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RBI Monetary Policy: Status quo on rates; stance shifts to "neutral"

The RBI's MPC—with a new set of external members—expectedly decided to retain the policy repo rate at 6.5% for the tenth consecutive time with a 5:1 majority. Dr Nagesh Kumar was the only member who dissented by voting for a 25bps rate cut. The stance, however, was unanimously revised from "withdrawal of accommodation" to "neutral", reflecting increased confidence in the disinflation trajectory later in the fiscal year. The GDP growth forecast for FY25 has been retained at 7.2%, with resilience primarily fuelled by momentum in consumption (festive season demand, revival in rural demand) and investment activities (thrust to government capex and signs of pick-up in private investment supported by healthy corporate balance sheets). Similarly, the inflation forecast for FY25 has been kept unchanged at 4.5%. A temporary spike in the near-term, thanks to unfavourable base and rising food prices, is likely to be followed by a moderation in Q4. The RBI's nimble and flexible approach towards liquidity management via variable rate repo (VRR) and reverse repo (VRRR) operations has ensured alignment of liquidity conditions with the monetary policy stance. Despite the improved performance of banks and NBFCs, the RBI governor explicitly highlighted the stress build-up in certain segments of NBFCs, underscoring the need for sustainable business goals and strong risk management framework.

The RBI's MPC is expected to balance global and domestic developments, closely monitoring the tensions in the Middle East and its impact on crude oil prices along with the near-term food inflation risks. On the domestic front, despite resilient economic growth, emerging signs of demand weakness add uncertainty to the outlook. That said, the ongoing festive season could help ease the incipient weakness. Given the current growth-inflation dynamics, the change in stance grants the MPC increased flexibility, allowing it to closely observe the continuing, albeit incomplete, progress of disinflation, while supporting growth if required. While it opens space for a rate cut as early as December, the probability remains evenly balanced for now given the MPC's unwavering focus on bringing down inflation within target levels on a durable basis. During this period, the RBI is likely to remain nimble and flexible on liquidity management to ensure orderly money market rates and maintain financial stability.

- **MPC remains status quo on rates; shifts stance to "neutral":** The RBI's MPC — with a new set of external members — expectedly decided to retain the policy repo rate at 6.5% for the tenth consecutive time with a 5:1 majority while unanimously deciding to revise the monetary policy stance to *"neutral"*, first time since April 2019. The MPC's increased confidence in the disinflation trajectory in the later part of the financial year faciliated the change the stance. That said, the MPC reiterated its commitment to ensure 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.

The RBI expectedly kept the policy repo rate unchanged at 6.5% with a 5:1 majority while the monetary policy stance has been changed to "neutral"

- **Inflation forecast retained at 4.5% for FY25:** Headline inflation projection for FY25 is unchanged at 4.5% with a downward revision in Q2 (4.1%; -30 bps), Q4 (4.2%; -10 bps) while the Q3 projection has been revised upward by 10 bps to 4.8%. Inflation forecast for Q1FY26 has also been revised lower by 10bps to 4.3%. Notwitstanding the recent moderation (3.6% in June-July), the headline inflation is expected to witness a noticeable jump in the near term on the back of unfavorable base-effect and food price momentum in some commodities. Subsequently, the headline inflation is projected to sequentially moderate due to good kharif harvest while encouraging monsoon, sowing and reservoir level data augur well for ensuing rabi crop and overall agriculture production. Upside risks emanate from unexpected weather events, worsening geopolitical conflicts, volatility in crude oil prices and uptick in metal prices.

Inflation and growth forecast for FY25 retained at 4.5% and 7.2% respectively.

