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RBI Monetary Policy: Yet another pause, inflation remains in focus

The RBI's Monetary Policy Committee (MPC) decided to keep the policy repo rate unchanged at 6.5% and retain the *'withdrawal of accommodation'* stance on a 5:1 majority. The Committee reiterated the need to bring down inflation to the 4% target on a durable basis in the light of volatile food prices, supported by a resilient growth landscape. Prof. Jayant R. Varma dissented for yet another time, voting for a 25bps cut and a change in stance to *'neutral'*. Headline inflation for FY25 is projected at 4.5%, with a sub-4% print in the second quarter, benefiting from an expected normal monsoon this year and the recent cut in fuel/LPG prices, and is pegged at 4.1% for FY26. That said, persistent volatility in food prices and supply disruptions caused by escalation in geopolitical hostilities may continue to impart upside pressure. Growth outlook remains robust, with FY25/26 GDP growth projected at 7% each, supported by strong investment activity and buoyant private consumption. The RBI's nimble and flexible approach towards liquidity management via variable rate repo (VRR) and reverse repo (VRRR) operations has ensured liquidity conditions remain aligned with the monetary policy stance. Other major regulatory announcements include trading permission to eligible foreign investors in Sovereign Green Bonds (SGrBs) in IFSC, introduction of a mobile app for the RBI Retail Direct Scheme, allowing small finance banks to deal in permissible rupee interest derivative products, and wider UPI use and access.

The MPC's decision to retain status quo was in line with expectations. Inflation has subsided but remains above the 4% target, with upside risks emanating from the persistent volatility in food prices and geopolitical tensions. The resilient growth outlook provides policy space to the MPC to unwaveringly focus on ensuring price stability on a durable basis by working towards fuller transmission of past rate hikes and anchoring of household inflation expectations. This leaves little scope for any change in rate/stance in the near term. Until then, RBI is likely to continue to focus on liquidity management to ensure liquidity conditions remain aligned with the monetary policy stance, and money market rates remain closer to the policy repo rate.

- **Yet another pause:** The RBI's MPC expectedly decided to retain the policy repo rate at 6.5% and the 'withdrawal of accomodation' stance with a 5:1 majority, citing the need to maintain vigilance on food and other supply shocks that may hinder the ongoing disinflation trend. The MPC reiterated its commitment to ensuring price stability on a durable basis, which in turn would provide a conducive environment for sustainable growth. With this, the Standing Deposit Facility (SDF) and the Marginal Standing Facility (MSF) rates—the upper and lower bounds of the Liquidity Adjustment Facility (LAF) corridor—remained unchanged at 6.25%, and 6.75% respectively. Prof. Jayanth R. Varma dissented for yet another time and voted in favour of a 25bps cut and a change in the policy stance to 'neutral'.

The RBI expectedly kept the policy repo rate unchanged at 6.5%, retaining the "withdrawal of accommodation" stance with a 5:1 majority.

- **Inflation for FY25 projected at 4.5%:** Moderating inflation conditions are expected to sustain in the near term, benefiting from an expected normal monsoon, record wheat buffer stock, recent cut in LPG/fuel prices and continuing focus on policy transmission. That said, the outlook remains vulnerable to food price uncertainties, and supply shocks emanating from persistent geopolitical tensions. Considering these risks, inflation is projected to average 4.5% in FY25—4.9% in Q1 (vs. 5.0% earlier), 3.8% in Q2 (vs. 4%), 4.6% in Q3 and 4.5% in Q4 (vs. 4.7%). For FY26, assuming a normal monsoon and no further external shocks, headline inflation is projected to average 4% in FY26, ranging between 3.9% and 4.3%. Key upside risks to the outlook include weather-related wagaries, escalation in geopolitical tensions and resultant supply-side disruptions, and financial market volatility.

Inflation projected at 4.5%/4.1% in FY25/26, whereas GDP growth forecast for FY25/26 is pegged at 7% each.

- **GDP growth for FY25 pegged at 7%:** Amidst a resilient global economy, the domestic economic outlook remains robust, underpinned by strong investments by the public and private sectors. With rural demand catching up and urban demand staying buoyant, the overall consumption demand should revive in FY25. Additionally, healthy corporate and bank balance sheets, coupled with a continued focus on capital expenditure by the Government, provides a conducive environment for a durable recovery in the private capex cycle. As such, the RBI expects growth to remain strong over the next years, projecting FY25 and FY26 GDP growth at 7% each. This, if materialised, would translate into five years of a 7%+ growth trajectory for India (FY22-26). Key downside risks may emanate from geopolitical uncertainties in the Middle East, volatility in international financial markets, geoeconomic fragmentations and extreme weather events.

