

RBI MPC Minutes: Comfort on inflation trajectory but uncertainties warrant caution against premature easing

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Key takeaways: Minutes of RBI MPC meeting, October 2024

In the latest meeting of the RBI MPC, the committee unanimously changed the policy stance to 'neutral' from 'withdrawal of accommodation'. The MPC held the key policy repo rate unchanged at 6.50%, with a 5:1 vote. The three new external members of the MPC appointed in October participated in the decision making for the first time, with one member Dr. Nagesh Kumar favoring a 25bp rate cut. In the previous meeting held in August, two of the three external members had voted for a 25bp rate cut and change in stance to 'neutral', while the remaining four members of the MPC had voted for a status quo on policy rates and stance.

The minutes of the latest MPC meeting indicated that most members were optimistic about domestic growth prospects, despite some distress due to recent weakness in high frequency indicators of economic activity. On the other hand, while the minutes of the August meeting suggested concerns about spillovers of higher food prices to other components of consumer inflation and risks of de-anchoring of inflation expectations, details of the latest meeting showed some extent of comfort in the current and future inflation path. There was also more or less a consensus regarding build up of uncertainties in the external and domestic environment that warranted flexibility in policy making and a cautious approach to cutting the policy rate. The risks from premature policy easing and the need for evidence on inflation aligning durably to target hints a greater probability of the MPC starting to calibrate its policy rate at the February meeting, rather than in December.

Comfort on inflation trajectory

- Most members noted the progress in disinflation, with core inflation remaining benign and CPI ex-vegetables staying below 4% for eight months (nine, including September data released post MPC meeting). There was an acknowledgment of an expected near-term hump in inflation that is also reflected in the MPC's estimate for Q3-FY25 due to statistical effects and price pressures in some parts of the food basket such as key vegetables, edible oils, and certain pulses.

- However, members sought solace from better monsoons this year and an improved spatial distribution that has filled reservoirs and augur well for both Kharif and Rabi output. The MPC members cited higher Kharif sowing, ample buffer stocks, and seasonal easing in prices of horticulture crops in winter months as factors that are expected to keep a lid on food inflation in the upcoming months. There was also comfort from surveys that show easing in households' and businesses' inflation expectations in the latest rounds and also over a period of time.

- Most members expect the headline CPI inflation to start aligning to the central bank's 4% target on a durable basis from Q4-FY25. The RBI's latest Monetary Policy Report, published bi-annually, has pegged CPI inflation for Q4-FY26 at 4.1% in its baseline projection, only mildly up from 4.0% in the April report, which adds credibility to the MPC's comfort on the domestic inflation trajectory.

- However, the MPC duly reiterated the risks to food inflation from adverse weather events that could impact farm produce. On the external front, members noted the recent rise in global food and metal prices that could have implications for domestic inflation, particularly where import dependence is considerable. Views on crude oil prices were mixed, with some members wary of the volatility, while others seeking comfort from range-bound movements in a lower band.

Mostly sanguine on growth

- Two MPC members noted concerns over mixed signals from some of the high frequency indicators of economic activity – Dr. Nagesh Kumar, who voted for a rate cut, and Shri Saugata Bhattacharya, who also put forth a contrarian view on resilient growth. Some of the worrisome data that were cited included 1) deceleration in PMI indices, 2) decline in core sector output, 3) lower passenger and commercial vehicle sales, 4) subdued export growth, 5) muted view for Q2 in the latest round of RBI's enterprise and confidence surveys, and 6) downgrade to growth forecast for FY25 in the latest survey result of Survey of Professional Forecasters to sub-7%.

- The other MPC members were sanguine about growth prospects, with Deputy Governor Dr. Patra citing idiosyncratic or one-off factors as reasons for a soft patch in Q2-FY25 such as unusually heavy rainfall towards the end of the southwest monsoon and pitrupaksha – a 16-lunar day period in the Hindu calendar when Hindus pay homage to their ancestors and refrain from new purchases or auspicious events – that could have dented consumption. This view was corroborated by authors of 'state of the economy' article in the latest RBI monthly bulletin, which is currently tracking real GDP nowcast for Q2-FY25 at 6.8%YY, lower than the MPC's 7% forecast.

