The RBI Affirms Status Quo: Task to Bring Inflation Down Remains Unfinished

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- In today's monetary policy meeting, the RBI maintained its repo rate unchanged at 6.5% for the seventh consecutive meeting. Furthermore, it also decided to remain focused on the withdrawal of accommodation. The voting pattern was similar to the previous meeting with one member voting against the consensus.
- The tone of the governor's address is assessed to be cautiously hawkish. The governor emphasised that upside risks to inflation remain, and that monetary policy should remain actively disinflationary to ensure fuller transmission and anchoring of inflation expectations.
- On the inflation front, the RBI slightly nudged down its quarterly projections for FY25, likely acknowledging quicker-than-expected easing of core inflationary pressures over the past few months. That said, it remains watchful of shocks arising from volatility in food inflation and other supply-side related disruptions (commodity prices, most notably oil). The annual forecast, however, remained unchanged at 4.5%.
- On growth, it remains upbeat on economic growth in FY25 due to an expected improvement in the agricultural sector and sustained momentum in the industrial and services sectors. Overall, the RBI has kept its FY25 growth forecast unchanged at 7% with minor adjustments to the quarterly profile.
- The central bank's focus very much remains on price stability, bringing inflation down and aligning it to the target of 4% on a durable basis. Given strong growth expectations, and based on the central bank's current inflation projections, we retain our view that the rate cuts could begin in Q2 FY25.
- However, also given that inflation is expected to accelerate again in the second half of FY25, we continue to believe that the room for substantial cuts will be limited and that the next rate cut cycle could be much shallower than the rate cutting cycles of the past.
- The central bank reiterated, that it will continue to remain flexible and nimble in managing evolving liquidity conditions through its two-way operations. Looking ahead, banking liquidity will receive support from a likely pickup in government spending post-elections and foreign capital inflows due to India's inclusion in the global bond indices.

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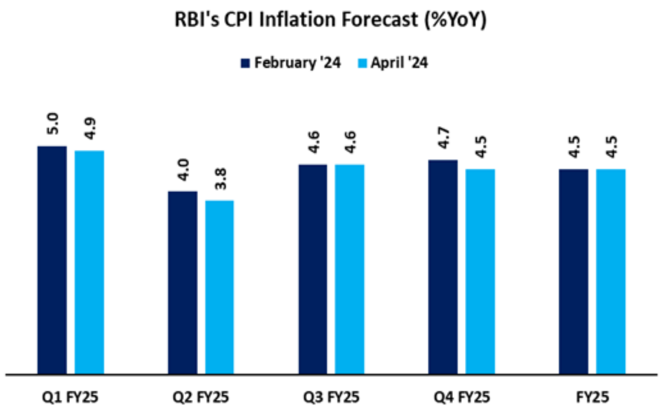
RBI maintains status quo on policy rate and stance

In line with market expectations, ***the monetary policy committee (MPC) decided to keep the repo rate unchanged at 6.50%, while retaining the stance of withdrawal of accommodation*** during its first policy meeting of the current financial year (FY25). Consequently, the ***Standing Deposit Facility (SDF) Rate remains at 6.25%, and the Marginal Standing Facility (MSF) Rate and Bank Rate remain at 6.75%***. The decision was not unanimous, as Prof. Jayanth Varma continued to vote for a 25bps rate cut and a change of stance to neutral.

Tone has remained hawkish; caution on inflation remains

The tone of the governor's address is assessed to be cautiously hawkish. While he acknowledged that significant progress has been made in reducing inflation, he also ***emphasised that upside risks to inflation remain from the uncertainty surrounding food prices amidst adverse weather conditions and geopolitical tensions***. This may lead to un-anchoring of the inflation expectations. Therefore, the MPC was of the view to keep the monetary policy actively disinflationary to ensure fuller transmission and anchoring of inflation expectations. With the policy tone largely on expected lines, there was no knee-jerk reaction in the market and the bond yields remained stable post the policy announcement.