- **Liquidity deficit eases in the face of nimble management:** Systemic liquidity eased significantly in the February-March period to a deficit of Rs 1 lakh crore compared to Rs 1.6 lakh crore in the December-January period. In fact, average liquidity deficit fell to Rs 0.4 lakh crore in March, and has remained in surplus since March 30th, 2024. This is due to considerable injection of liquidity by the RBI in the form of undertaking multiple VRR auctions, which was followed by VRRR auctions in response to the surpus in liquidity witnessed recently. These measures have all been taken with a focus on keeping the interbank rate close to the repo rate, and have succeeded in bringing the average Weighted Average Call Money Rate (WACR) to 6.61% in February-March from 6.76% in December-January. The RBI is likely to continue to remain flexible in its liquidity management approach to facilitate fuller transmission of the previous rate hikes into the system.

- **Regulatory measures:** RBI has now permitted eligible foreign investors in International Financial Services Centre (IFSC) to invest in Sovereign Green Bonds, with the view of fostering wider non-resident participantion. In addition, Small Finance Banks (SFBs) are now allowed to deal in permissible rupee interest derivative products to provide them with wider hedging avenues. RBI is also considering making modifications to the Liquidity Coverage Ratio (LCR) framework for better liquidity risk management by the banks. Apart from this, a mobile application of Retail Direct portal would be launched to allow investors to conveniently buy and sell government securities. Amid the increasing usage and popularity of the UPI, RBI has now proposed to: (i) introduce cash deposit facility using UPI, and (ii) permit the linking of Prepaid Payment Instuments (PPI) through third party UPI applications. The RBI also intends to expand CBDC-Retail user access by enabling wallet offerings from non-bank operators.

- **Rates to remain on hold for now:** The MPC's decision to retain status quo was in line with expectations. Inflation has subsided but remains above the 4% target, with upside risks emanating from the persistent volatility in food prices and geopolitical tensions. The resilient growth outlook provides policy space to the MPC to unwaveringly focus on ensuring price stability on a durable basis by working towards fuller transmission of past rate hikes and anchoring of household inflation expectations. This leaves little scope for any change in rate/stance in the near term. Until then, RBI is likely to continue to focus on liquidity management to ensure liquidity conditions remain aligned with the monetary policy stance, and money market rates remain closer to the policy repo rate.

Table 1: Current policy rates

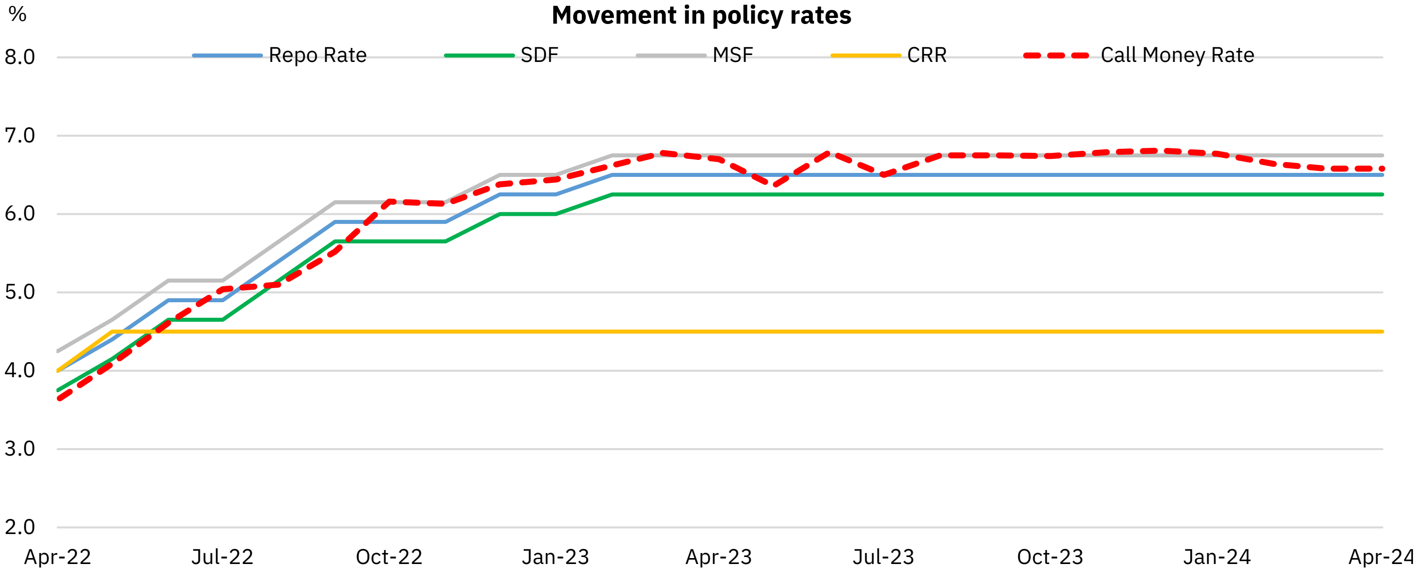
The policy repo rate was retained at 6.5% in the April policy, accompanied with continuation of "withdrawal of accommodation" stance, with a 5:1 majority.

