February MPC Meeting: RBI Delivers a Balanced Policy

February 08, 2024 l Economics

The Monetary Policy Committee (MPC) of the Reserve Bank of India (RBI) has opted to maintain the policy repo rate at 6.5% with a 5:1 majority during the bi-monthly policy meeting today. Concurrently, the MPC has upheld its stance at 'withdrawal of accommodation,' with the same majority. The governor has delivered a well-balanced policy today, aligning largely with the market expectations.

The governor reiterated the RBI's commitment to achieving a sustained alignment of headline inflation with the 4% target. He underscored that the policy stance should be viewed through the lenses of dynamics of current inflation and the incomplete transmission of monetary policy hikes.

The RBI Remains Confident on Growth

The RBI expressed confidence in the economic growth, citing recent positive macroeconomic data. Factors such as robust economic growth, improved labour market conditions, strong urban demand, and the government's continued emphasis on capital expenditure contribute to the RBI's optimistic outlook on growth. As shown by the PMIs for manufacturing and services, the outlook in the organized sector remained in the expansionary zone. The buoyant demand for residential housing and government's thrust on capex, is expected to propel construction activity. Other high-frequency data like GST collections and E-way bill continue to remain robust. The revival in private investment is underway with increasing capacity utilisation and policy support from schemes like production linked incentive (PLI). The labour markets also showed improvement as indicated by the fall in unemployment figures and contraction in demand for MNREGA jobs.

Robust economic performance is also underscored by the fact that FY24 growth is now seen at 7.3% as per the first advanced estimates, led by strong growth in the investment demand. The RBI's projection of a 7% growth for FY25 indicates that the growth momentum is expected to sustain next year as well. Compared to the previous projections of December, the RBI now sees a higher growth in first three quarters of the next fiscal year (Refer: Table1).

While the overall economic performance remains strong, we see notable challenges, particularly at the bottom of the pyramid. Consumption demand within the economy is anticipated to exhibit a tepid trajectory, with the growth rate estimated to decelerate from 7.5% in FY23 to 4.4% in FY24. This marks the slowest consumption growth in the past two decades, excluding the pandemic year of FY21, when it contracted by 5.2%. The significant deceleration in private consumption, a driver of over 50% of the GDP, raises concerns. We project a growth of 6.7% in FY25 lower than RBI's projection.

Table 1: RBI's Growth Outlook (%)

	FY25	Q1 FY25	Q2 FY25	Q3 FY25	Q4 FY25
Feb-24	**7**	7.2	6.8	7	6.9
Earlier (Dec-23)	--	6.7	6.5	6.4	--

External Environment Remains Comfortable

On the external front, odds of soft landing have increased with softening of the global inflationary pressures and growth holding up better than expected in major economies. India's external position remains sound with robust foreign investment inflows, moderation in current account deficit (CAD) and comfortable foreign exchange reserve. However, the governor emphasized the importance of monitoring external developments, particularly in light of rising geopolitical tensions and rising global public debt, which could have implications for India's external sector. Even though, our CAD has narrowed, the goods export growth continues to remain muted on account of slower global demand.

The RBI Remains Cautious on Inflation

The RBI has maintained its inflation projections for FY24 at 5.4%. This projection assumes significance in terms of timing of potential future policy rate cuts. The governor found reassurance in the benign nature of core inflation and ongoing deepening of deflation in fuel and light category. However, the governor acknowledged the risks from weather related events disrupting food prices and disruptions due to ongoing geopolitical conflicts. The headline inflation maintained its upward trajectory over the past two months touch a four-month high of 5.7% in December. While prices of perishables, led by vegetable prices (27.6%), continue to be in double digits, enduring inflationary trend in non-perishable food categories, such as cereals (9.9%), pulses (20.7%), and spices (19.7%), raises serious concerns about the potential broadening of price pressures due to their inherent stickiness.