- **GDP growth forecast kept unchanged at 7.2% for FY25:** The RBI also retained the FY24 GDP growth forecast at 7.2%, with a downward revision of 20bps in Q2 to 7% offset by upward revisions of 10bps/20bps in Q3/Q4 to 7.4% each. The Monetary Policy Report projects India's GDP growth at 7.1% in FY26 (higher than 7% in April's MPR). The resilience in growth is likely to be fuelled by momentum in consumption and investment activity. Key drivers include a) improved agriculture outlook and revival in rural demand, b) pick-up in government expenditure, c) continued thrust on government capex, d) healthy balance sheets of banks and corporates, e) visible signs of private investment pick-up, f) festive season spending momentum, and f) buoyancy in services to support urban consumption. Key downside risks to growth emerge from lingering geopolitical conflicts.
- **Banking liquidity remains largely in surplus:** Systemic liquidity during Aug-Sep'24 remained in surplus, averaging Rs 1.3 lakh crore, with a brief deficit in late September due to tax-related outflows. By early October (up to October 7th, 2024), the surplus rebounded to Rs 2.3 lakh crore, aided by increased government spending and a decline in currency in circulation. During this period, the RBI conducted two-way operations to manage shifting liquidity conditions, including VRRR auctions absorbing Rs 11.5 lakh crore (up to October 7th, 2024) and VRR operations injecting Rs 2.1 lakh crore (during September 17-24th, 2024). The weighted average call rate (WACR) averaged 6.53% in August-September as against 6.55% during June-July, before decreasing to 6.44% in early October (up to October 7th, 2024). However, it remained well anchored within the LAF corridor of 6.25%-6.75%. The RBI is likely to remain flexible in its approach to liquidity management to ensure orderly money market conditions and financial stability.
- **Regulatory measures:** The RBI has broadened its regulations to prohibit banks and NBFCs from levying foreclosure charges on floating rate loans, extending the coverage to loans provided to Micro and Small Enterprises (MSEs). A discussion paper on capital-raising avenues for Primary (Urban) Co-operative Banks is also set to be issued, focusing on the issuance of special shares and premium shares, following recommendations from the RBI's expert committee. In response to climate-related financial risks, the RBI proposed a public directory and a data portal for regulated entities namely the Reserve Bank Climate Risk Information System (RB-CRIS). Additionally, the RBI plans to raise UPI123Pay's transaction limit to Rs 10,000 and expand UPI Lite's wallet limit to Rs 5000. Finally, a beneficiary account name look-up feature will be introduced for RTGS and NEFT transactions to reduce payment fraud and enhance customer confidence.
- **Rate cut in the offing?:** The RBI's MPC is expected to balance global and domestic developments, closely monitoring the tensions in the Middle East and its impact on crude oil prices along with the near-term food inflation risks. On the domestic front, despite resilient economic growth, emerging signs of demand weakness add uncertainty to the outlook. That said, the ongoing festive season could help ease the incipient weakness. Given the current growth-inflation dynamics, the change in stance grants the MPC increased flexibility, allowing it to closely observe the continuing, albeit incomplete, progress of disinflation, while supporting growth if required. While it opens space for a rate cut as early as December, the probability remains evenly balanced for now given the MPC's unwavering focus on bringing down inflation within target levels on a durable basis. During this period, the RBI is likely to remain nimble and flexible on liquidity management to ensure orderly money market rates and maintain financial stability.

Table 1: Current policy rates

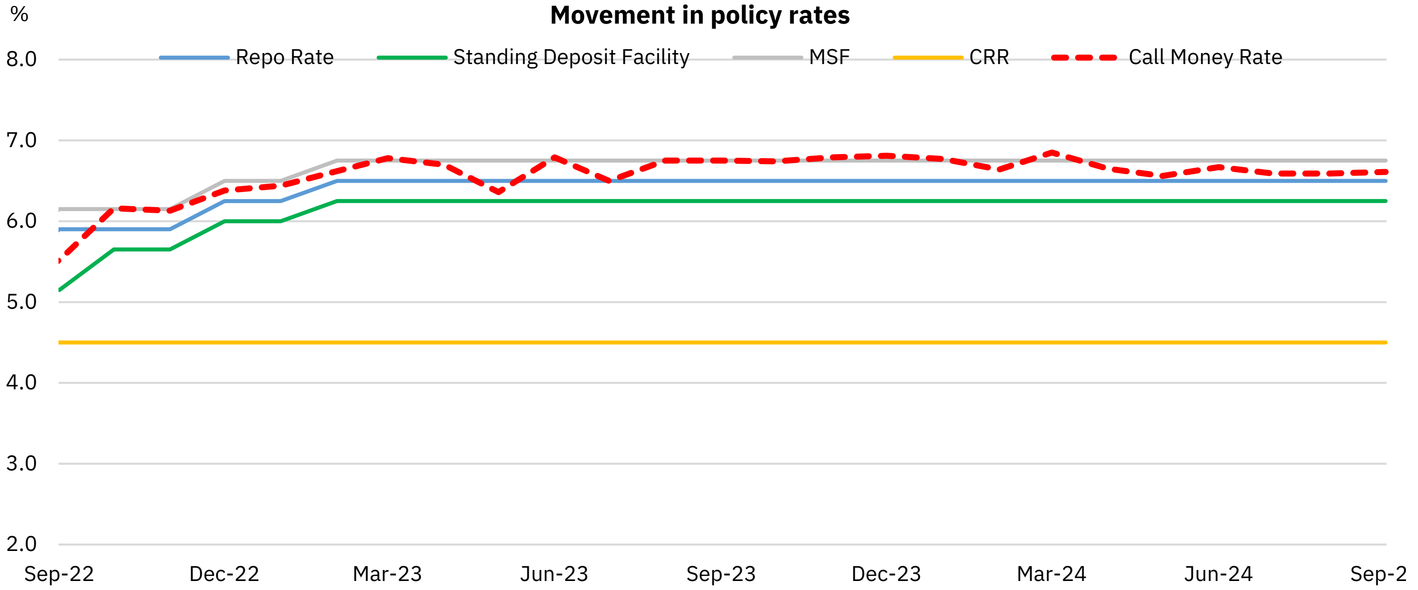
The policy repo rate was retained at 6.5% in the October policy with a 5:1 majority, while the policy stance has been unanimously changed to "neutral".

