RBI MPC maintains a cautious status quo on policy rates and stance

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February 6-8, 2024

Key takeaways: RBI MPC meeting, February 2024

At its bi-monthly meeting held during February 6-8, the RBI MPC held its policy rate(s) and stance for the sixth consecutive meeting. Though the policy outcome was in line with market expectations, financial markets were disappointed due to the cautious tone of the MPC in its endeavor towards the last mile of the disinflation process. Despite expectations of a status quo, there were hopes of cues regarding a policy pivot or a neutral tone in the statement. With the probability of monetary policy easing being pushed further into the year across most major central banks, it could be a wait-and-watch approach for the RBI MPC as well, as it awaits complete transmission of its previous policy rate hikes and keeps inflation expectations anchored.

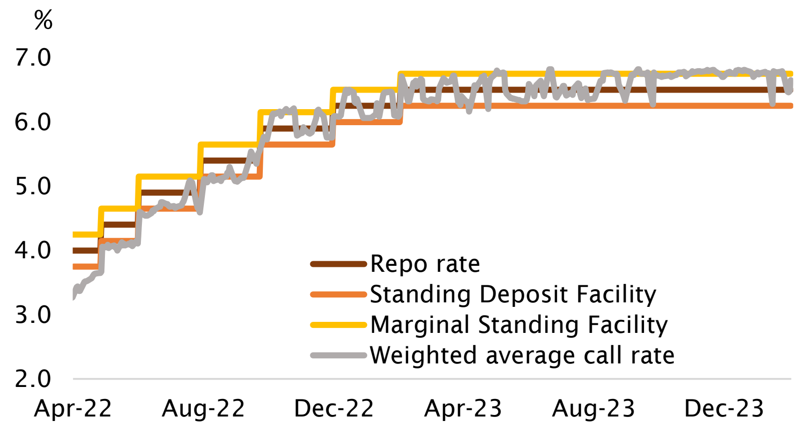
Highlights

- The policy repo rate was unchanged at 6.5%, and the policy stance was maintained at 'withdrawal of accommodation'.
  - While the vote on policy stance was unchanged at 5:1, **the vote on policy rate was not unanimous, with one member favoring a rate cut by 25bps.**
  - The MPC maintained the policy stance to ensure fuller transmission of earlier rate hikes and to keep inflation expectations anchored.
- The MPC was **bullish on domestic growth outlook and projected real GDP growth at 7%YY in FY25**.
- The MPC kept the CPI forecast for FY24 unchanged at 5.4%YY and introduced FY25 forecast at 4.5%.
- The MPC noted that potential liquidity in the banking system (adjusted for government balances) was still in surplus, and suggested that it **will use appropriate mix of tools to manage liquidity**.
- The MPC expressed comfort over external account balances and stability of the Indian rupee.
- The MPC **noted the uncertainties clouding the global macroeconomic backdrop**. Though growth is expected to be steady in 2024, international financial markets have been volatile and new areas of geopolitical stress continue to emerge.

Dissent over policy rate decision

- Both policy repo rate and the stance of 'withdrawal of accommodation' were kept unchanged for the sixth consecutive RBI MPC meeting. While the voting pattern on policy stance remained at 5:1, the unanimity on policy rate vote changed with **one member voting in favor of a 25bp rate cut.**
- **In the post policy conference, the MPC reiterated its endeavor to keep the call rate (WACR) close to the policy repo rate. With the WACR hovering near the ceiling of the corridor, any softening towards the repo rate might not necessarily imply change in the MPC's stance, though there could be better balance in liquidity conditions.**

Policy rates and stance unchanged at Feb RBI MPC meeting



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
08-Feb-24	0.00	6.50	6.25	6.75	5:1#	WoA	5:1
Cumulative (bps)	250						

