

RBI MPC likely to hold policy at October meet but could soften tone to counter risks to growth outlook

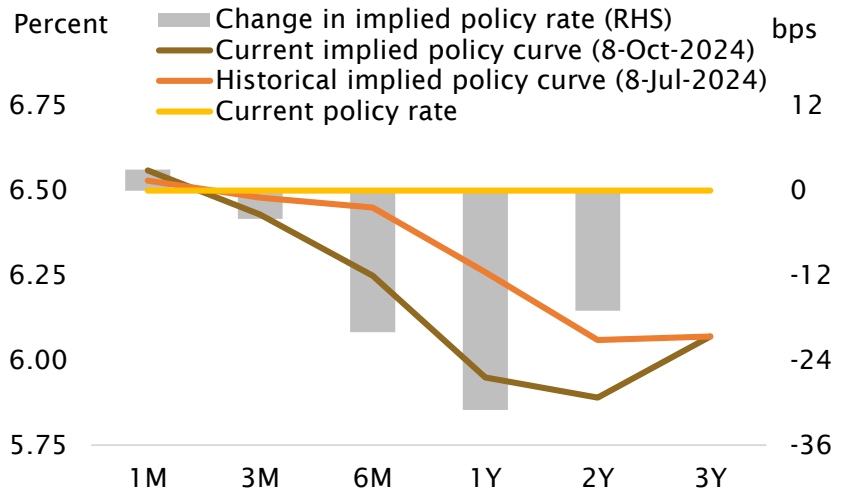
October 8, 2024

TRUST
In Partnership. With Trust.

RBI MPC likely to hold policy but could soften tone at Oct meet

- The Bloomberg survey suggests market expectations of no change in the policy repo rate at the RBI MPC meeting decision due on October 9. Futures pricing indicates 25bp cut six months ahead and another 25bp easing a year from now, taking the policy rate to 6%. The timing of shift in stance to 'neutral' from the current 'withdrawal of accommodation' would also be a function of views of three new external members that will participate in decision making at the October meeting for the first time, as the earlier members completed their term. While the MPC could signal policy tweaks by changing stance, it has so far sought comfort in using liquidity measures to drive changes in the weight average call rate, which is its operating target, and could continue to do so to avoid any reversal of gains from its prudence so far.
- However, new risks have emerged since the last MPC meet and some of the ongoing ones have further exacerbated. Even as the headline CPI inflation print was lower than the central bank's target for the second consecutive month in August, food price volatility remains a concern. Also, high frequency indicators of economic activity turned rather sluggish in the months of August and September, creating possibility for growth to print below the MPC's latest forecasts for the second quarter in a row.
- On the external front, the US Fed embarked on policy easing with a higher-than-expected 50bp rate cut in September but market expectations regarding future policy path remains vulnerable to incoming economic data. Even as major systemic central banks have started to ease, policy divergences remain. Commodity prices remain volatile amid push and pull pressures due to global growth concerns on one hand, and escalating geopolitical tensions on the other. Despite these uncertainties, the RBI MPC is likely to hold policy settings in pursuit of its goal of aligning inflation to 4% on a durable basis, but could soften its tone to address risks to its growth objective.
- Three new external MPC members include:
- Prof. Ram Singh, Director, Delhi School of Economics, University of Delhi
- Shri Saugata Bhattacharya, Senior Fellow, Centre for Policy Research
- Dr. Nagesh Kumar, Director and Chief Executive, Institute for Studies in Industrial Development

