RBI's Monetary Policy Review

8th August 2024

RBI Policy Stance

- The MPC decided to keep the policy repo rate unchanged at 6.50% by a 4:2 majority.
- MPC also decided to remain focused on further withdrawal of accommodation with 4 out of 6 policy members in agreement.

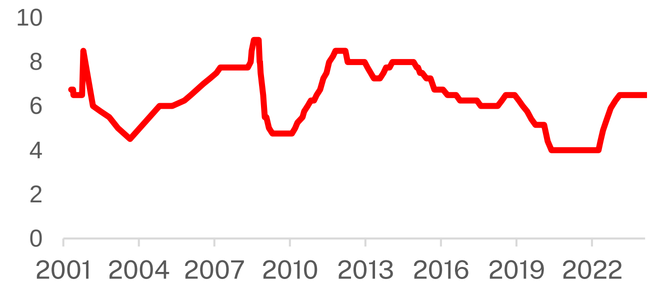
Policy Rates	Pre Policy	Post Policy	Status
Repo	6.50%	6.50%	Unchanged
Reverse Repo	3.35%	3.35%	Unchanged
MSF	6.75%	6.75%	Unchanged
Bank Rate	6.75%	6.75%	Unchanged
CRR	4.50%	4.50%	Unchanged
SDF	6.25%	6.25%	Unchanged
SLR	18.00%	18.00%	Unchanged

Key Highlights

- System liquidity, was, on an average, in deficit of about ₹0.45 lakh crore during June but turned surplus of about ₹1.1 lakh crore during July.
- As liquidity conditions tightened, the RBI injected liquidity through VRR operations during the second half of June but mopped up surplus liquidity through VRRR auctions as liquidity conditions eased in July.
- The inflation forecast for FY'25 is 4.5%, same as previous policy guidance.
- For FY'25, the GDP forecast at 7.2% also remained the same as previous policy guidance .
- RBI slightly moderated the growth projection to 7.1% for Q1'24 in relation to the Jun'24 projection of 7.3%, primarily due to updated information on certain high frequency indicators which show lower than anticipated corporate profitability, general government expenditure and core industries output.
- Gross FDI rose by more than 20 per cent during April-May 2024, while net FDI flows doubled during this period compared to the corresponding period of the previous year.

Time Frame	Projection – Inflation		Projection - Real GDP	
	Jun-24	Aug-24	Jun-24	Aug-24
Q2 FY'25	3.8%	4.4%	7.2%	7.2%
Q3 FY'25	4.6%	4.7%	7.3%	7.3%
Q4 FY'25	4.5%	4.3%	7.2%	7.4%
Q1 FY'26	-	4.4%	7.2%	7.2%
FY'25	**4.5%**	**4.5%**	**7.2%**	**7.2%**

RBI Repo Rate Trajectory



RBI's Projection on Inflation and Growth

Chart 1: Quarterly Projection of Real GDP Growth (y-o-y)

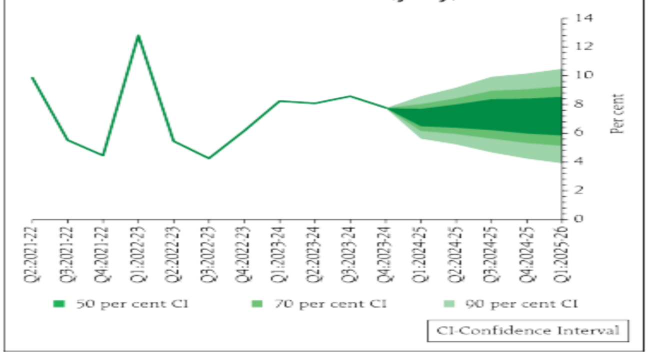
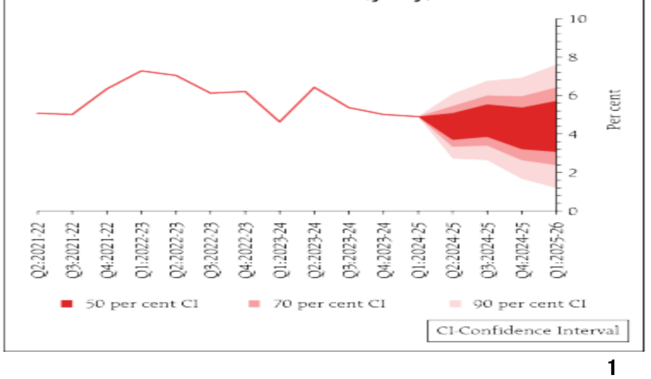


