



RBI MPC delivers status quo policy; additional member votes for neutral stance and rate cut

June 9, 2024





Key takeaways: RBI MPC meeting, June 2024

In its June policy meeting, the RBI MPC kept the policy rate and stance unchanged at 6.50% and 'withdrawal of accommodation' respectively. However, there was a change in the voting pattern of the six-member committee to 4:2 from 5:1, with an additional member (Dr. Ashima Goyal) voting for change in stance to 'neutral' and a policy rate cut of 25bps. This is unsurprising, based on Dr. Goyal's views in the previous MPC meeting minutes.

The MPC expressed comfort in the evolution of growth-inflation dynamics within the economy. With confidence in the domestic growth momentum, **the committee raised its real GDP growth forecast for FY25 by 20bps to 7.2%, with growth above 7% for each of the quarters.** Despite the content over progress in disinflation in the core component, the MPC remains cautious and vigilant regarding food price shocks and their spillover to other components of the CPI basket. **The committee retained CPI inflation forecast for FY25 at 4.5% without any tweaks to quarterly projections.** The policy statement also reiterated the central bank's approach to manage liquidity in a nimble and flexible manner with two-way variable rate repo and reverse repo operations.

The committee drew solace on the external front, with global trade expected to recover in 2025 that could be a tailwind for domestic growth prospects. The record level of foreign exchange reserves, lower volatility in INR exchange rate, and moderate current account deficit were noted as additional sources of comfort. While the forecast of an above normal monsoon bodes well for both growth and inflation, the spatial and intertemporal distribution need to be watched out for. Also, the volatility in global commodity prices, supply chain disruptions amid ongoing geopolitical conflicts remain additional sources of risks.

Among advanced economies, even as the European Central Bank and the Bank of Canada were the latest to join the policy easing cycle, prospects for the US Fed remain clouded by mixed trends in economic data. Latest non-farm payrolls data was strong, even as the Fed's preferred measure of core PCE inflation softened but remained above the 2% target. Financial markets remain volatile amid re-pricing of expectations of a Fed cut. On the domestic front, **the policy statement noted that domestic monetary policy is not dependent on Fed actions, possibly implying the possibility of a rate cut ahead of the Fed.** Though the policy statement noted that the moderation in headline inflation in Q2-FY24 to below 4% target on the basis of statistical effects is likely to reverse in subsequent quarters, **the context of real interest rates flared up in the post policy conference, akin to the previous MPC meeting.**



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The central bank is slated to revise its estimate of natural rate of interest for the economy in its upcoming monthly bulletin, typically released post the third week every month. The central bank's latest estimate of the natural rate of interest for the Indian economy is in the range of 0.8%-1.0% for Q3-FY22. Based on the current policy repo rate of 6.5% and the central bank's FY25 CPI inflation projection of 4.5%, the current real rate of interest stands at 2%, which could be construed as restrictive. Prior to the revision in 2022, the RBI's estimate of natural rate of interest was at 1.6-1.8% for Q4-FY15. The decline since then was on account of the moderation in potential output of the economy due to the pandemic.

If the neutral rate of interest is revised to around 1.5%, it indicates policy scope to cut rates by around 50bps for the policy to turn 'neutral'. It would still not imply any easing of policy but could give the required fillip for GDP level to catch-up to the pre-pandemic trend. Despite high growth rates of real GDP in the past couple of years, the level of real GDP remains below the pre-pandemic trend and still has room to grow. The ongoing deceleration in core inflation despite high growth also indicates the potential slack in the economy. The continued weakness in personal consumption in recent years suggests that a shallow rate cut could yield the required boost to consumer sentiment. As per the RBI's survey on consumer outlook, both the current situation and future expectations indices remain below the pre-pandemic average.

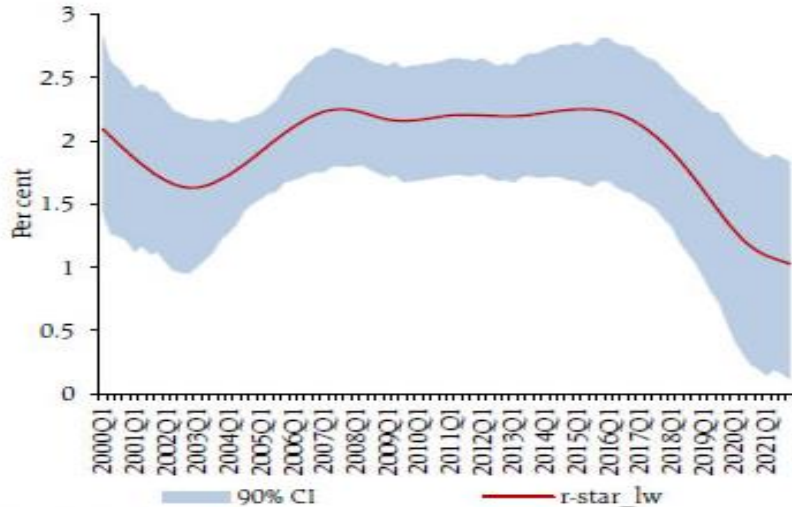
In the policy statement, the MPC also highlighted the wedge between credit and deposit growth and urged financial institutions to take relevant steps to narrow this gap for a better balance between asset and liabilities from a long term sustainability perspective. The committee remains vigilant regarding trends in credit growth that has moderated after the RBI, in November, increased risk weights attached to certain segments of consumer credit.