Key rates	Apr 2024	June 2024	August 2024	October 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.

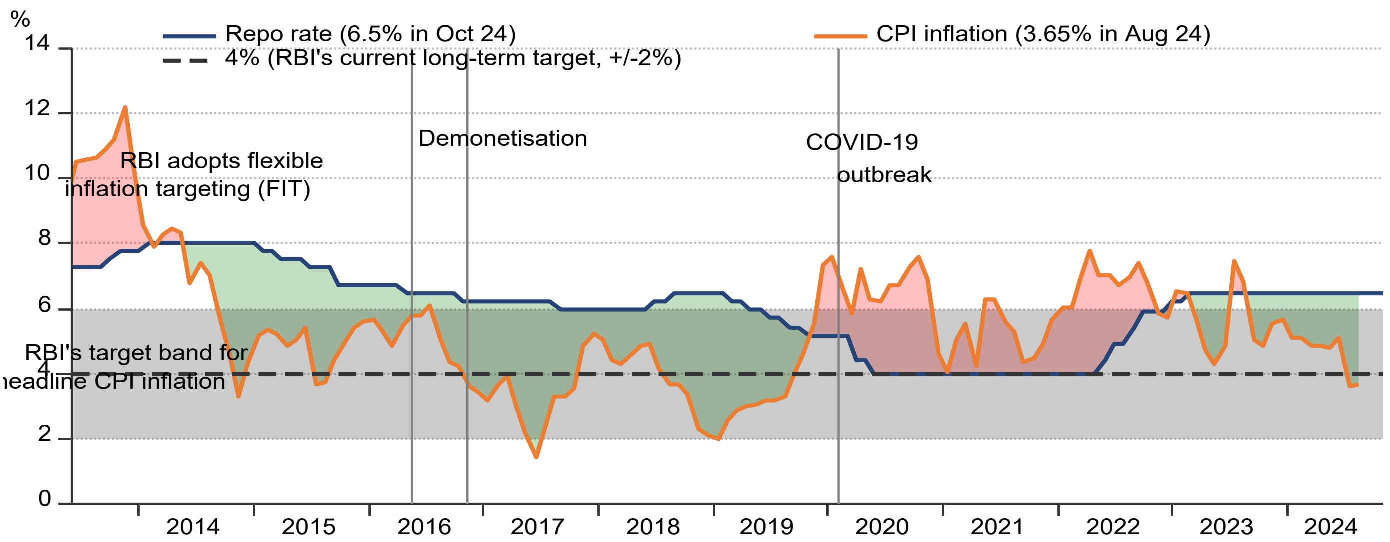
Figure 1: Movement in key policy rates

Flexible liquidity management by the RBI has helped bring down money market rates closer to the policy repo rate. The average Weighted Average Call Money Rate (WACR) fell to 6.53% during August-September from 6.55% during June-July. The WACR averaged 6.44% during October (up to October 7th).