- Despite an element of uncertainty to growth outlook from the recent bout of muted data, majority of the MPC members remained upbeat due to the following factors – 1) festive boost to demand in Q3-FY25 2) results of the RBI's latest enterprise surveys that show improved outlook across sectors for Q4-FY25 and Q1-FY26 2) cyclical fillip to rural consumption from improved farm prospects this year 3) strength in services sector that is expected to sustain urban demand 4) pickup in public capital expenditure post the election-induced slump in Q1-FY25 5) rebound in private consumption and investment growth that were reflected in Q1-FY25 GDP data.

- When the MPC meets next in the first week of December, it will have data on Q2 GDP growth and CPI inflation print till October at its disposal and these are expected to be unfavorable. The committee might have to wait until its meeting in February 2025 to gain clarity on the domestic demand situation based on data from the first advance estimate of real GDP growth for FY25 that is due in the first week of January. The initial evidence on seasonal softening in food inflation in winter months will also start trickling in from January for the MPC to consider at its meeting in February. There are external uncertainties to account for and though most of them could linger in 2025, a relatively clearer picture could emerge, and ease the job of policy makers to an extent.

Uncertainties warrant flexibility but caution against premature easing

Change in stance to insure against build up of uncertainties, both local and global:

- Domestic uncertainties: Since the previous RBI MPC decision in August, domestic growth has disappointed, with Q1 GDP growth missing the MPC's forecast, though internal details were favorable. High frequency indicators paint a mixed picture for Q2, with the MPC itself trimming projection for Q2 in its latest meeting and the RBI's bulletin article on the economy tracking growth at sub-7%, as noted earlier. Headline inflation has evolved mostly in line with expectations, though the upside in September print was higher than anticipated. In H2-FY25, growth is expected to bounce back, and inflation is slated to inch closer to the RBI's target, but risks to outlook remain from adverse climate events that could push inflation off its projected path and complicate the MPC's task, particularly in an environment where domestic demand woes have started to surface and systemic central banks have embarked on easing.

- External risks: On the external front as well, uncertainties remain and have exacerbated in certain instances such as: 1) two concerns remain related to China a) excess capacity and implications of possible dumping in domestic market amid the ongoing trade tensions with the US and Europe b) magnitude and details of China's recent stimulus, repercussions for its own economy and rest of the world, including commodity prices. 2) US election outcome and the impact of its policies 3) escalation of geopolitical tensions that could induce commodity price shocks 4) divergences in monetary policies across economies that are imparting volatility to financial markets.

- Need for flexibility: It would be difficult to gauge when these domestic and external risks could abate and most of them seem likely to spill over to 2025, which probably compelled the MPC to insure its policy making by changing stance to neutral and buying in some flexibility to act depending on the evolving situation.

Risks from premature easing:

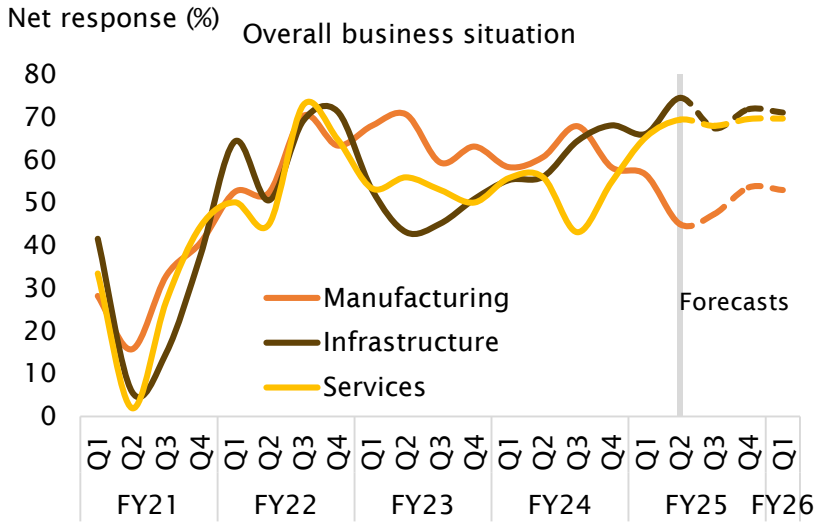
- The MPC members' unanimous confidence in the domestic inflation trajectory could imply a lean towards calibrating the policy rate at some point, even if one accounts for members that have expressed some discomfort in the evolving domestic growth path. However, more than one member cautioned against premature easing that could erase the gains from disinflation so far, and trigger excessive easing of financial conditions. The MPC is likely to continue with its wait-and-assess, data-dependent approach, though in recent occasions, the RBI Governor, has reiterated that the MPC will also be forward looking in its policy making, and account for outlook on variables, including the future trajectory for growth and inflation.

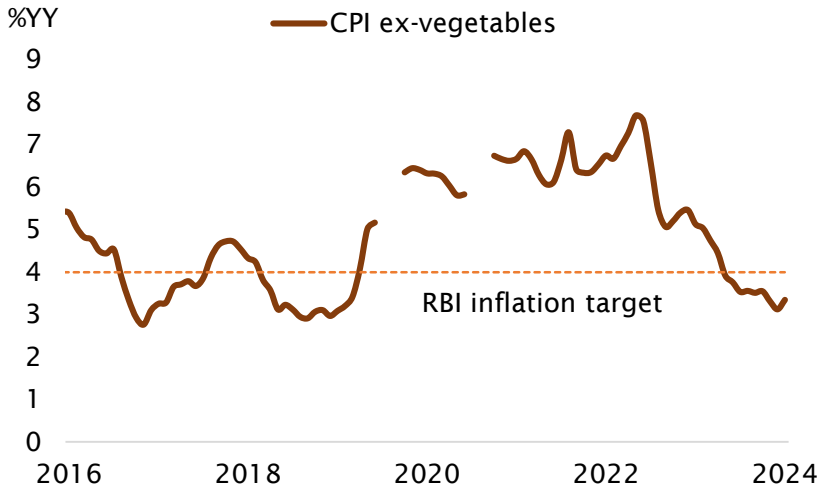
RBI MPC more likely to start easing policy rate from February

Policy rate path implied by SPF survey: Despite concerns of some of the MPC members regarding premature easing, results from the RBI's latest rounds of survey of professional forecasters suggest expectations of the start of easing at the upcoming MPC meet in December. The latest survey result shows median forecast of 75bp rate cut cycle, starting in Q3-FY25, and two more in the first two quarters of FY26. This marks a shift from the previous round that had penciled in 50bp easing cycle, with one 25bp cut in Q3-FY25 and another in Q1-FY26.

Well-poised balance of risks in growth-inflation dynamics: In the latest MPC minutes, there is no indication of any sense of urgency to the lower policy rate. Despite the demand deficits noted by Dr. Kumar on the domestic and external fronts, most members are either comfortable with the current and evolving growth-inflation dynamics, or have indicated an openness to reduce the degree of policy restraint. However, risks of another bout of inflation from premature easing and the need for evidence on inflation aligning durably to 4% hints a greater probability of the MPC starting to calibrate its policy rate at the February meeting, rather than in December. However, the balance of risks could change if the festive season and expected farm bounty fail to lift domestic demand, or government spending fails to catch up in H2-FY25, which could prompt the MPC to start easing earlier, or perhaps, delay easing if weather surprises and global commodity price shocks keep headline inflation volatile and elevated.

Optimistic business expectations across sectors in Q4-FY25, Q1-FY26; CPI ex-vegetables below 4% since January 2024





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