The RBI MPC's meeting in August marks the last one for the existing external members in the committee that will change from the October meeting. Currently two of the three external members (Dr. Ashima Goyal and Prof. Jayant Varma) are in favor of a 'neutral' stance and a 25bp rate cut. It is likely that in August, an additional MPC member (most probably internal member Dr. Rajiv Ranjan) votes also sides with the two dissenters (assessment based on April MPC meeting minutes), so that the Governor's vote becomes the deciding factor for a change in stance. This will keep options open for the MPC in its upcoming meetings to reduce policy rate, if required. In Q3-FY25, the MPC will also have clarity on the actual monsoon outcome, Union Budget that is likely due in the first week of July, and a possible pivot by the US Fed. The easing in policy rate, if any, is likely to be shallow (around 50bps) to adjust policy rate towards a neutral setting.

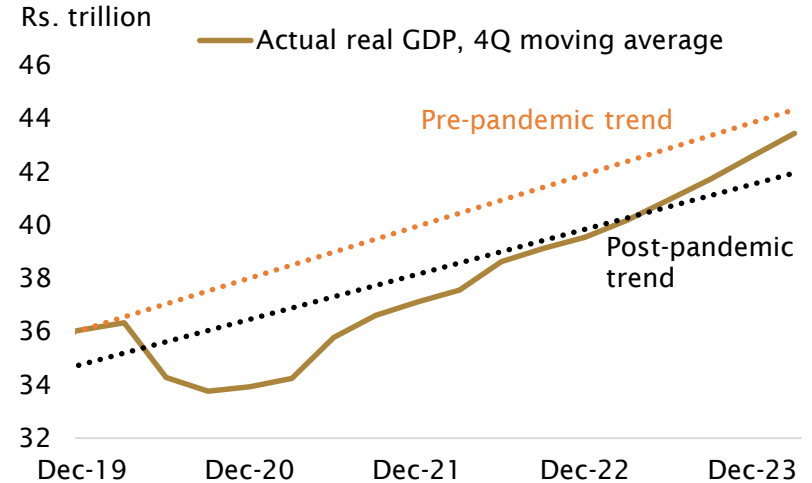


RBI to publish updated estimate of neutral rate of interest

RBI's latest natural interest rate estimate at 0.8-1% (Q3-FY22)



Real GDP level remains below pre-pandemic trend

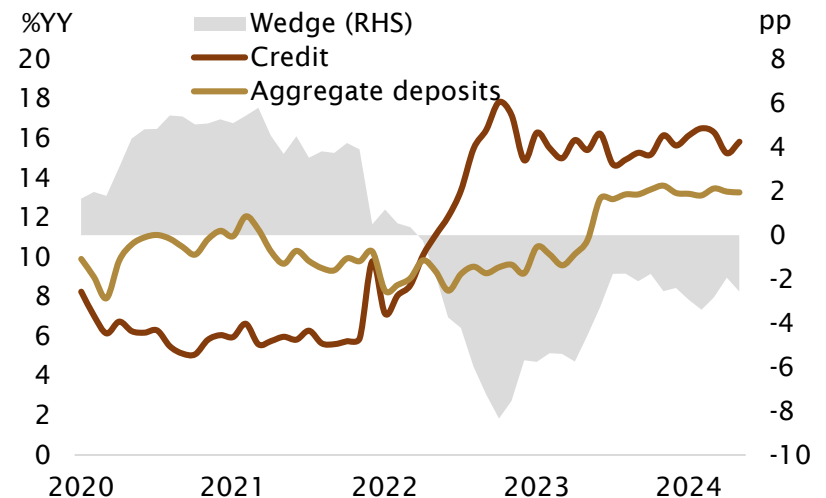


RBI MPC raised FY25 real GDP forecast by 20bps to 7.2%

Real GDP %YY	Feb-24 MPC	Apr-24 MPC	Jun-24 MPC
Q1:FY25 F	7.2	7.1	7.3
Q2:FY25 F	6.8	6.9	7.2
Q3:FY25 F	7.0	7.0	7.3
Q4:FY25 F	6.9	7.0	7.2
FY25 F	7.0	7.0	7.2

CPI %YY	Feb-24 MPC	Apr-24 MPC	Jun-24 MPC
Q1:FY25 F	5.0	4.9	4.9
Q2:FY25 F	4.0	3.8	3.8
Q3:FY25 F	4.6	4.6	4.6
Q4:FY25 F	4.7	4.5	4.5
FY25 F	4.5	4.5	4.5

RBI MPC noted persisting gap between credit-deposit growth





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