MPC Pauses; No change in policy rates and stance

The Monetary Policy Committee (MPC) of the Reserve Bank of India (RBI), unanimously decided to keep the policy repo rate unchanged at 6.5% in today's announcement. The calibrated withdrawal of accommodation stance of the MPC continues to remain unchanged, with a 5-1 majority. Today's policy decision by MPC comes as a bit of a surprise as the market expected a 25-bps rate hike.

Rationale for MPC's decision

- The policy rate has been increased by a cumulative 250 basis points since May 2022, which is still working through the system. The RBI wants to see and wait for its effect to work before raising the rate this time.
- Domestic economic activity remains resilient, and headline inflation is projected to moderate in FY24.
- Although the global financial markets have seen volatility in recent times, the impact of this on Indian financial markets is seen to be negligible
- Recent high frequency indicators suggest some improvement in global economic activity, but the outlook is now tempered by additional downside risks from financial stability concerns. Global inflation is moderating but remains well above the targets of central banks.

Key Takeaways from RBI Governor's Statement

- Maintain the repo rate at 6.5%, accordingly the Standing Deposit Facility (SDF) rate stands 6.25% and the Marginal Standing Facility (MSF) rate and bank rate at 6.75%.
- Inflation remained above the target in FY23 so far and given its current level the present policy rate can still be regarded as accommodative.
- There is large moderation in surplus liquidity. RBI has ensured the completion of the Government borrowing programme in a non-disruptive manner, while maintaining orderly market conditions during FY24.
- RBI to remain flexible in meeting the productive requirements of the economy through two-way operations, as may be necessary.
- The overall monetary and liquidity conditions have remained accommodative and hence, the MPC decided to continue with the withdrawal of accommodation stance.
- One of the MPC members voted against the decision to continue the current policy stance.

Growth outlook: Economic activity remains resilient

In the monetary policy statement, the RBI continue to remain optimistic with its growth projections despite the external vulnerabilities. GDP growth outlook has been revised upwards for FY24 to 6.5% from 6.4%. While Q1 and Q2 FY24 outlook remained unchanged and Q2 and Q3FY24 growth outlook is revised upwards by 10 bps each.

The domestic fundamentals continue to remain strong, evident from recent high frequency indicators. Favourable domestic demand and new business gains were reflected in continuous expansion in PMI manufacturing and PMI services indices in FY23. On the supply side, rabi foodgrain production is estimated to increase by 6.2% in 2022-23. Rural demand indicators such as consumer non-durables, tractor and two-wheeler sales registered healthy growth and are expected to remain strong boosted by improved prospects of agriculture and allied activities. Urban demand indicators show a mixed trend, while rebound in contact-intensive sectors and discretionary spending enhance services sector prospects. Demand for credit also remained robust so far and the total flow of resources to the commercial sector has increased by Rs 26.0 lakh crore during FY23 as against Rs 19.0 lakh crore a year ago. Supply chains are returning to normalcy globally as well as domestically.

Chart 1: GDP growth outlook (in %)

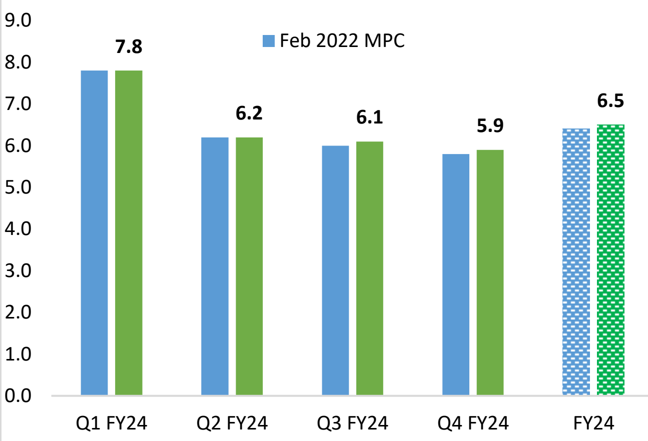
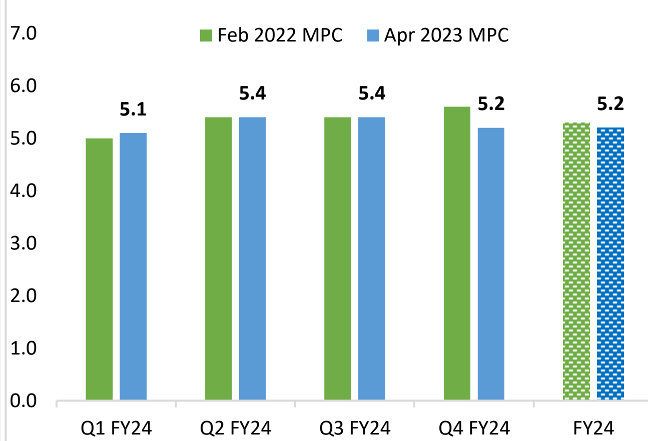


Chart 2: CPI Inflation Outlook (in %)



Source: RBI's Monetary Policy Statements, B2K Analytics

Inflation outlook: Prices likely to ease

RBI revised the inflation outlook for FY24 to 5.2% from 5.3% projected in the previous meeting. The quarterly inflation outlook for all four quarters of FY24 has been placed above the 5% levels. The RBI believes that the monetary policy actions taken since May 2022 are still working through the system. The expectation of a record rabi harvest, moderation in global commodity prices, falling household inflation expectations and global demand are likely to ease the price pressures going forward. However, the recent decision by OPEC nations to control the supply of crude oil prices is likely to exert pressure on oil prices and imports. Adverse climatic conditions are also a risk to the future inflation trajectory.

