MPC Policy Review

05th April 2024

MPC Policy Review

Economy doing well….Full transmission underway…Inflationary pressures not out of way….Rates maintained

The RBI MPC voted 5-1 to keep policy repo rate unchanged at 6.5% on Apr 05, maintaining status quo for the seventh time. The MPC is resolute in its commitment to align the CPI to its target of 4% as uncertainties in food prices continue to pose challenges. The MPC continued with the 'withdrawal of accommodation' stance (with 5:1 majority) to ensure that inflation progressively aligns to the target, while supporting growth. The GDP and inflation forecast for FY25 were maintained at 7% and 4.5% respectively.

Although growth has continued to sustain its momentum surpassing all projections, headline inflation has cooled and core inflation has been the lowest in the past nine months, the MPC remains vigilant to the upside risks to inflation that might derail the path of disinflation. The RBI Governor highlighted global risks from debt overloads and geopolitics, and the recent upturn in oil prices. A record rabi wheat production, early indication of normal monsoon and benign international food prices could lend support to a reduction in food inflation which has been impacted by frequent and overlapping adverse climate shocks. The RBI retained its inflation forecast for FY25 at 4.5%. However, it revised down Q1 forecast by 10 bps to 4.9%, and Q2 and Q4 forecast by 20 bps to 3.8% and 4.5%, respectively.

There were no changes to the RBI's communication on liquidity management. Liquidity conditions have improved in recent weeks and the overnight rate (WACR) has moved closer to the repo rate. Increased Government spending and foreign inflows due to the inclusion in the JP Morgan bond index are supportive to liquidity conditions. The Reserve Bank conducted fourteen fine tuning variable rate reverse repo (VRRR) operations during February and early March to absorb intermittent surplus liquidity.

While the recent surplus liquidity could reduce (seasonal impact) by the middle of April, on average liquidity balances are expected to be close to neutral over the coming quarter and sustained large deficits are unlikely. Some further improvement in liquidity balances is likely once government spending picks up pace by Q2FY25 and foreign inflows due to the inclusion in the JP Morgan bond index are supportive.

During the first three quarters of 2023-24, India's current account deficit (CAD) narrowed significantly on account of a moderation in merchandise trade deficit coupled with robust growth in services exports and strong remittances. India continues to be the largest recipient of remittances in the world. During Q3: 2023-24, the CAD stood at US$ 10.5 billion (1.2% of GDP) as compared to US$ 11.4 billion (1.3% of GDP) in Q2. Net FPI inflows stood at US$ 41.6 billion during 2023-24, as against net outflows in the preceding two years (US$ 14.1 billion in 2021-22 and US$ 4.8 billion in 2022-23). However, FDI inflows moderated sharply to US$ 14.2 billion in April-January 2023-24 from US$ 25.0 billion a year ago.

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Domestic economic activity continues to expand at an accelerated pace, supported by fixed investment and improving global environment. The purchasing managers' index (PMI) for manufacturing displayed a sustained expansion in February-March, touching a 16-year high. The services sector has exhibited broad based buoyancy with all sectors registering strong growth. The second advance estimates (SAE) placed real GDP growth at 7.6 per cent for 2023-24, the third successive year of 7 per cent or higher growth.

Long term G-sec yields have remained stable since the last policy meeting. 10-year G-sec yields rose to 7.11% from its previous day close of 7.09% post the announcement as monetary transmission of past actions continues to be work in progress. The money market however is understandably a bit cautious in the very short term given pick up in global rate volatility and the recent rise in oil prices.

Given the recent global resilience in economic activity, there has been a tendency to keep monetary policy tight to take on the last mile challenge on inflation by global central banks. Despite the buoyant GDP growth and declining inflation trajectory, the RBI MPC remains steadfast ensuring that inflation aligns durably and sustainably to its target and will continue to be actively disinflationary. Domestic economic activity continues to expand at an accelerated pace, supported by fixed investment and improving global environment. Recent uptick in fuel prices, expectation of a harsh summer and continuing geo-political tensions pose upside risk to commodity prices and supply chains. Consequently, a rate cut soon remains unlikely. We expect a rate cut perhaps in Q2/Q3FY25 but that too would be data dependent.

Equity markets would be largely indifferent to the policy outcome as there were no major surprises in it.

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