Even though, governor derived comfort from the fact that rabi sowing has increased this year, it is important to note that much of it was driven by sowing of coarse cereals and wheat. Rabi sowing of pulses (-4.6%) and rice (-3.7%) still remains a concern, especially when pulses inflation continues to remain in double digit. The governor iterated a need for vigilance regarding the possibility of food price shocks evolving into broader trends that could disrupt the ongoing disinflation process and de-anchoring of inflation expectations.

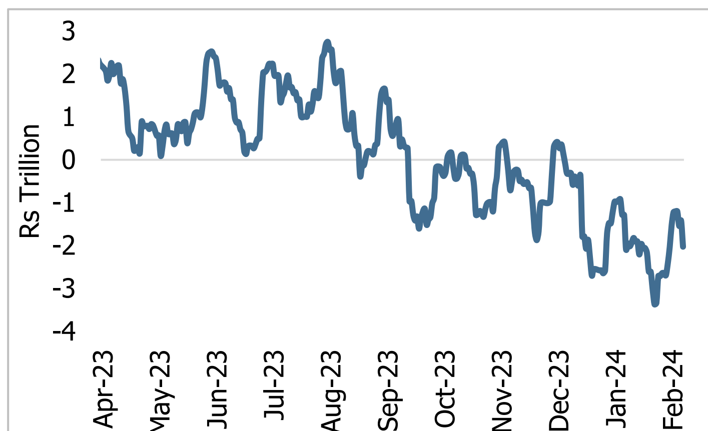
While overall inflation is projected at average of 4.5% for FY25, it is important to note that the disinflationary trend is not being sustained, with marginal increase in inflation in the third and fourth quarter of FY25. Furthermore, our projection indicates a headline inflation of 4.7% for FY25 marginally higher than RBI's projection.

RBI's Inflation Outlook (%)							
	FY24	**Q4 FY24**	**FY25**	**Q1 FY25**	**Q2 FY25**	**Q3 FY25**	**Q4 FY25**
Feb-24	**--**	5.0	**4.5**	5.0	4.0	4.6	4.7
Earlier (Dec-23)	**5.4**	5.2	--	5.2	4.0	4.7	--

Liquidity Management on a Need Basis

The RBI will continue managing liquidity through both main and fine-tuning operations as necessary to uphold favourable money market conditions. The governor noted that although systemic liquidity has been in deficit over recent months, durable liquidity continues to remain in surplus. A higher government cash balance with RBI has contributed to the deficit in systemic liquidity, with the expectation that conditions may ease as government spending sees an uptick.

Banking Sector Liquidity*



Source: CareEdge. Derived from LAF. *Negative number indicate Deficit

The deficit in systemic liquidity currently stands at ~ Rs 2 trillion and has consequently tightened overall money market conditions, leading to an inversion in a segment of the yield curve. Markets were hoping for announcements of liquidity measures to address the tightness in the money market conditions in this policy meeting.

The governor emphasized the fluctuations in short-term rates while observing the relative steadiness of long-term rates. This stability in long-term rates suggests a more effective anchoring of inflation expectations. However, in the credit market, there is an acknowledgment that monetary transmission remains incomplete.

Going ahead, we expect the RBI to keep liquidity conditions tight while ensuring ample liquidity is available to support the credit demand.

Key Fact Statement (KFS) for Retail and MSME Loans

To bolster transparency in the disclosure of fees and charges, in addition to interest rates, the RBI has directed specific categories of lenders to furnish borrowers with a Key Fact Statement (KFS). This statement is designed to include crucial information such as the all-inclusive annual percentage rate (APR) and details regarding the recovery and grievance redress mechanism. This will enable borrowers to make informed decisions.

Way Forward

While the moderation observed in core inflation offers a certain level of reassurance, it's important to note that certain upside risks to inflation continues to persist. The growth outlook continues to remain strong with some pressures in certain sectors. The notable break in the consensus on the policy rate is an intriguing development in this policy with potential implications for future rate actions. The liquidity conditions will continue to remain tight. Looking ahead, moderation of inflation in the Q2 FY25 will provide scope for the RBI to consider prospect of rate cuts in Q2 FY25.

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