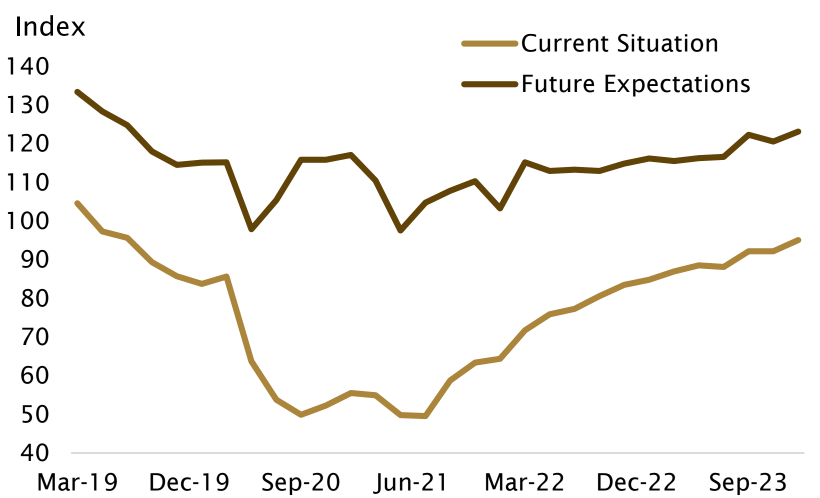
WoA: Withdrawal of accommodation; * One MPC member voted for hike by 35bps; ** One MPC member voted against hike; *** Two MPC members voted against hike, # one MPC member voted in favor of a 25bp rate cut.
Effective April 2022, floor of the LAF corridor was changed to SDF from reverse repo

RBI MPC bullish on growth with FY25 real GDP forecast at 7%YY

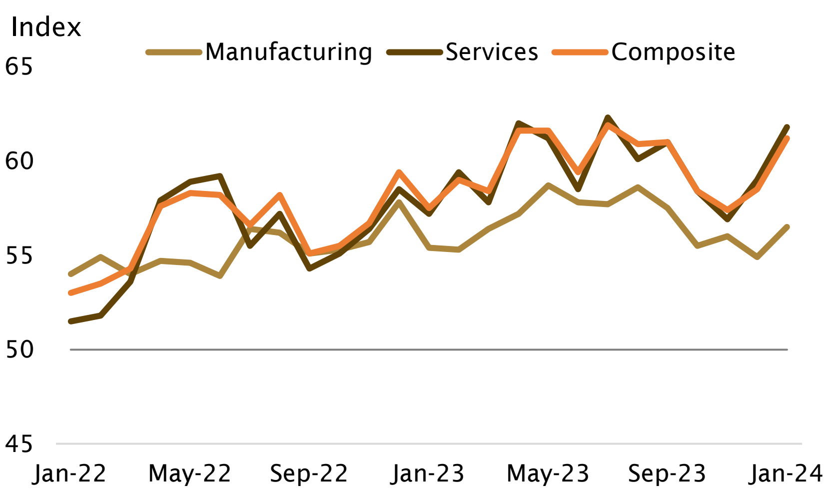
- The MPC expects the growth momentum of FY24 to continue and projected real GDP growth for FY25 at 7%YY.
- Agricultural activity is holding up well, with **Rabi sowing surpassing previous year's acreage**.
- Industrial sector remains buoyant due to **improving performance of the manufacturing sector**.
- Services sector is likely to continue receiving boost from **construction activity due to strong demand for residential housing and thrust on public capex.**
- On the demand side, the MPC noted these **supportive factors** for respective components: :
  - Domestic consumption: Improving employment conditions, moderating inflation, rebound in agricultural activity, extension of food subsidy.
  - Investment: Thrust on public capex, increasing capacity utilization, revival in private investment, public sector schemes such as PLI.
  - External sector: Narrowing merchandise trade deficit, improving outlook for global trade.
- Additionally, various soft data/**surveys continue to suggest improving consumer and business confidence.**
- **Headwinds to growth:** Geopolitical tensions, volatile global financial markets, geo-economic fragmentation.

Real GDP growth (%YY)	Q4:FY24 F	FY24 F	Q1:FY25 F	Q2:FY25 F	Q3:FY25 F	Q4:FY25 F	FY25 F
February 2024			7.2 (+0.5pp)	6.8% (+0.3pp)	7.0% (+0.6pp)	6.9%	7.0%
December 2023	6.0%	7.0%	6.7%	6.5%	6.4%		

