sentiment in financial markets and lowering sovereign yields.

View on growth

- The MPC remained **optimistic about domestic growth prospects**, particularly in light of better-than-expected Q2-FY24 GDP growth data. The MPC **raised its GDP growth forecast for FY24 by 50 basis points (bps) to 7.0%YY.** Soft and hard data for manufacturing activity suggest continued buoyancy in Q3-FY24, and so do high frequency indicators in October-November for the services sector. On the demand side, the MPC noted these supportive factors for respective components: :
  - Domestic consumption: Gradual improvement in rural demand, strengthening of manufacturing activity, and buoyancy in services.
  - Investment: Healthy balance sheets of banks and corporates, high capacity utilization, continuing business optimism, government's thrust on infrastructure spending.
  - External sector: Turnaround in merchandise and services exports.
  - Risks to growth outlook: Protracted geopolitical turmoil, volatility in global financial markets and geo-economic fragmentation.

Real GDP growth (%YY)	Q3:FY24 F	Q4:FY24 F	FY24 F	Q1:FY25 F	Q2:FY25 F	Q3:FY25 F
December 2023	6.5% (+0.5pp)	6.0% (+0.3pp)	7.0% (+0.5pp)	6.7% (+0.1pp)	6.5%	6.4%
October 2023	6.0%	5.7%	6.5%	6.6%		

Q2-FY24 real GDP growth surprised on the upside



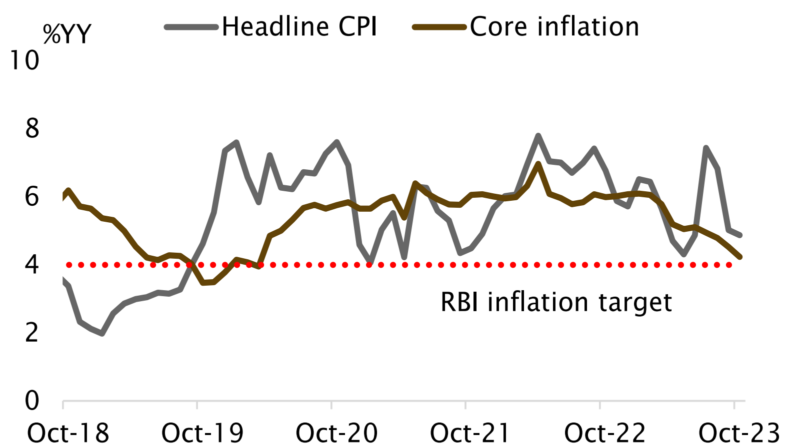
Source: RBI

View on inflation

- The MPC maintained its CPI inflation forecast for FY24, and introduced estimates for Q2:FY25 and Q3:FY25. **While inflation is expected to average 4% (MPC's target) in Q2:FY25, it is projected to rise again in the subsequent quarter, thereby raising questions regarding the notion of 'durability' in the MPC's objective of returning inflation to target, and the corresponding timing of change in policy rate(s) and/or stance.**
- In the near-term, the MPC noted the following risks to domestic inflation.
  - **Upside risks:** Food inflation (particularly, key vegetables), muted progress in rabi sowing, low reservoir levels, lower-than-expected Kharif harvest, El Nino weather conditions, persistent price pressures for services and infrastructure firms (based on RBI's enterprise surveys).
  - **Downside risks:** Recent softening in global crude oil prices, low global agricultural commodity prices (except rice), pro-active supply side interventions by the government, adequate buffer stocks for cereals, softer growth in input costs and selling prices for manufacturing firms in Q4 relative to Q3 (based on RBI's enterprise surveys).

CPI Inflation (%YY)	Q3:FY24	Q4:FY24	FY24	Q1:FY25 F	Q2:FY25 F	Q3:FY25 F
December 2023	5.6%	5.2%	5.4%	5.2%	4.0%	4.7%
October 2023	5.6% (-0.1pp)	5.2%	5.4%	5.2%		