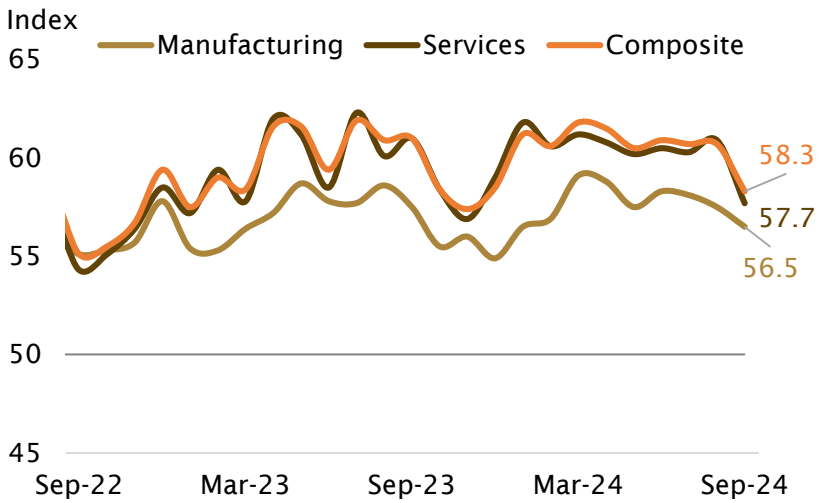
Market pricing of policy rate path



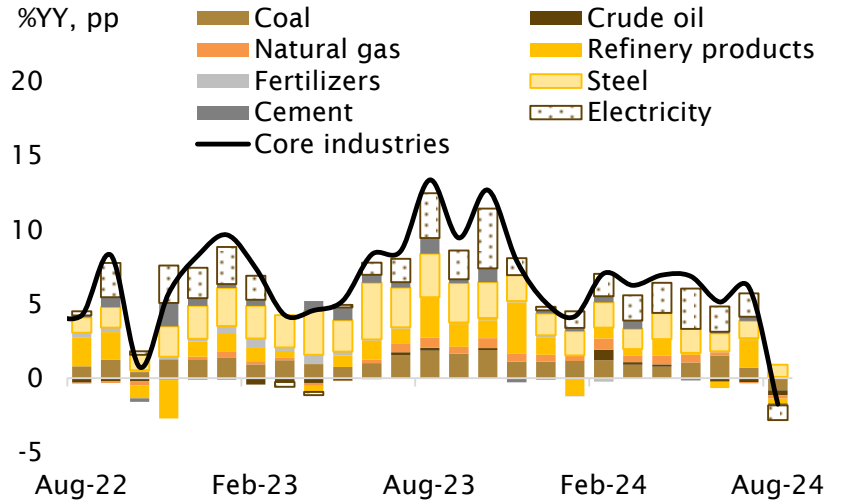
GDP growth could undershoot latest RBI MPC projection for Q2

- In Q1-FY25, real GDP growth of 6.7%YY was below RBI MPC's projection of 7.1% that had already been trimmed at the August meeting from 7.3%. Muted government spending due to the model code of conduct ahead of general elections was the main drag in Q1 that is expected to improve in the subsequent quarters. However, new headwinds have emerged that indicate slowing economic activity in Q2.
  - High frequency indicators such as automobile sales and registrations turned weak in August and September. GST revenue collections remained strong in September but year-on-year growth eased to the slowest pace since July 2021.
  - Core industries output (40% weight in the index of industrial production) posted negative year-on-year growth in August for the first time since March 2021.
  - Despite continuing to indicate expansion in economic activity, recent PMI prints have turned soft, with the composite index for September receding to a ten-month low. The PMI releases also indicate pressures on firms' margins due to higher input costs not completely translating into output charges.
  - In its latest monthly bulletin, the RBI authors noted that their nowcast model was tracking growth at 7% in Q2, indicating better momentum relative to Q1, but lower than the RBI MPC estimate at 7.2%.
- It would be early to conclude if these early signals of slowing momentum are a cause of worry. There is a possibility that growth improves in H2 due to better farm sector prospects and pick up in public spending.

India composite PMI print was the softest in 10 months



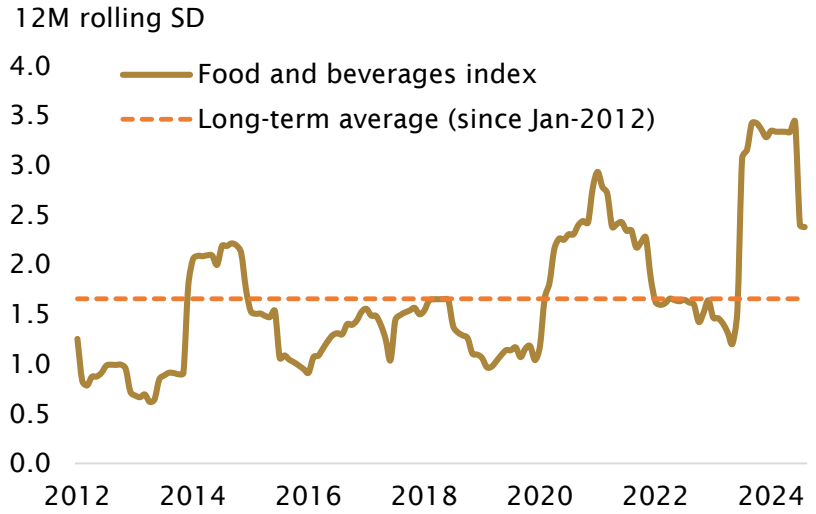
Core industries output contracted in August



Despite comfort on headline CPI, food price volatility risks remain

- In the latest RBI monthly bulletin, authors of the 'state of the economy' article noted that though the headline inflation print was below the RBI's target for the second consecutive month in August, food price volatility remains a contingent risk. In July and August, CPI inflation was at 3.6% and 3.7%, respectively and will need to rise to 6% in September to align with the MPC's latest projection for Q2 at 4.4%. Though an unfavorable base is already expected to add a percentage point to the September print, historical trends for the month suggest a likely undershoot by around 25 basis points for the quarter.
- Even as disinflation in certain sticky pockets of the food basket such as cereals and pulses continues to remain sluggish, it is mostly vegetable prices that have been imparting volatility since mid-2023 when tomato prices had surged over 200%YY. In early October this year, tomato prices again climbed over 100%, though it remains to be seen if the trend sustains. The government has already started selling tomatoes at subsidized rates and will likely need to continue with supply side intervention to keep food prices in check.
- Though the country received above normal rainfall this year, at 108% of long-period average, the spatial variation was higher, with more number of sub-divisions receiving excess rainfall compared to a year ago, while east and north-east regions recorded deficient rains. However, overall Kharif sowing has been better than last year, and above the average for FY19-23. Reservoir levels are replenished, exceeding previous year and normal levels for the country as a whole. This bodes well for Rabi sowing as well.