RBI Consumer Confidence Survey



India PMI

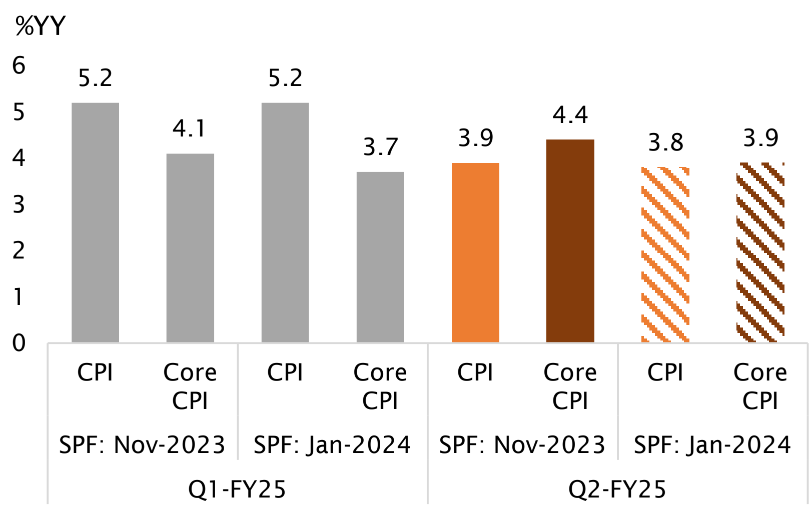


Headline inflation estimated at 4.5% for FY25

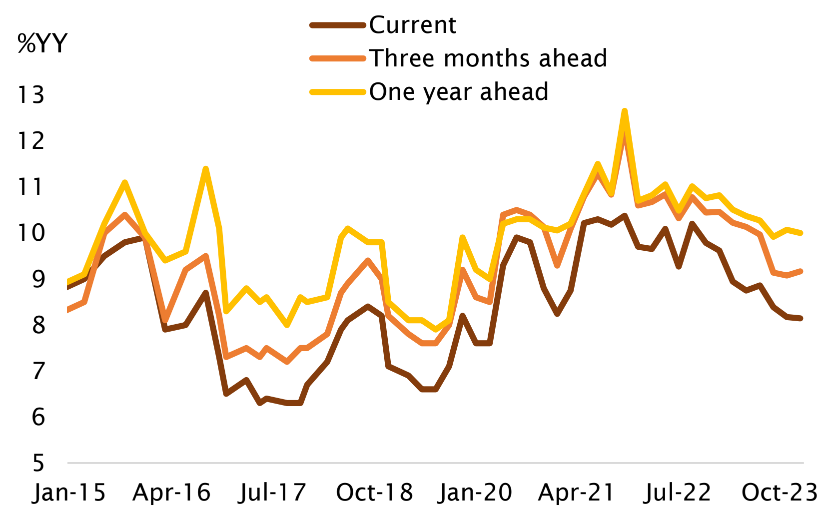
- The MPC noted that despite broad-based moderation in core inflation and deflation in fuel prices, **food prices continue to impart volatility to overall inflation**, with risks that overlapping shocks could interrupt the disinflation process by de-anchoring inflation expectations and generalization of price pressures.
- In the near-term, the MPC noted the following risks to domestic inflation.
  - **Upside risks:** Adverse weather events; volatility, supply chain disruptions due to geopolitical tensions, higher input costs and selling prices expected by services firms in RBI's latest enterprise survey.
  - **Downside risks:** Progress in Rabi sowing, seasonal correction in vegetable prices, softening in input and output prices expected by manufacturing firms as per RBI's latest enterprise survey.
- RBI's latest survey on households' inflation expectations suggest a slight uptick in the 3-month ahead inflation.
- **In the recent rounds of RBI's Survey of Professional Forecasters, respondents' median forecasts suggests core inflation to exceed headline CPI by Q2-FY25, though the latest survey indicates lower gap vs. the November survey.**

CPI Inflation (%YY)	Q4:FY24 F	FY24 F	Q1:FY25 F	Q2:FY25 F	Q3:FY25 F	Q4:FY25 F	FY25 F
February 2024			5.0% (-0.2pp)	4.0%	4.6% (-0.1pp)	4.7%	4.5%
December 2023	5.2%	5.4%	5.2%	4.0%	4.7%		

RBI Survey of Professional Forecasters: Headline vs Core CPI



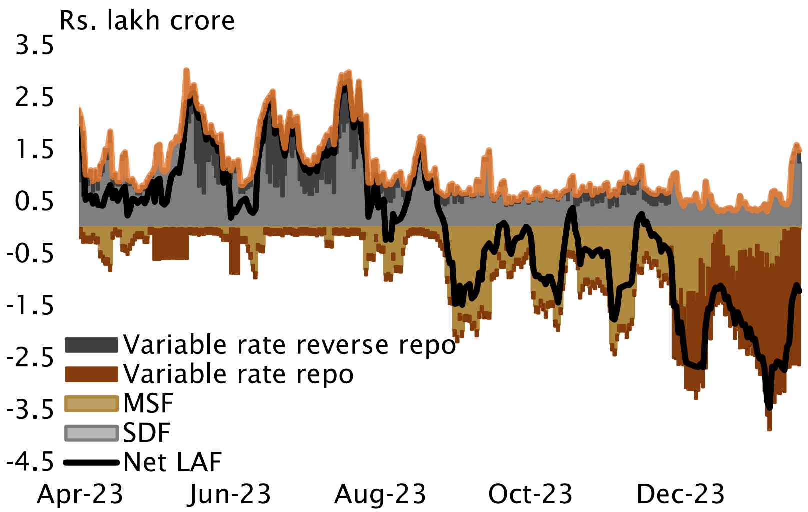
RBI Households' Inflation Expectations Survey