Chart 2: Quarterly Projection of CPI Inflation (y-o-y)



RBI's Assessment of Global and Domestic Economy

- The global economy remains steady with positive outlook for near-term albeit significant challenges for the medium-term. Inflation is de-escalating, though reluctantly, across major economies. Services PMI continues to expand while Manufacturing contracted in July. There has been divergence across countries regarding Monetary Policy with some moving cautiously towards rate cuts while some have been tightening rates. This has led to volatility in the global financial markets. Since the last meeting, bond yields and dollar index have softened. Demographic shifts, climate change, geopolitical tensions and fragmentations, rising public debt and new technologies, such as artificial intelligence, pose new sets of challenges for the global economy.

- The Indian economy continues to display resilience and is expected to grow at 7.2% in FY'25.

- On the supply side, steady progress in south-west monsoon supported higher cumulative kharif sowing.

- Urban demand continues to be robust with growth in consumer durables (12.3% in May'24), increase in the sales of passenger vehicles (4.9% in Jun'24) and domestic air passengers (6.9% in Jun'24 and 6.0% in Jul'24 on the back of very high base). Rural demand also witnessed a turnaround with consumer non- durables expanding by 2.3% in May'24 and two- wheeler sales by 21.3% in June.

- **Outlook for Growth –** Investment Activity will be robust owing to push in govt capex, healthy balance sheets of banks and corporates and pick up in private investment. Rural Consumption is likely to improve with improved agricultural activity and Urban Consumption will be supported by resilience in services activity. However, geopolitical tensions, volatile international markets and geoeconomic fragmentation pose some risk to the economy.

- **Outlook for Inflation –** Headline CPI inflation increased to 5.1% in Jun'24 mainly due to higher- than expected food inflation which has a weight of 46% in CPI. On the contrary, core inflation softened in virtue of a wide range of factors.

Outlook

- The interest rate pause from RBI was in line with consensus estimates and we do not foresee any further increase in interest rates in the current cycle.

- A shift in current policy stance especially with regards to easing of interest rates is unlikely in the near term as the MPC reiterated the need to continue with the disinflationary stance of withdrawal of accommodation to ensure inflation progressively aligns to the target, while supporting growth. RBI is cautious of the spillovers from the food inflation to the core inflation through pick-up in wages on cost-of-living considerations leading firms to increase the price of services, thus impacting the overall policy credibility.

- Meanwhile, fiscal prudence and reduction in government borrowing calendar in FY'25 has led to drop in yields especially in the mid to longer tenors. We believe a reduction in sovereign bond issuances coupled with higher FPI inflows into Indian bond markets especially post inclusion into JP Morgan's Emerging Bond Market index in June may favour a resultant drop in yields even if interest rates remain at current levels.

- While interest rate easing may take place with a lag, a favourable demand supply scenario may continue to aid downtick in yields especially in the mid to longer end of the duration curve. We continue to prefer the 3-5 year maturity bucket for a portfolio exposure to duration owing to continued negligible term premia and expectations of an extended 'higher for longer' narrative at play. At the same time, we are of the view that tactical allocation to duration build up in a portfolio can be initiated with an aim to be opportunistically deployed in a gradual manner for a horizon of next 2-3 years.

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