Key rates	Oct 2023	Dec 2023	Feb 2024	Apr 2024
Repo Rate	6.50%	6.50%	6.50%	6.50%
Standing Deposit Facility (SDF)*	6.25%	6.25%	6.25%	6.25%
Marginal Standing Facility (MSF)	6.75%	6.75%	6.75%	6.75%
Bank Rate	6.75%	6.75%	6.75%	6.75%
Cash Reserve Ratio (CRR)	4.50%	4.50%	4.50%	4.50%

Source: RBI, NSE EPR. * Introduced in April 2022 policy as the new floor of the LAF corridor.

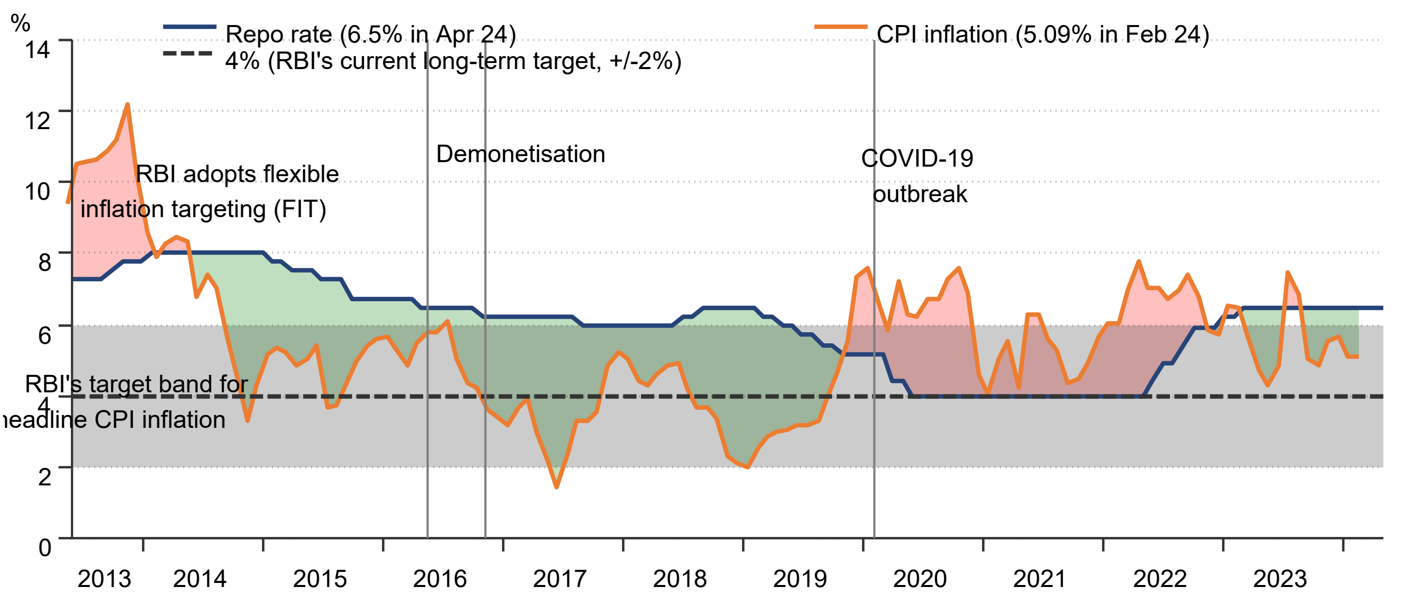
Figure 1: Movement in key policy rates

Flexible liquidity management by the RBI has helped bring down money market rats closer to the policy repo rate. The average Weighted Average Call Money Rate (WACR) to 6.61% in February-March from 6.76% in December-January.