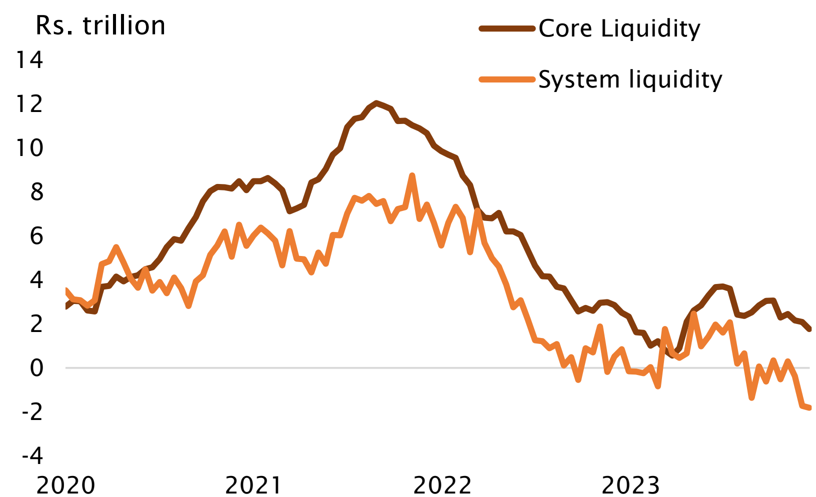
RBI to use appropriate mix of tools to manage liquidity

- The MPC noted that **adjusting for government cash balances, potential liquidity in the banking system remained in surplus.**
- The central bank has been actively managing liquidity. **During December-January, the RBI conducted multiple VRR auctions to ease tight liquidity conditions. Since the beginning of February, a pick up in government spending led to augmenting of system level liquidity**, as also reflected in build-up of reserves at the standing deposit facility. This prompted the central bank to resort to **VRRR to absorb excess liquidity**.
- In December, the RBI decided to allow reversal of liquidity facilities under both SDF and MSF during weekends and holidays to address skewed distribution of liquidity with simultaneous high utilisation of both MSF and SDF by the banks. This facility, in addition to the two-way main and fine-tuning operations in repo and reverse repo, has somewhat **eased the skewness in distribution of liquidity**.
- The MPC noted that the current liquidity conditions are being driven by exogenous factors such as government cash balances and are likely to correct in the foreseeable future. **The committee expressed willingness to deploy appropriate mix of instruments to manage both frictional and durable liquidity.**
- **In the coming months, while advance tax payments in mid-March is likely to strain banking system liquidity, year-end government spending and flows due to EM bond index inclusion could support liquidity conditions.**

RBI eased liquidity tightness via multiple VRR in Dec-Jan



Core liquidity remains in surplus



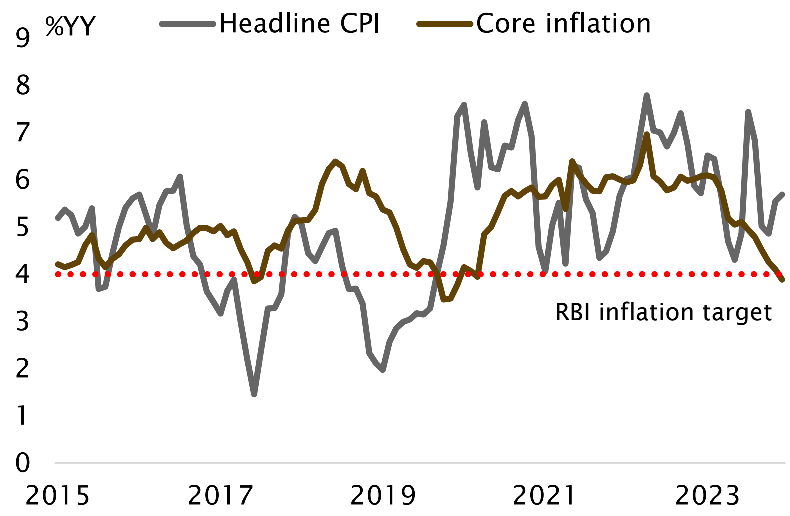
Policy stance held due to incomplete transmission, high inflation

- The MPC stated that it maintained its stance of withdrawal of accommodation as the transmission of earlier policy rate hikes in the credit market remains incomplete and the headline inflation continues to remain above its 4% target.