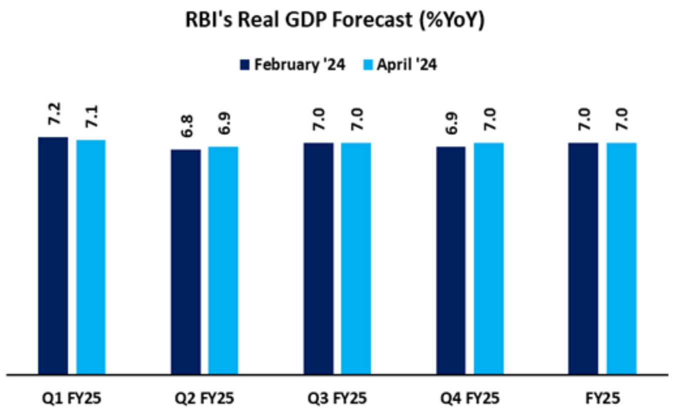
Inflation forecast was nudged down slightly



Source: RBI; Note: February '24 and April '24 refer to projections given by the RBI in its February 2024 and April 2024 MPC updates respectively.

The RBI slightly nudged down its quarterly inflation projections for FY25, although the full year average remains unchanged at 4.5%. The slight downward adjustment in the quarterly profile likely reflects the quicker-than-expected easing of core inflationary pressures over the past few months, providing confidence that barring food price shocks, disinflation could occur at a quicker pace. Indeed, core inflation in February 2024 came in at 3.4% (easing from an average of 4.1% in Q3 FY24). The governor also pointed out strong Rabi wheat production, the forecast of a normal southwest monsoon (important for the Kharif crop season), and benign international food prices as comfort points. That said, the RBI remains cautious of upside risks emanating from the tight demand-supply conditions in certain categories of pulses and production outcomes of key vegetables given the prediction of above normal temperature in coming months. A return of cost push pressure faced by firms (corroborated by the PMI data for March), along with the recent surge in global crude oil prices also pose genuine risks to ongoing disinflation. Additionally, frequent and overlapping adverse climate shocks and continuing geo-political tensions in many parts of the world cast further uncertainty on the future path of inflation.

Growth forecast remains unchanged; expectations are upbeat



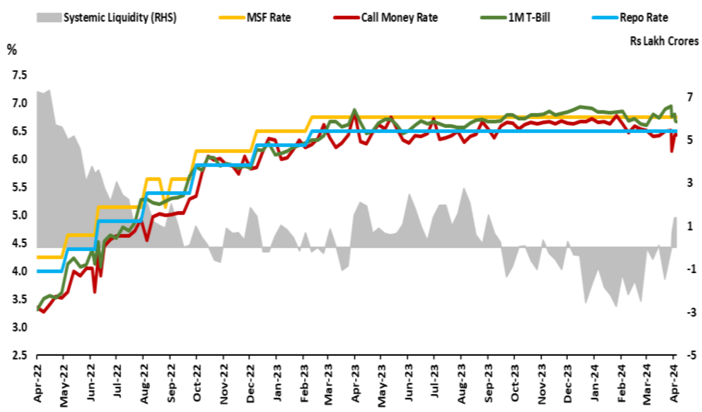
Source: RBI; Note: February '24 and April '24 refer to projections given by the RBI in its February 2024 and April 2024 MPC updates respectively.

The RBI remains upbeat on economic growth in FY25. It expects the prospects for agriculture to improve with good Rabi wheat production and a normal southwest monsoon, which augurs well for the Kharif crops season. This together with moderating food price pressures is expected to support rural demand. Furthermore, momentum in the manufacturing and services sector (in March both manufacturing and services PMI recorded readings close to 60) is expected to sustain. Robust government capital expenditure, healthy corporates' and banks' balance sheets and rising capacity utilisation are all positive signs for an upturn in the private CAPEX cycle. External demand for goods and services is also expected to improve with improving global growth and trade prospects. Overall, the RBI has kept its FY25 growth forecast unchanged at 7% with minor adjustments to the quarterly profile as can be seen from the above chart.