Source: Refinitiv Datastream, NSE EPR.

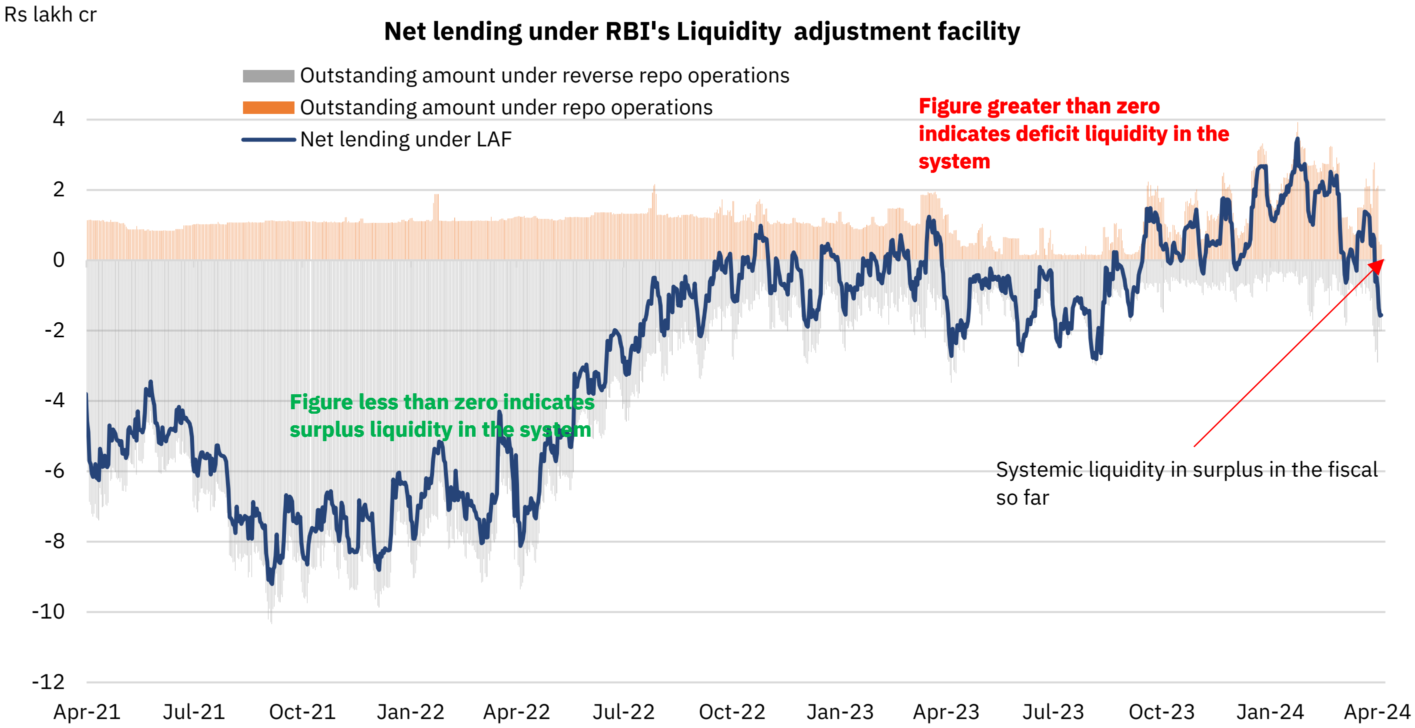
Figure 2: Real interest rates



Source: Refinitiv Datastream, NSE EPR.