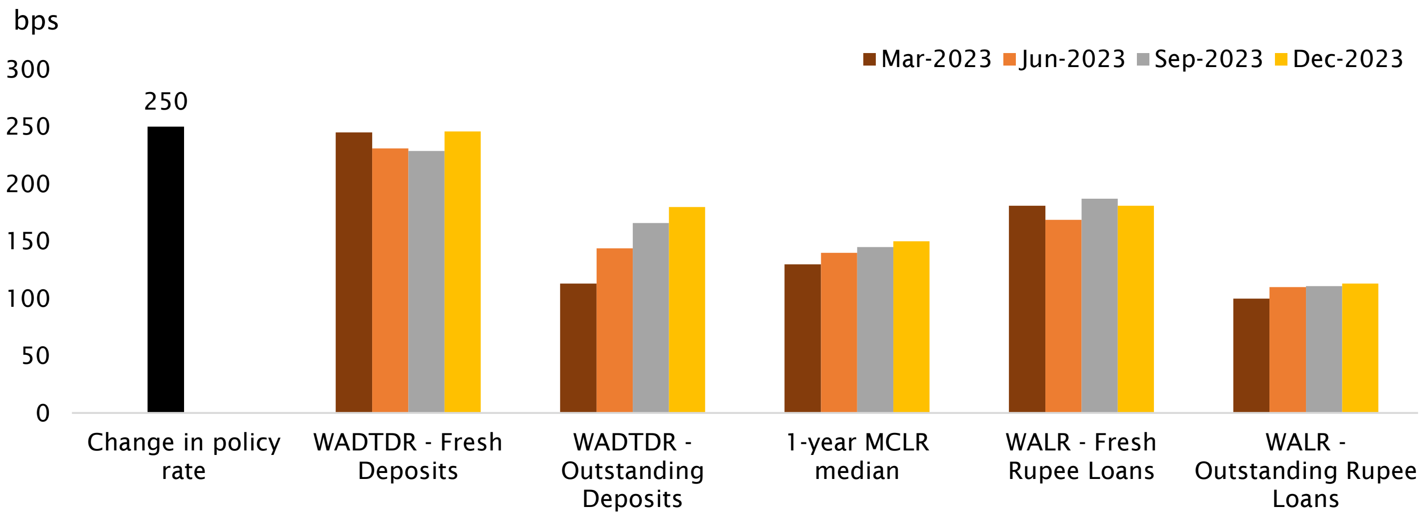
- **The transmission of policy rate hikes is greater in case of deposit rates than lending rates. Within both deposit and lending rates, transmission is higher in case of fresh transactions as compared to outstanding ones.**

- Within bank groups, **transmission is higher in case of foreign banks** as compared to public and private sector banks, both in case of lending and deposit rates.