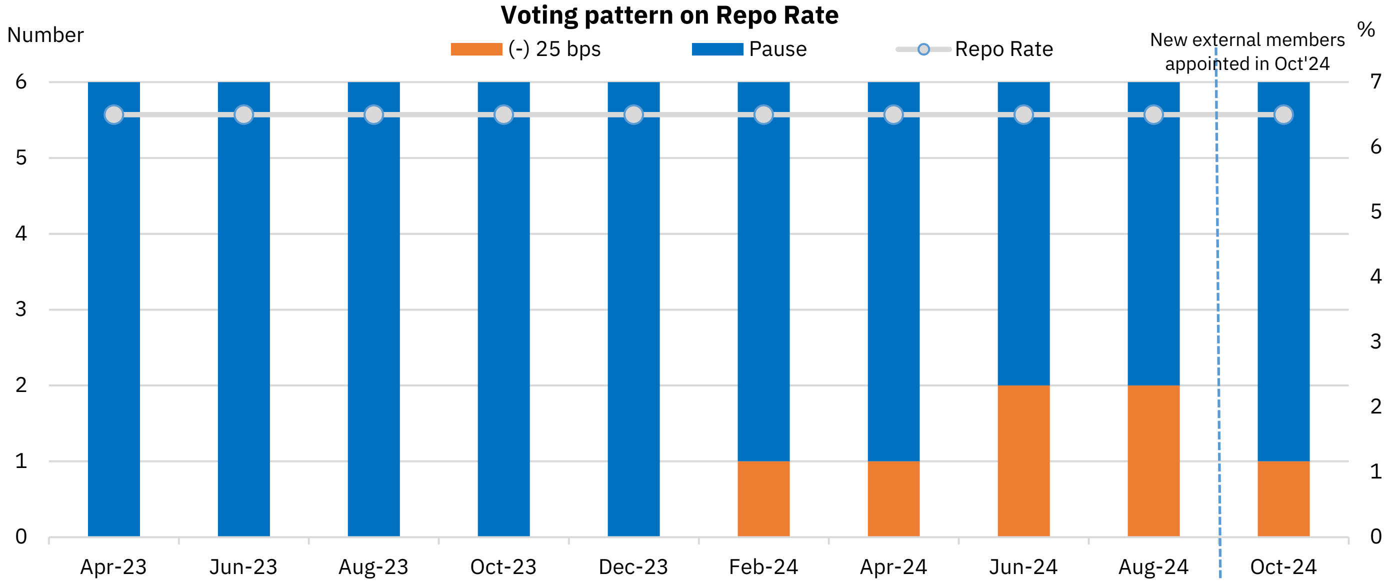
Source: LSEG Datastream, NSE EPR.

Figure 2: Real interest rates



Source: Refinitiv Datastream, NSE EPR.