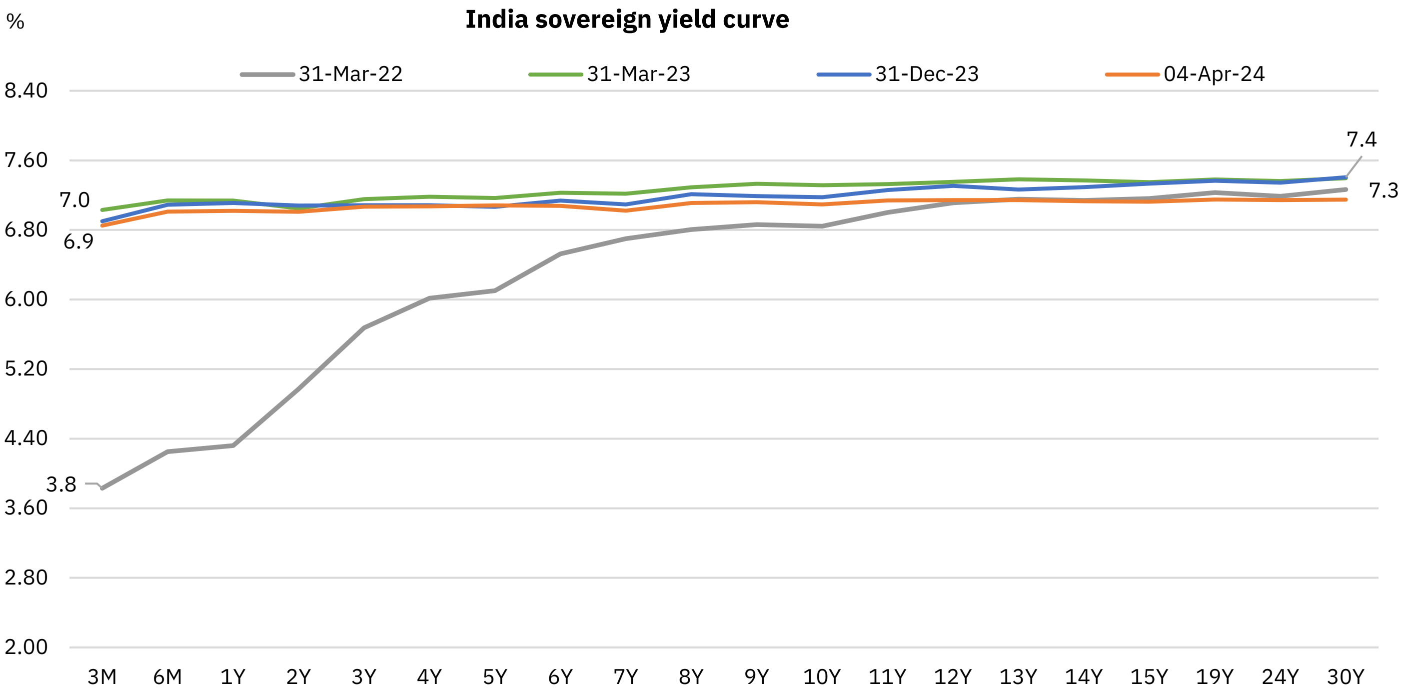
Figure 3: Net lending under RBI's Liquidity Adjustment Facility

Systemic liquidity eased significantly in the February-March period to a deficit of Rs 1 lakh crore compared to Rs 1.6 lakh crore in the December-January period. In fact, average liquidity deficit fell to Rs 0.4 lakh crore in March, and has remained in surplus since March 30th, 2024.