Core inflation continues to move closer to 4%

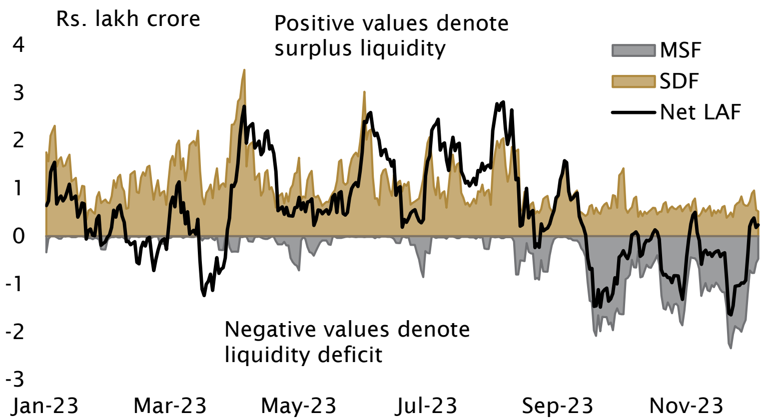


Source: RBI

View on liquidity

- **Reduction in balance sheet size:** The size of RBI's balance sheet has moderated to 21.6% of GDP in the current FY (up to Dec 1) from 23.3% in FY23 and from the peak of 28.6% in FY21 during the COVID period.
- **Liquidity conditions:** The MPC noted its **comfort with current liquidity conditions** that were in alignment with the monetary policy stance. Higher currency leakage during the festive season, government cash balances and the central bank's market operations tightened liquidity to the extent that the need to undertake auction of OMO sales did not arise. The recent increase in government spending had evened out the net LAF position and was expected to ease liquidity conditions going forward.
- **Addressing skewed distribution of liquidity:** The MPC reiterated its observation on the simultaneous high utilisation of both MSF and SDF by the banks. To enable better fund management by banks, the RBI decided to **allow reversal of liquidity facilities under both SDF and MSF during weekends and holidays with effect from December 30, 2023.** This central bank will review this measure after six months or earlier, if needed.

Distribution of liquidity remains skewed

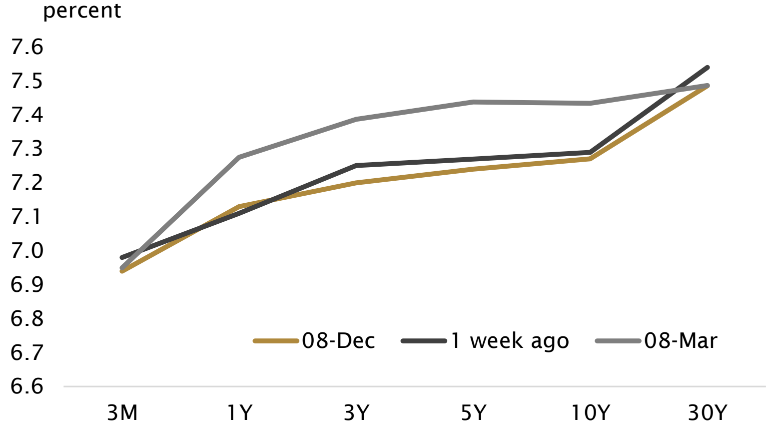


Source: RBI

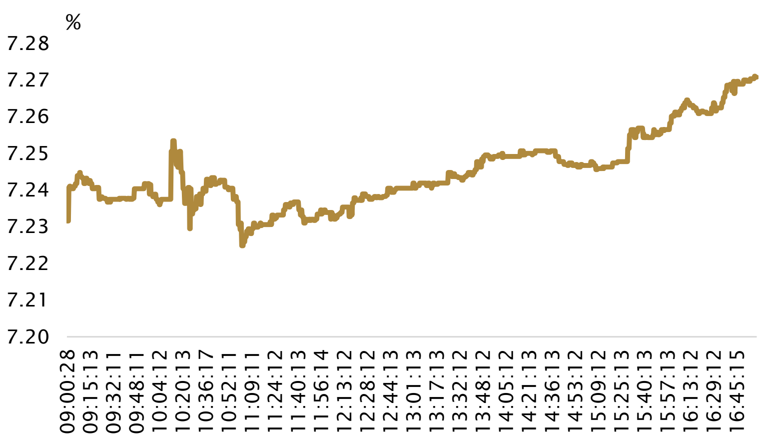
Equity market cheered RBI MPC policy outcome

- The yield curve remains well-behaved, unlike the inversion signals seen in March earlier this year.
- The 10-year benchmark remains range-bound. Bond markets largely shrugged off the RBI MPC policy outcome in December, which was in line with expectations.
- Equity markets cheered the monetary policy outcome with both the Nifty and Sensex benchmark indices hitting fresh high levels. The optimistic growth prospects amid receding inflation outlook attest to the Goldilocks state of the economy.

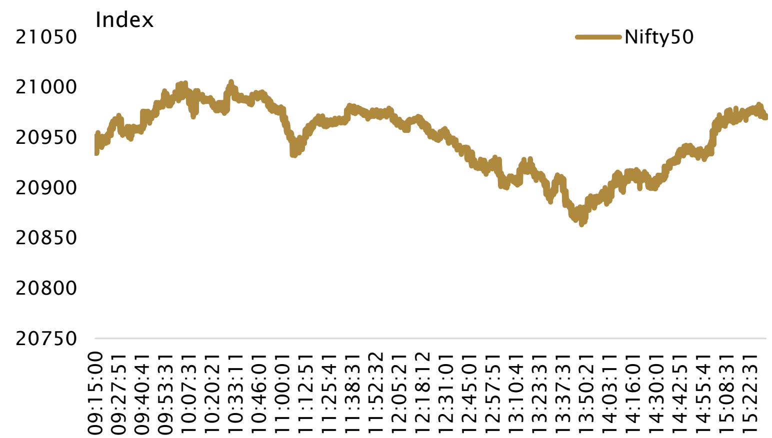
Yield curve



10-year G-sec yield – December 8, 2023



Equity market – December 8, 2023



Source: Bloomberg

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