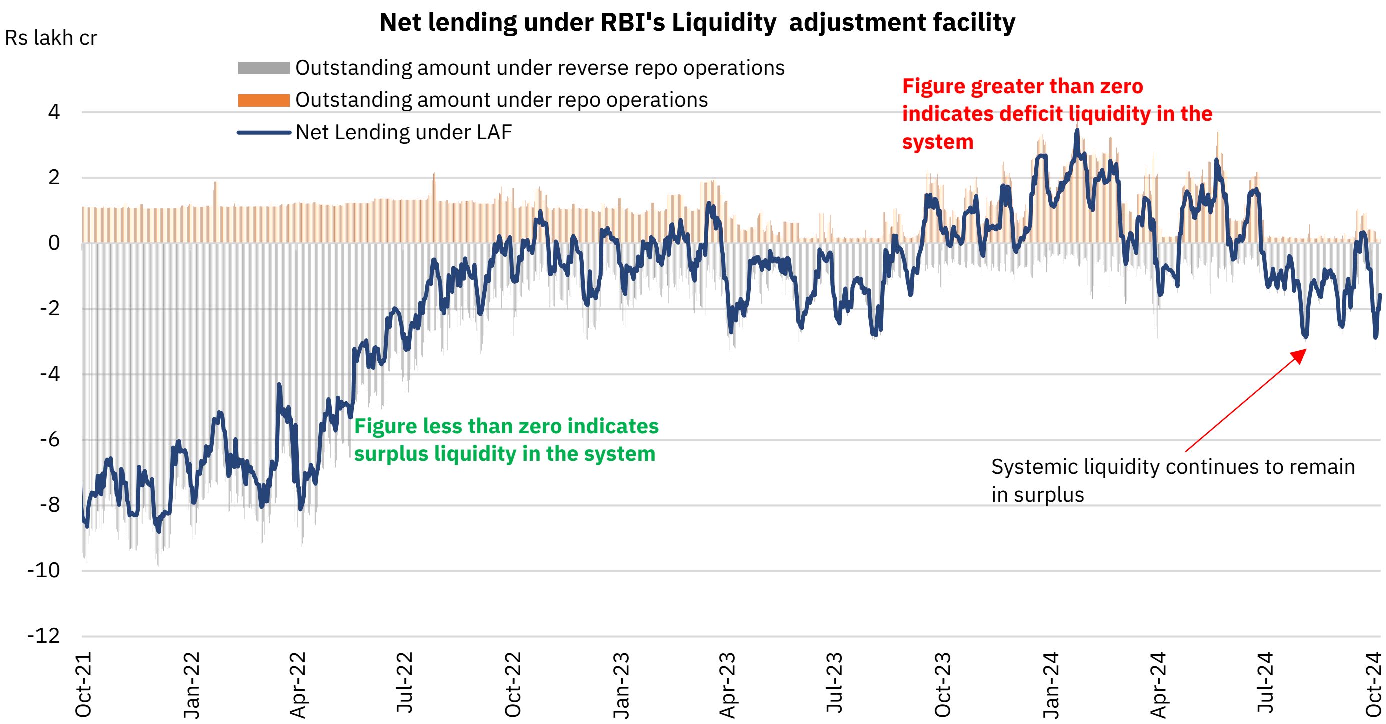
Figure 3: MPC members' voting pattern



Source: RBI, NSE EPR.

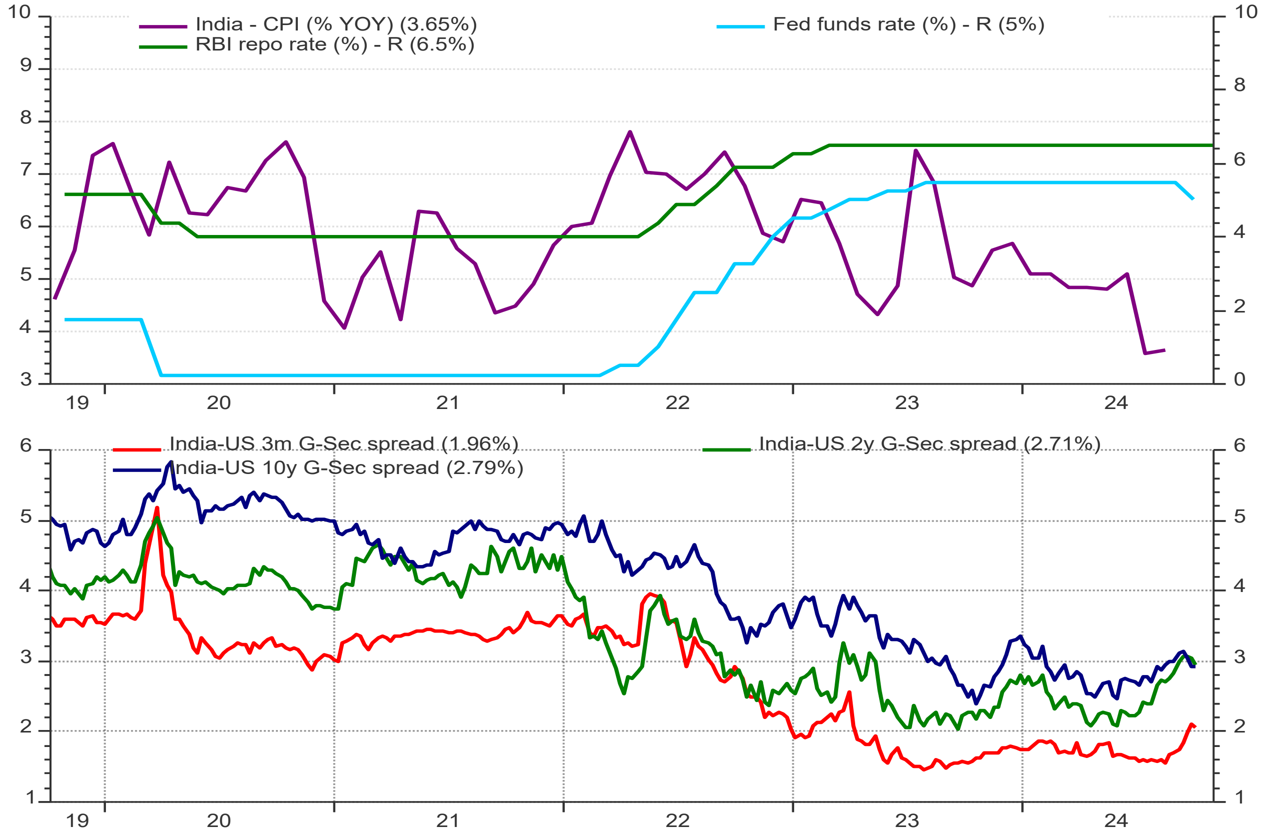
Figure 4: Net lending under RBI's Liquidity Adjustment Facility

System liquidity remained in surplus during August-September, averaging Rs 1.3 lakh crore. It moved from a surplus of Rs 2.7 lakh crore during early August to a deficit of Rs 0.2 lakh crore during late September and then back to a surplus of Rs 2.3 lakh crore in early October (up to October 6th). This surplus is mainly due to pick up in government spending and decline in currency in circulation.