CPI inflation has already breached the target and increased by 80 bps to 6.5% in January and 6.4% in February 2023, from a low of 5.7% in December 2022. Further, the core inflation continues to be sticky. The persistence of elevated core inflation and the threat of a likely increase in crude oil prices is warranting the MPC for a calibrated monetary policy action. The rising uncertainty in international financial markets and imported inflation pressures are the key monitorable. RBI continues to foresee inflation at above 5% level in all the four quarters for the next fiscal, hence any reversal in policy actions in the near term is unlikely.

Moderation in liquidity surplus: The MPC voted with 5-1 majority to remain focused on 'withdrawal of accommodation' as its monetary policy stance. Amidst large moderation in surplus liquidity, the RBI conducted 14-day variable rate repo (VRR) auctions (main operation) on 10 February and 10 March and a fine-tuning 5-day VRR auction on 24 March 2023. RBI has emphasised remaining flexible in meeting the productive requirements of the economy through two-way operations, as may be necessary. It also ensured the completion of the Government borrowing programme in a non-disruptive manner while maintaining orderly market conditions during FY24.

B2K Analytics View

Global headwinds, financial instability, OPECs decision to control crude oil supply and crop losses due to unseasonal rains on the domestic front, are likely to have an adverse impact on the domestic growth and inflation outlook. The global economic outlook has changed significantly following the financial volatility, and the central banks have moderated their pace and size of rate hike actions recently. Despite the global adversities, the growth rates for FY24 have been slightly revised upwards from the February forecasts as ddomestic growth outlook remains resilient compared to other global economies. Several high frequency indicators continue to show resilience suggesting sustained growth in economic activity. The government's continued thrust on infrastructure spending also augurs well for crowding in private investment. However, the global economic environment poses serious uncertainties, which is likely to dent external demand and pose adverse implications for exports. On the inflation front, prices may soften in the coming months from the current elevated levels, favoured by high base effect, only if there is no major increase in oil prices going forward.

On the policy cycle front, RBI may continue with a pause depending on the incoming data on inflation. The MPC's decision to pause the policy rate hike without changing the policy stance suggests that the RBI is most likely done with its monetary tightening cycle and provides some hope for a pause in the next MPC meeting as well. The future course of action by the MPC is largely dependent upon the inflation trajectory and evolving global developments. The unanimous decision of the committee members to pause the rate hike suggests the members are hoping for the transmission of past policy actions to take course. However, upcoming inflation reading and global developments likely to play a major role in these expectations. Overall, the dilemma of supporting growth on the one hand and controlling inflation on the other is not over yet.

Other Regulatory Measures Announced by the RBI

- **Developing an Onshore Non-deliverable Derivatives Market:** With a view to develop the onshore Indian Rupee (INR) Non-Deliverable Foreign Exchange Derivative Contracts (NDDCs) and to provide residents with the flexibility to efficiently design their hedging programmes, RBI has decided to permit banks with International Financial Services Centre (IFSC) Banking Units (IBUs) to offer INR NDDCs to resident users in the onshore market. These banks will have the flexibility of settling their NDDC transactions with non-residents and with each other in foreign currency or in INR while transactions with residents will be mandatorily settled in INR

- **Enhancing Efficiency of Regulatory Processes:** RBI has decided to develop a secured web based centralised portal named as 'PRAVAAH' (Platform for Regulatory Application, Validation And Authorisation) which will gradually extend to all types of applications made to RBI across all functions.

- **Development of Centralised Web portal for Public to Search Unclaimed Deposits**: In order to improve and widen the access of depositors / beneficiaries to such data, RBI has decided to develop a web portal to enable search across multiple banks for possible unclaimed deposits based on user inputs. The search results will be enhanced by use of certain AI tools.

- **Grievance Redress Mechanism relating to Credit Information Reporting by Credit Institutions and Credit information provided by Credit Information Companies:** With the increase in customer complaints regarding credit information reporting and the functioning of credit information companies (CICs), it has been decided to put in place a comprehensive framework for strengthening and improving the efficacy of the grievance redress mechanism and customer service provided by the credit institutions (CIs) and CICs. For this purpose, the CICs have been brought under the aegis of the Reserve Bank Integrated Ombudsman Scheme (RB-IOS). In addition, it is also proposed to put in place the following measures: a compensation mechanism for delayed updation/rectification of credit information; a provision for SMS/ email alerts to customers when their credit information are accessed from CICs; a timeframe for ingestion of data received by CICs from Credit Institutions; and disclosures relating to number and nature of customer complaints received on the website of CICs.

- **Operation of Pre-Sanctioned Credit Lines at Banks through the UPI:** RBI has proposed to expand the scope of UPI by enabling transfer to / from pre-sanctioned credit lines at banks, in addition to deposit accounts. In other words, UPI network will facilitate payments financed by credit from banks. This can reduce the cost of such offerings and help in development of unique products for Indian markets.

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