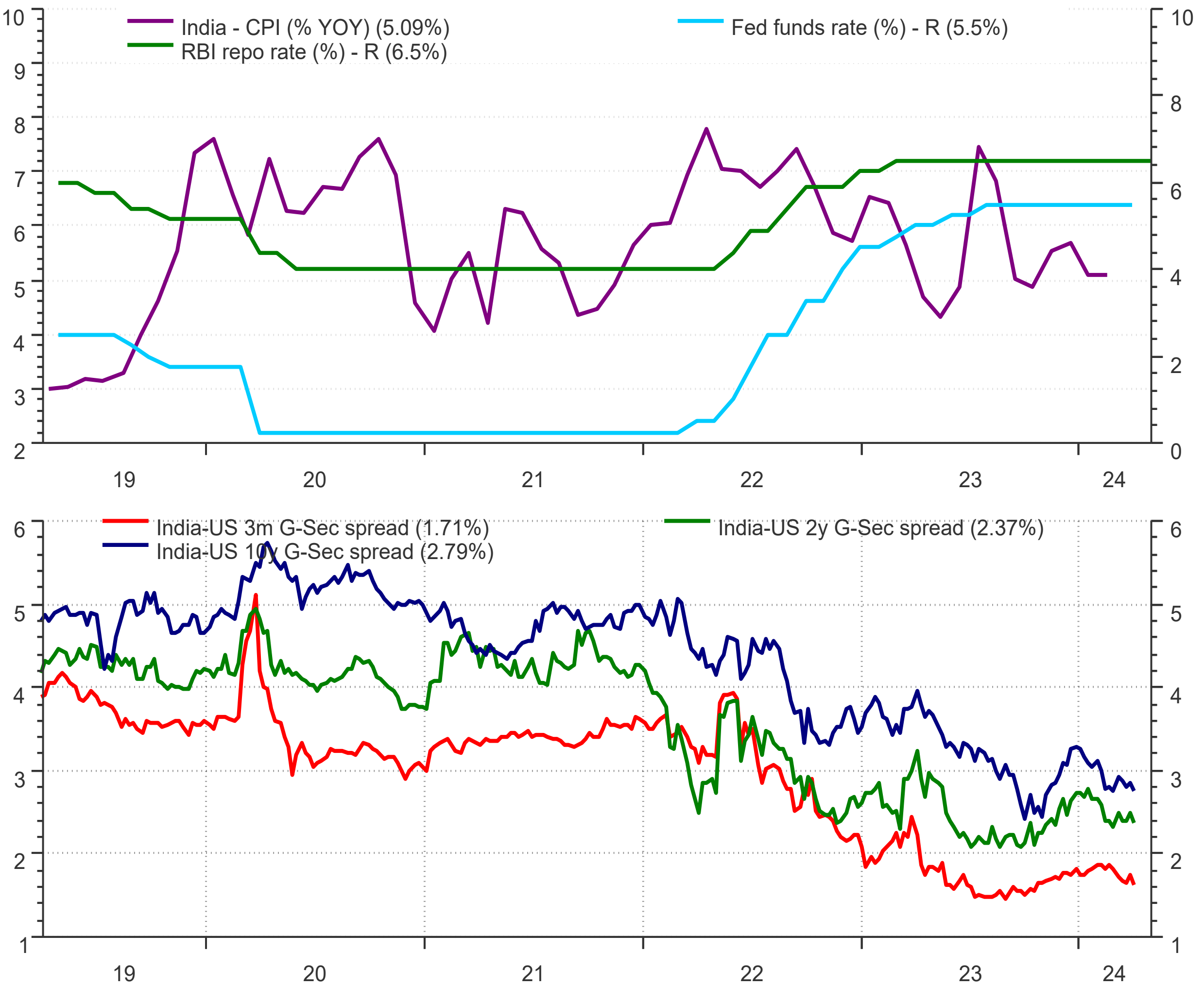
Source: CMIE Economic Outlook, NSE EPR.

Figure 4: India sovereign yield curve



Source: Refinitiv Datastream, NSE EPR.