Source: CMIE Economic Outlook, NSE EPR.

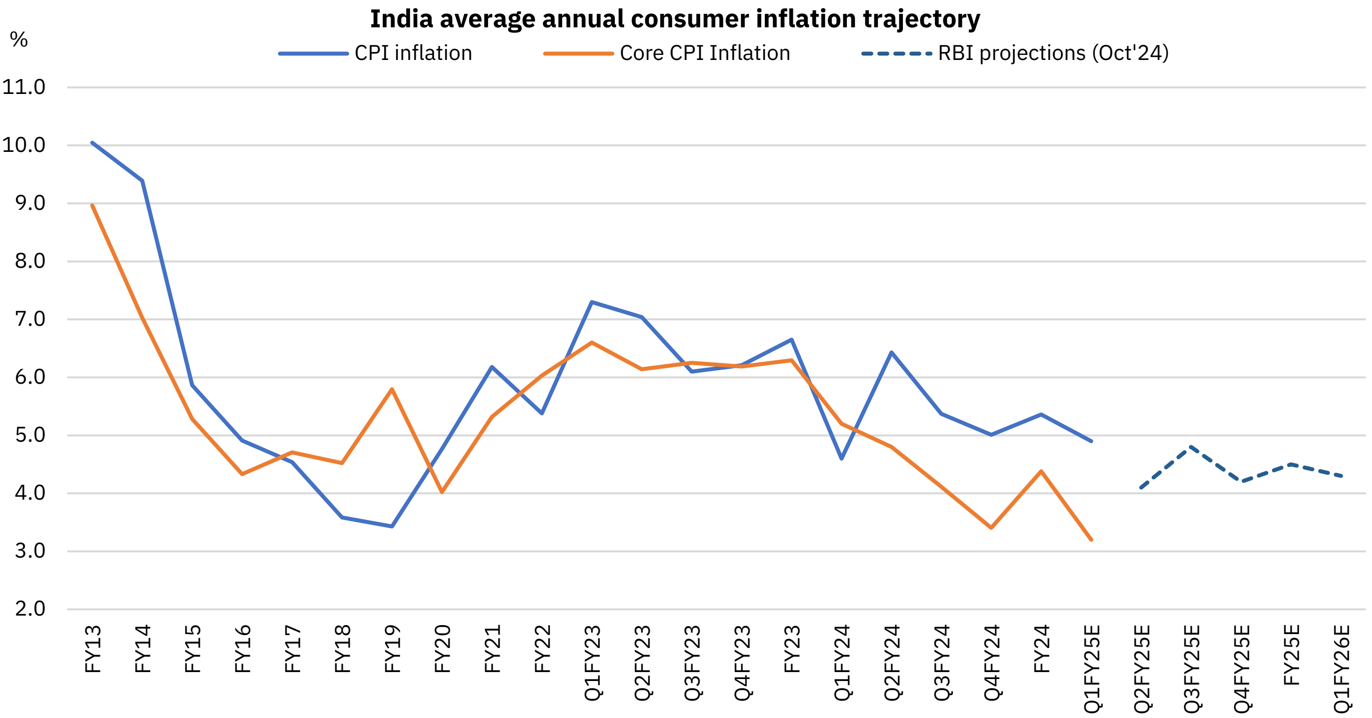
Figure 5: India vs. US policy rates and yield differential



Source: LSEG Datastream, NSE EPR.