Headline inflation remains above RBI's target



Monetary Policy Transmission – Scheduled Commercial Banks

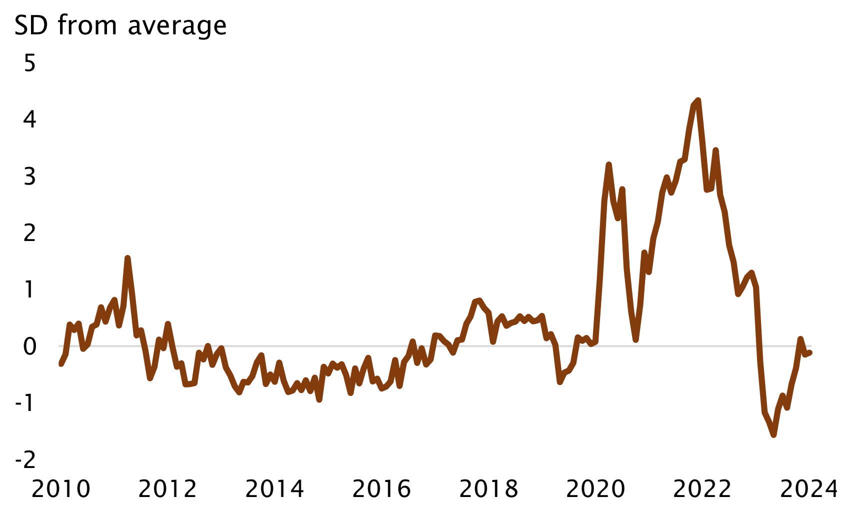


Elevated debt, Red Sea woes impart uncertainty to global outlook

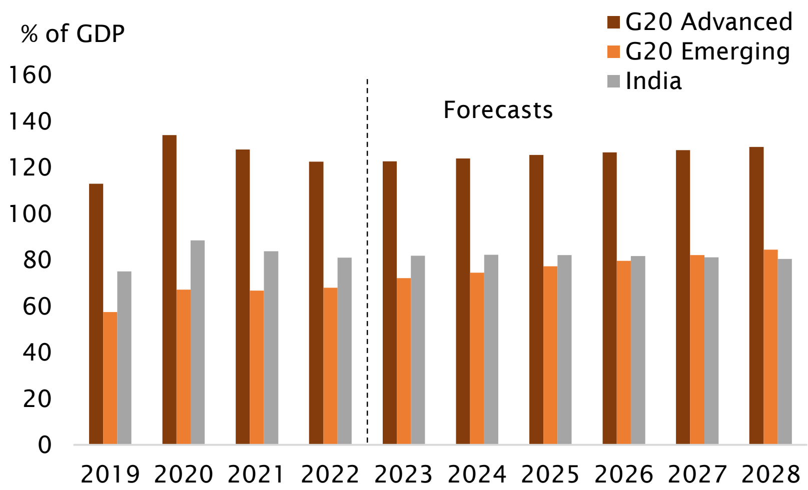
- The MPC noted that **elevated public debt could add to macroeconomic stability concerns, particularly in advanced economies** where debt is expected to remain high relative to emerging market economies, including India. Debt sustainability could be challenging in an environment of high interest rates and low growth. However, India is poised to fare relatively better as per the latest IMF projections.

- **Disruptions in the Red Sea could accentuate supply chain pressures**, adding to volatility and upside risks to global commodity prices. In recent months, the global supply chain pressure index has inched closer to the long term average after easing significantly in H1-2023.

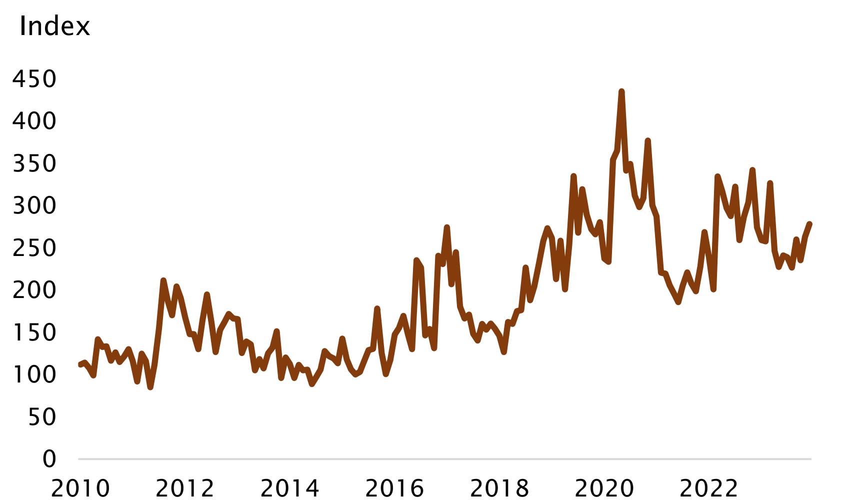
Global Supply Chain Pressure Index



General Government Gross Debt (Percent of GDP)