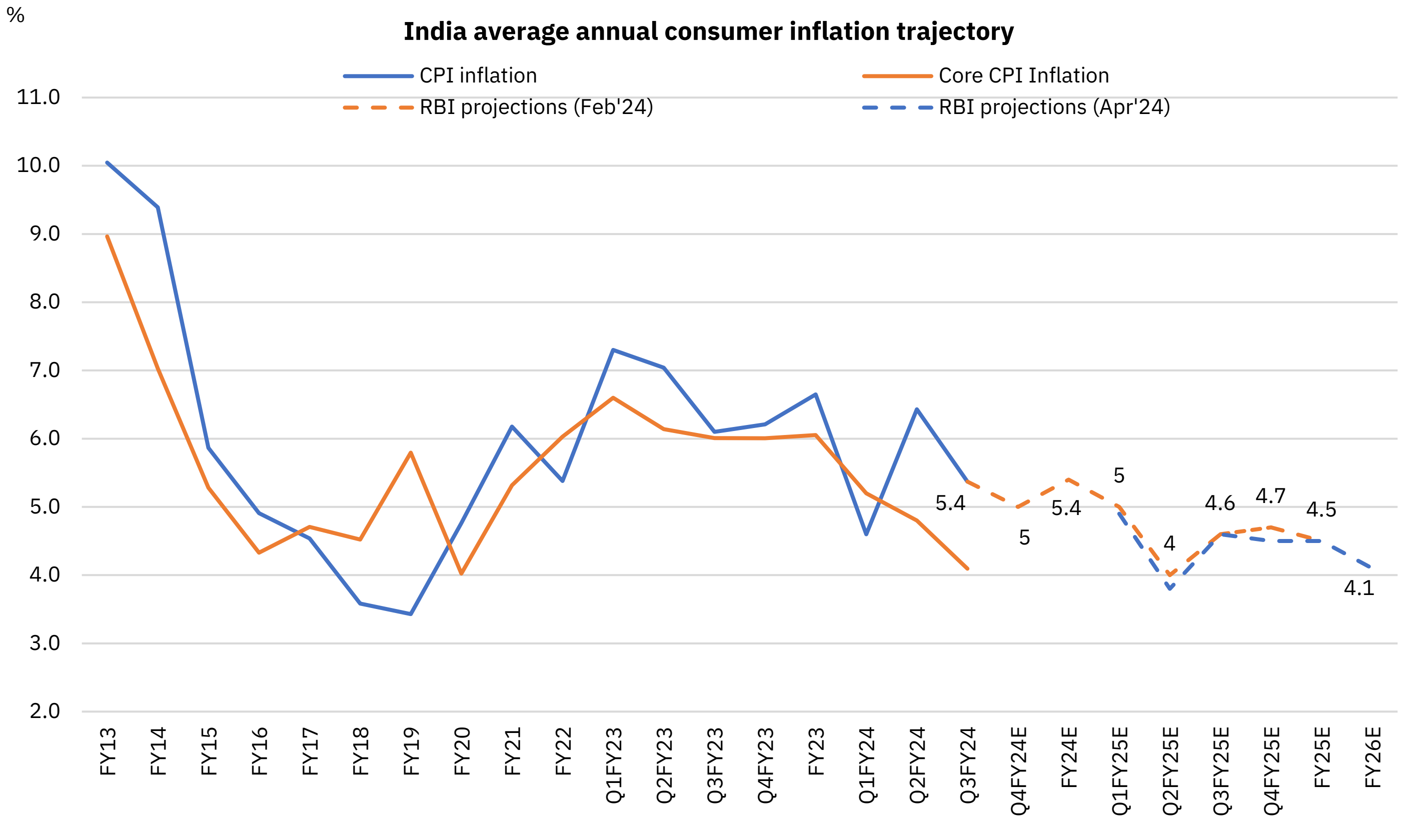
Figure 5: India vs. US policy rates and yield differential



Source: Refinitiv Datastream, NSE EPR.

Figure 6: India's consumer inflation trajectory and RBI's forecasts

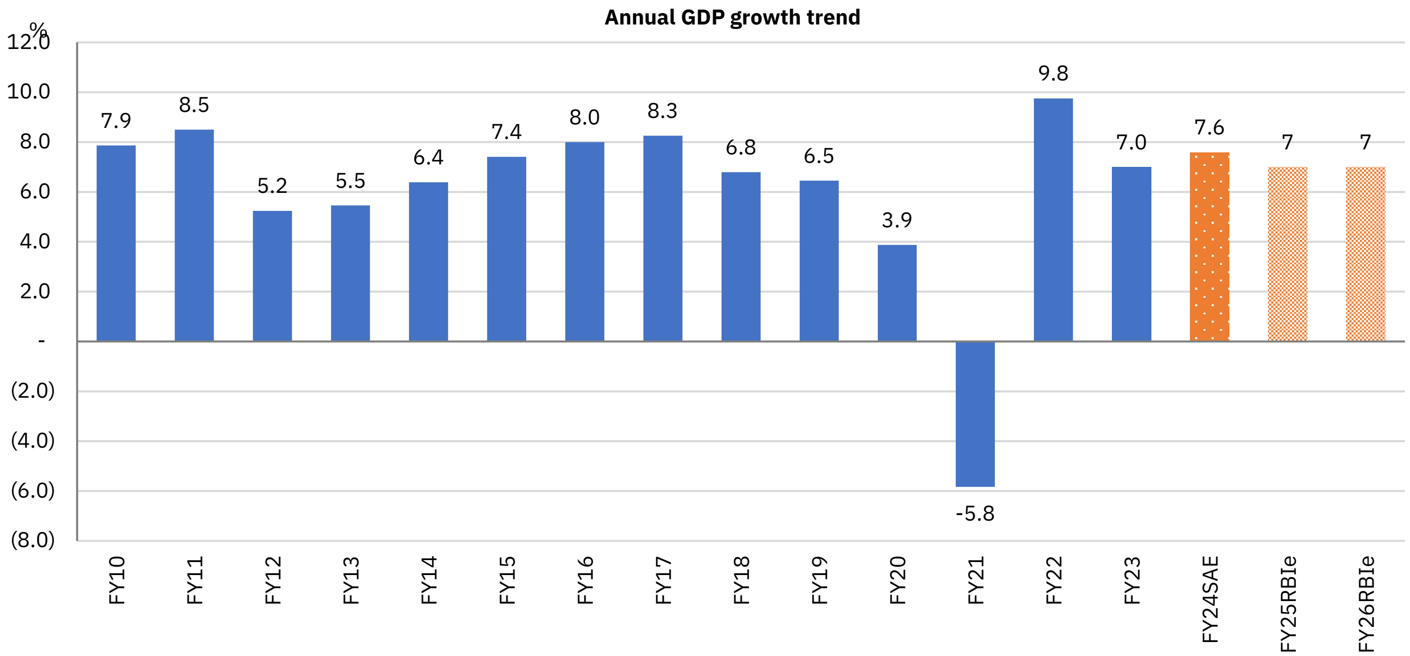
The headline inflation for FY25 is projected at 4.5% with marginal downward revisions in Q1FY25 (10 bps), Q2FY25 (20bps) and Q4FY25 (20bps). For FY26, assuming a normal monsoon and no external shocks, CPI inflation is expected to average 4.1%.