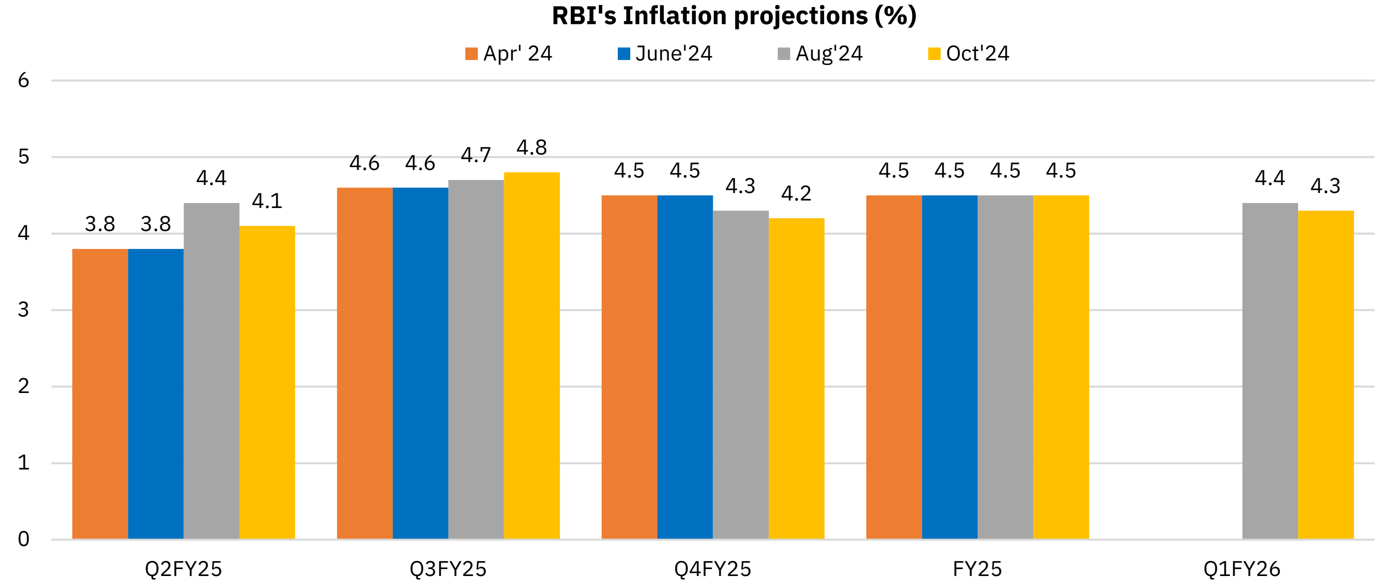
Figure 6: India's consumer inflation trajectory and RBI's forecasts

Headline inflation projection for FY25 is unchanged at 4.5%, with a downward revision in Q2, Q4 and Q1-FY26 while the Q3 projection has been revised upward.



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

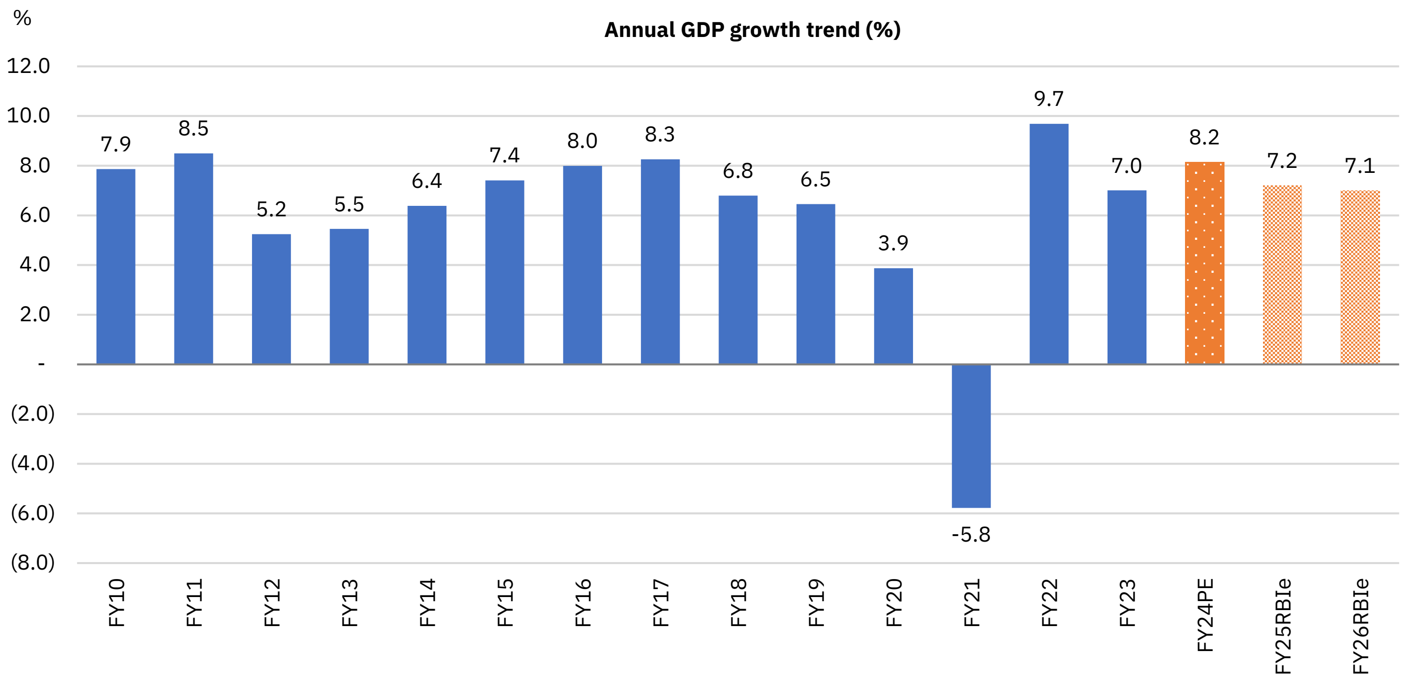
Figure 7: Quarterly inflation forecasts by RBI for FY25



