Status Quo on Policy Rates

The Monetary Policy Committee (MPC) of the Reserve Bank of India (RBI), unanimously decided to pause and keep the policy repo rate unchanged at 6.5% in today's announcement. Also, the MPC decided to emphasise on the withdrawal of accommodative stance, with a 5-1 majority. The decisions are in conformity with our expectations.

Rationale for MPC's decision

- The decision to pause was based on the need to assess the cumulative impact of past monetary policy actions while charting out the future course. The policy rate has been increased by a cumulative 250 basis points since May 2022, which is still working through the system.
- Domestic demand conditions remain supportive of growth; the near-term inflation outlook on inflation looks more favourable and is projected to moderate in FY24.
- The real policy rate continues to be positive.
- The average system liquidity, however, is still in surplus mode and could increase as Rs 2,000 banknotes get deposited in the banks.

Key Takeaways from RBI Governor's Statement

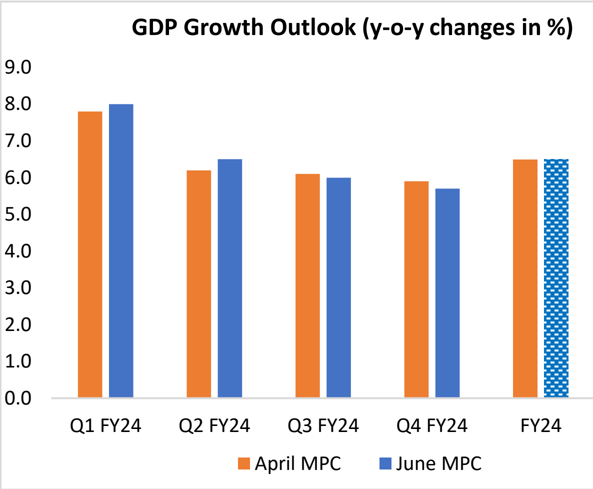
- The repo rate was unchanged at 6.5%. Accordingly, the Standing Deposit Facility (SDF) rate stands at 6.25% and the Marginal Standing Facility (MSF) rate and bank rate at 6.75%.
- The MPC also decided by a majority of 5-1 to remain focused on the withdrawal of accommodation to ensure that inflation progressively aligns with the target, while supporting growth.
- Real GDP growth projections for FY24 has been kept unchanged at 6.5%, while Q1 and Q2 projections have been revised upwards and Q3 and Q4 projections have been revised downwards from the earlier estimates.
- CPI inflation is projected at 5.1%, marginally lower than the 5.2% projected in the April meeting.
- The system liquidity is in significant surplus mainly due to the decline in currency in circulation and the pick-up in government spending. This has got further augmented due to the RBI's market operations and the deposit of Rs 2,000 banknotes in banks.
- The RBI is to remain nimble in its liquidity management while ensuring that adequate resources are available for the productive requirements of the economy.

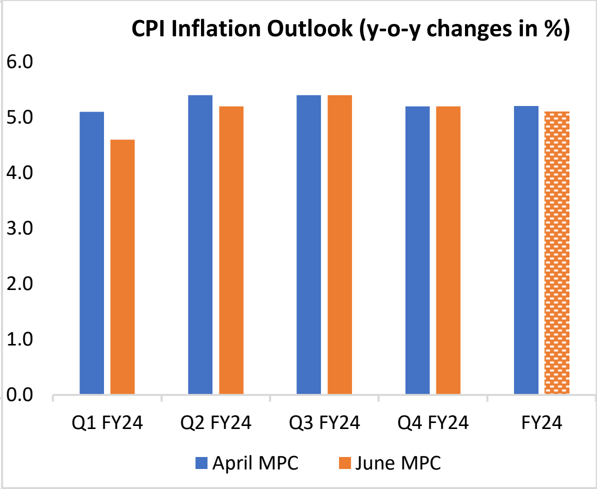
Growth and Inflation Outlook

In the monetary policy statement, the RBI continues to remain optimistic with its growth projections despite external vulnerabilities. The domestic fundamentals continue to remain strong, as evident from the recent high-frequency indicators. In addition, the FY23 growth estimate released by MOSPI is higher than expected at 7.2% as compared to RBI's estimate of 6.8%.

RBI has revised upwards its GDP growth outlook for Q1 and Q2 FY24, on the back of improving household consumption and investment activity. However, the global economic uncertainty and uncertain weather conditions continue to weigh on the outlook. The RBI has maintained the FY24 GDP growth outlook unchanged at 6.5%, but revised downwards the Q3 and Q4 outlook.

On the inflation front, although the near-term outlook on prices looks more favourable, geopolitical tensions, international commodity prices and uncertainties around the monsoon continue to pose upside risks. Despite some ease in the last two months, headline inflation is still above the median target of the MPC and is expected to remain above 5% in the three-quarters of FY24, as per RBI's projections. This necessitates a vigilant approach by RBI for its future course of actions.





Source: RBI's Monetary Policy Statements, B2K Analytics

Liquidity Management: The MPC voted with 5-1 majority to remain focused on 'withdrawal of accommodation' as its monetary policy stance. In the first two months of FY24, surplus liquidity averaged (daily absorptions under the LAF) to Rs 1.7 lakh crore as compared to Rs 2.9 lakh crore during FY23. The moderation in liquidity surplus was largely due to maturing of Targeted long-term repo operations (TLTROs) amounting to about Rs 61,000 crore which were announced during Covid-19. However, with the decline in currency in circulation on account of RBI's decision to withdraw Rs 2000 banknotes from circulation, there has been an increase in surplus liquidity. Pick-up in government spending have also expanded the system liquidity. To absorb surplus liquidity, the RBI has conducted variable rate reverse repo (VRRR) auctions of different maturities in four auctions totalling Rs 4.5 lakh crore between 2 June and 7 June 2023. We expect the RBI to conduct more such auctions to absorb the excess liquidity in the system. In the policy statement, RBI ensured that adequate resources will be available for the productive requirements of the economy along with supporting the orderly completion of the government's market borrowing programme.

B2K Analytics View

The pace of monetary tightening has slowed in recent months, but uncertainty remains on MPC's future trajectory, as inflation continues to rule above targets across the world. Benign inflation and growth prospects on the domestic front support the current stance of focussing on the withdrawal of accommodation. While lingering geopolitical conflicts and their impact on international commodity prices along with uncertainties around the monsoon continue to pose risks to both inflation and growth outlook. We expect the RBI to follow a cautious approach in its future actions. If the retail inflation continue to show a downward trend, there is scope to lower the rates in the August meeting.

.

Contact Us

P: +91 9513323220
E: research@b2kanalytics.com
W: www.b2kanalytics.com

Research

Dr M Govinda Rao	**Ritaban Basu**	**Anita Shetty**
Chief Economist	Research Head	Team Lead-Research

About B2K

B2K Analytics is a boutique consulting firm that helps clients profit from analytical insights. B2K provides services and solutions in the areas of Risk Management, Research, Analytics, Investment Management, Education, and Infrastructure.

The B2K team has experienced domain experts and industry practitioners who have provided such services and implemented solutions across institutions in different countries. As such, team members are experts in regulatory and management practices in these areas and have helped many clients in adopting best practices.

DISCLAIMER