Source: CMIE Economic Outlook, RBI EPR. Core inflation is calculated as CPI inflation excluding food, pan, tobacco & intoxicants and fuel & light.

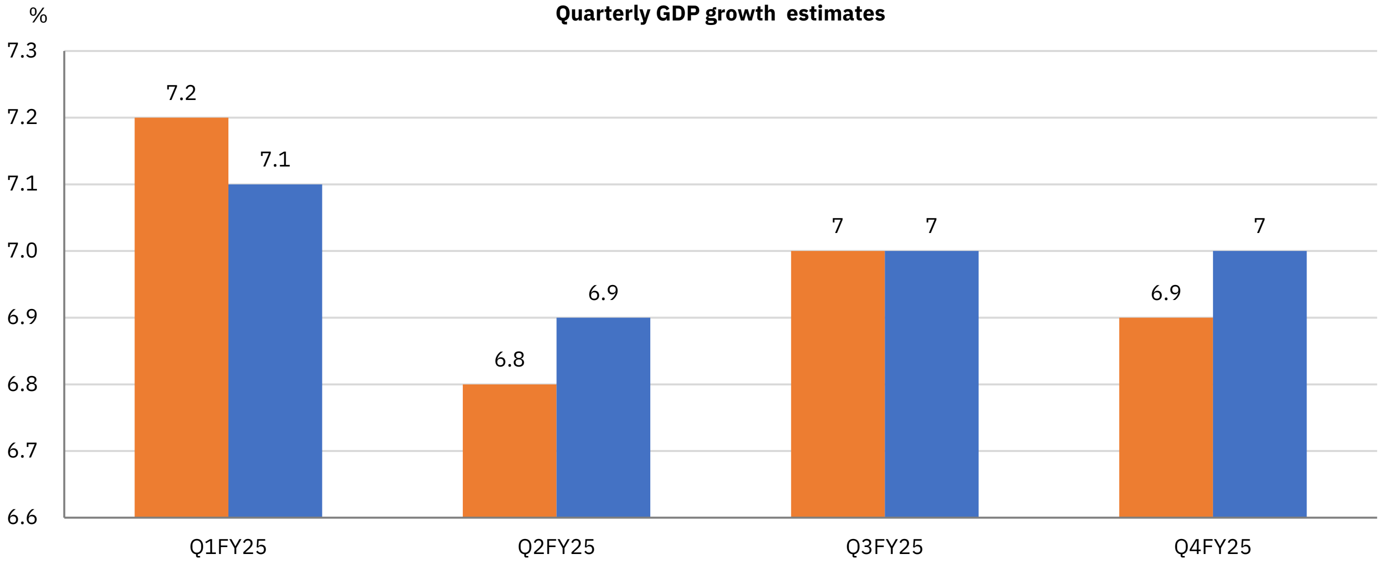
Figure 7: GDP growth trend and RBI's estimates

Growth momentum is expected to sustain in FY25, with the GDP growth forecast pegged at 7% in FY25. For FY26, GDP growth is also estimated at 7%.



Source: CMIE Economic Outlook, RBI, NSE EPR. RBIe = RBI estimate, SAE = First Advance Estimate.

Figure 8: Quarterly GDP growth forecasts by RBI for FY25



Source: RBI, NSE EPR.

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