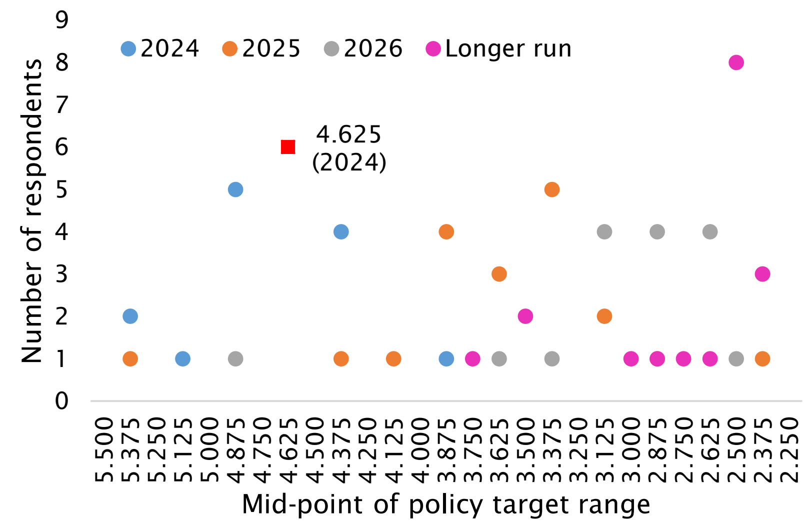
Global Economic Policy Uncertainty



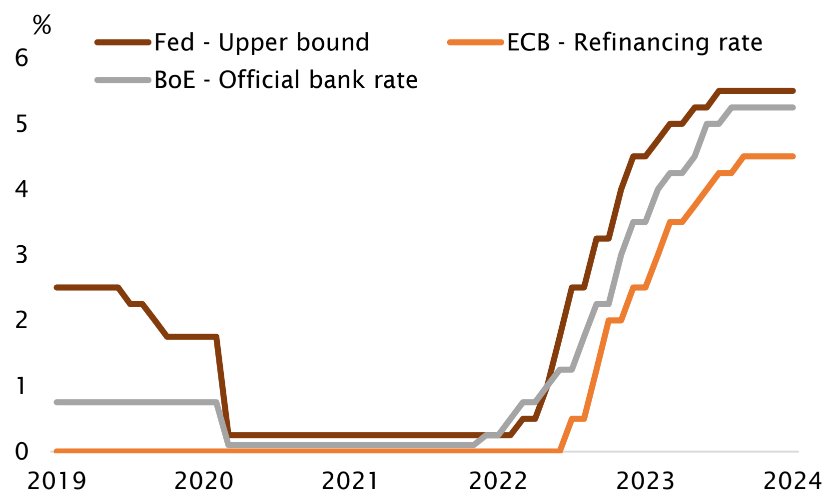
Expectations of Fed policy rate cut pushed to May meeting

- Most major central banks in advanced economies have kept policy rates unchanged in recent months, as they await outcomes of policy transmission.
- While economic resilience continues to surprise in some economies, most continue to grapple with elevated inflation prints.
- At its latest meeting, the Federal Reserve held its policy rate, adding that the Federal Open Market Committee deemed inappropriate to reduce the target range until inflation sustainably moved to its 2% target. **The FOMC outcome pushed market expectations of a rate cut to May from March.**
- **The RBI MPC noted the volatility in global financial markets amid such changing expectations on timing and pace of rate cuts by major central banks,**

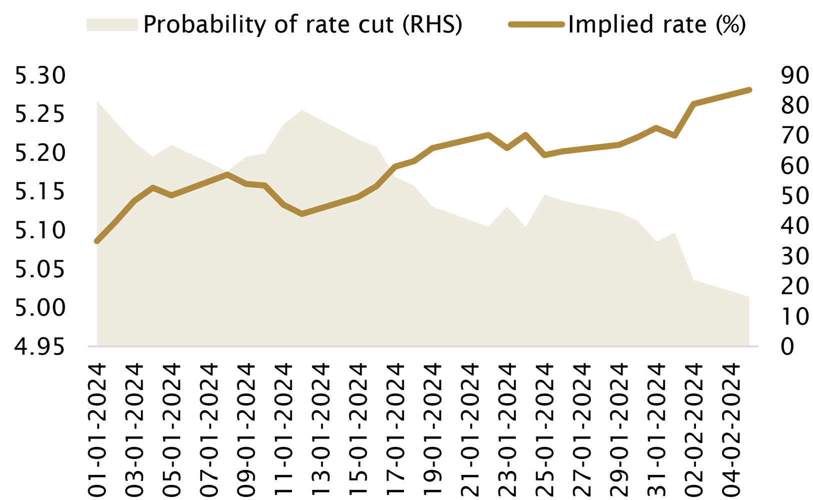
Latest (Dec-2023) Fed dot plot suggests 75bps hike in 2024