Source: RBI, NSE EPR.

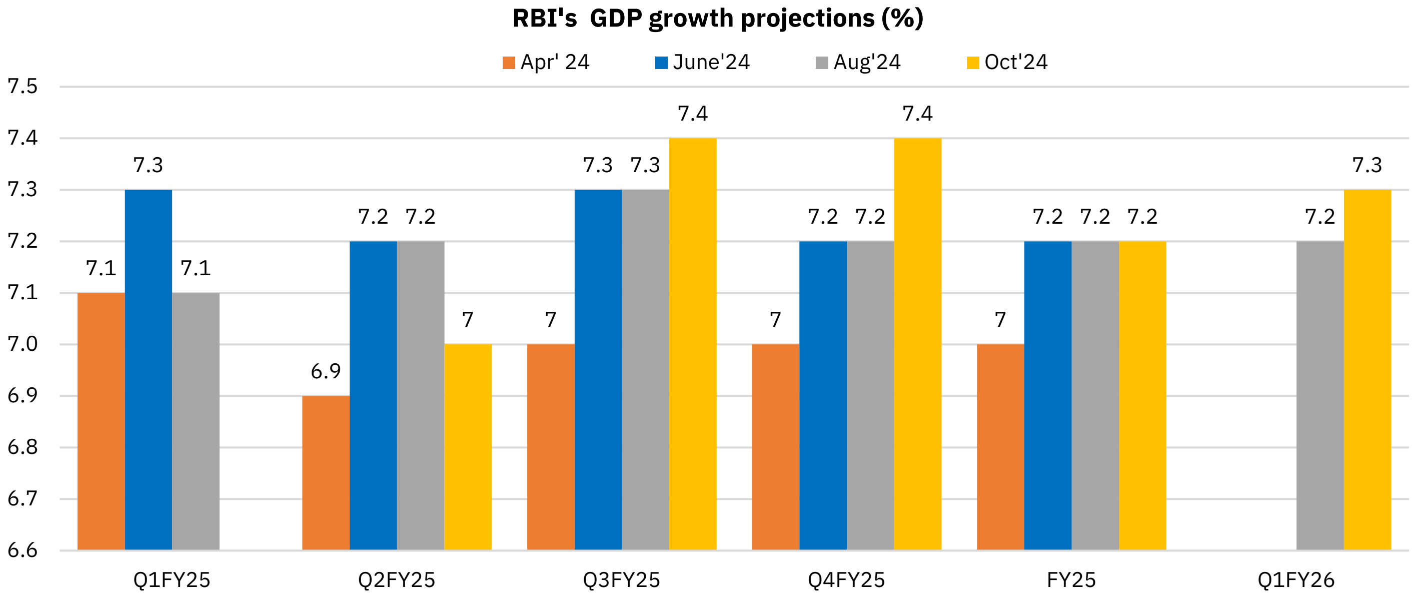
Figure 8: GDP growth trend and RBI's estimates

The GDP growth projection for FY25 has been retained at 7.2%.



Source: CMIE Economic Outlook, RBI, NSE EPR. RBIe = RBI estimate, PE= Provisional Estimate.

Figure 9: RBI's quarterly GDP growth forecasts for FY25



Source: RBI, NSE EPR.

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