Monetary Policy Outlook for FY25

The central bank's focus remains very much on price stability, bringing inflation down and aligning it to the target of 4% on a durable basis. This was reiterated many times in the governor's statement with emphasis on ensuring the anchoring of inflation expectations and fuller transmission of past actions. The MPC remains watchful of shocks arising from volatility in food inflation and other supply-side related disruptions (commodity prices, most notably oil). Reading this in conjunction with the minutes of the last policy meeting, the MPC is likely to wait and watch the progress of the southwest monsoon to judge its likely impact on the trajectory of food price inflation. ***Given that economic growth remains robust and is expected to remain strong, and based on the central bank's current inflation projections, we retain our view that the rate cuts could begin in Q2 FY25. However, also given that inflation is expected to accelerate again in the second half of FY25, we continue to believe that the room for substantial cuts will be limited. This means that the next rate cut cycle could be much shallower than the rate cutting cycles of the past where 110-200 bps of cuts were implemented***.

The RBI will continue to conduct two-way operations to maintain overnight call rates closer to the repo rate



Source: CMIE; Note: Data for Apr is till 4th April.

Regarding the liquidity management approach, there were no changes in the governor's statement as it stated that the central bank will continue to remain flexible and nimble in managing evolving liquidity through its two-way, main, and fine-tuning operations. Liquidity conditions have improved considerably in the past few weeks with the average liquidity deficit declining from Rs 2.1 lakh crores in January to Rs 1.9 lakh crores in February and Rs 0.4 lakh crores in March potentially due to a pick-up in government spending and the infusion of liquidity by the RBI to address liquidity concerns amidst advance tax payments. Indeed, the RBI has conducted multiple Variable Rate Repo (VRR) auctions over the past couple of months. Accordingly, the weighted average call night rate, which was hovering towards the upper corridor of MSF (6.75%) in January has moved closer to the policy rate (6.5%) in the week ending 29th March. With liquidity turning into surplus and the overnight rate falling below the policy rate since March 30th, the RBI has conducted Variable Rate Reverse Repo (VRRR) auctions as well which led to an increase in the overnight call rate from 6.15% on March 30th to 6.44% on April 4th. Looking ahead, banking liquidity will receive support from a likely pickup in government spending post-elections and foreign capital inflows due to India's inclusion in the global bond indices (no separate guidance was provided on managing foreign inflows).

The RBI also announced the developmental and regulatory policy measures listed below:

Financial Markets

- **Trading of Sovereign Green Bonds in International Financial Services Centre (IFSC):**
  RBI has announced that a scheme to facilitate broader non-resident engagement in Sovereign Green Bonds will be introduced shortly, aimed at fostering investment and trading in these bonds within the IFSC.

- **RBI Retail Direct Scheme - Introduction of Mobile App**
  The RBI Retail Direct Scheme, launched in November 2021 (which gives access to individual investors to maintain gilt accounts with RBI and invest in government securities), will soon introduce a mobile app for accessing its portal. This initiative aims to enhance convenience for retail investors and strengthen the G-Sec market.

Regulations

- **Review of Liquidity Coverage Ratio (LCR) Framework:**
  RBI intends to review the LCR framework for banks due to challenges posed by instant fund withdrawals facilitated by technological advancements. This will facilitate better management of liquidity risk by the banks.

- **Dealing in Rupee Interest Rate Derivative products – Small Finance Banks:**
  RBI has decided to permit Small Finance Banks (SFBs) to use permissible rupee interest derivative products for proprietary hedging, in addition to Interest Rate Futures (IRFs). This decision aims to provide SFBs with increased flexibility for interest rate risk hedging, thereby enhancing their resilience.

Payment and FinTech

- **Enabling UPI for Cash Deposit Facility:**
  Given the popularity and acceptance of UPI and the benefits observed from the availability of UPI for card-less cash withdrawals, the RBI has proposed

to facilitate a cash deposit facility through UPI – which was earlier available through debit cards in cash deposit machines.

- **UPI access for Prepaid Payment Instruments (PPIs) through third-party applications:**
  To provide more flexibility to the PPI holders, the RBI will allow the linking of PPIs through third-party UPI applications – currently, PPIs can be used to make UPI transactions but only by using the application provided by the PPI issuer.

- **Distribution of CBDCs through Non-bank Payment System Operators:**
  To expand the CBDC pilot, the RBI has proposed to make CBDC-Retail accessible to a broader segment of users in a sustained manner, by enabling non-bank payment system operators to offer CBDC wallets. This is expected to enhance access and expand choices available to users apart from testing the resiliency of the CBDC platform to handle multi-channel transactions.