Major AE central banks have held rates in recent months



Market expectations of Fed policy rate cut at March meeting



Financial markets disappointed on RBI MPC policy outcome

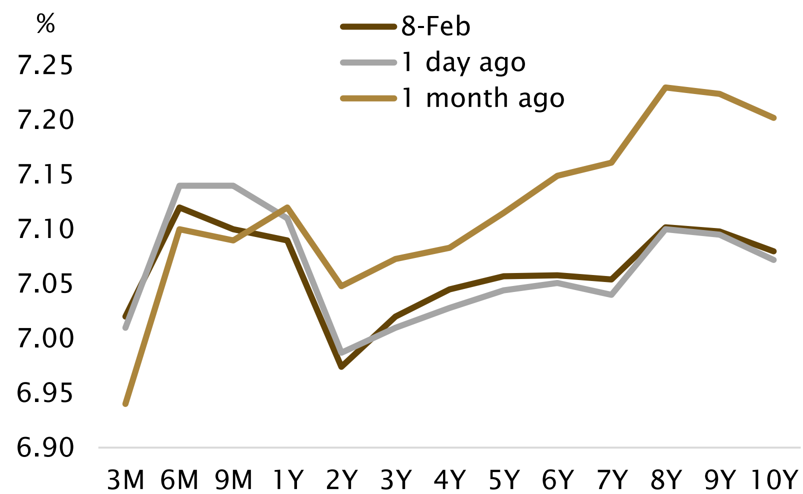
- **Continued policy stance interspersed with a cautious tone undermined market expectations** of guidance on policy pivot towards a neutral stance and rate cuts.

- Equities corrected, and the 10-year G-sec yield rose after softening in the earlier part of the day.

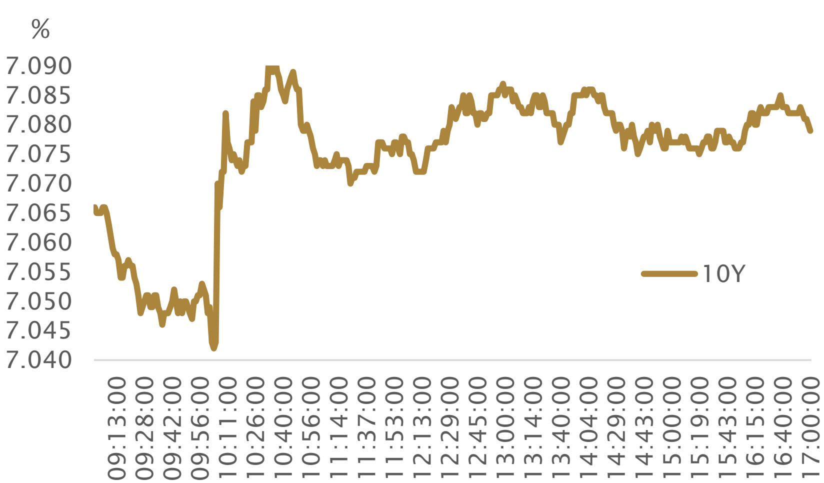
- Perhaps there was **some respite in the front end of the curve**, with the central bank's willingness to conduct two-way operations to manage banking system liquidity.

- Longer-term yields have softened over the month, in line with global trend.

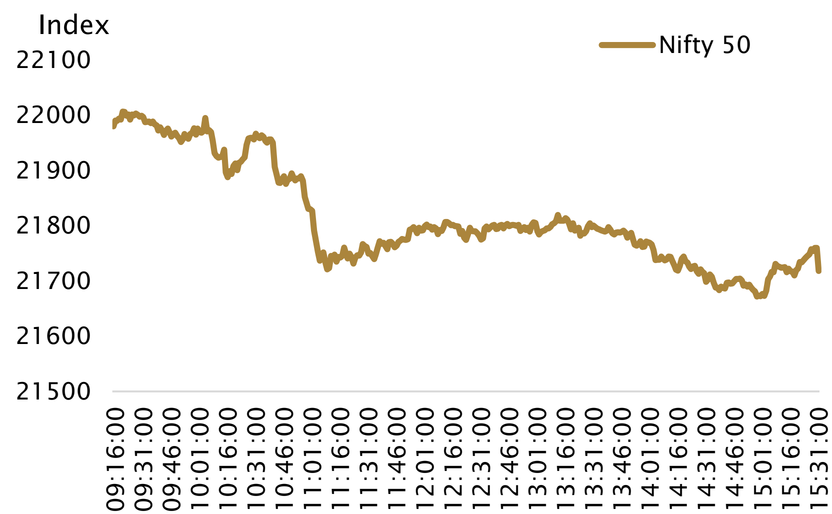
Yield curve



10-year G-sec yield – February 8, 2024



Equity market – February 8, 2024



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