Food price volatility remains a risk to headline inflation



Tomato prices flared up in early October

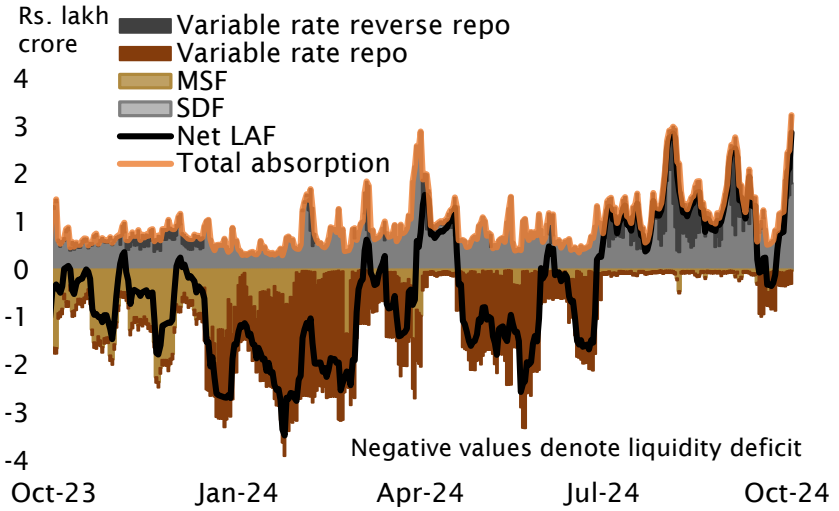
%YY	Tomato	Onion	Potato	Vegetables
Wt. in CPI	0.57	0.64	0.98	6.0
Jun-24	26.5	58.4	57.6	29.3
Jul-24	-43.0	60.6	65.8	6.8
Aug-24	-47.9	54.1	64.0	10.7
Sep-24*	18.3	53.3	49.5	
Oct-24**	108.2	56.3	47.3	
%MM	Tomato	Onion	Potato	Vegetables
Jun-24	48.8	24.1	12.2	14.2
Jul-24	41.7	20.5	16.7	14.1
Aug-24	-28.8	7.8	1.2	-2.5
Sep-24*	-8.8	13.6	-2.3	
Oct-24**	38.8	7.5	-1.4	

Note: *Provisional; **All India retail price till Oct 6.

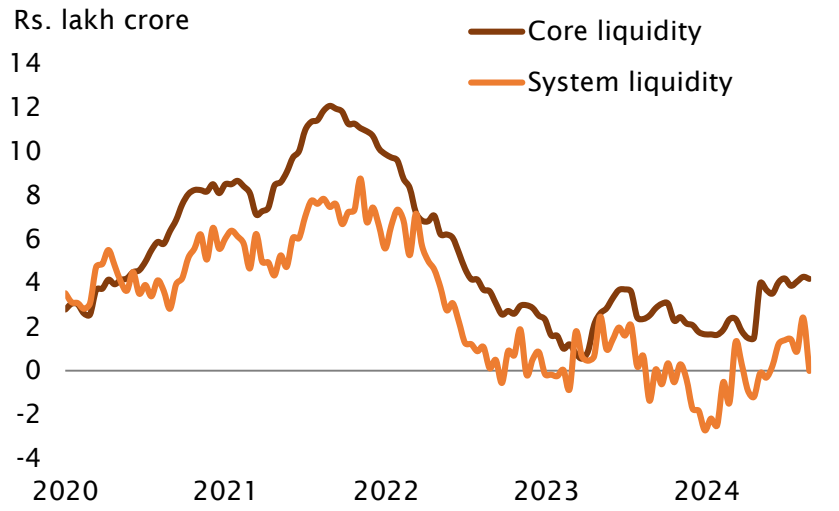
Liquidity remained in surplus despite VRRR auctions, OMO sales

- As of October 3, net liquidity outstanding under the RBI's adjustment facility stood at Rs.2.9 lakh crore, higher than Rs.1.7 lakh crore on August 8, when the last RBI MPC decision was announced. Liquidity conditions have largely remained in surplus since the last MPC meeting, except towards mid-September when advance income tax payments dragged liquidity into deficit. The RBI was quick to respond, resorting to one main VRR and three fine-tuning VRR operations to inject liquidity to the tune of Rs.2.3 lakh crore.
- The central bank mostly conducted VRRR auctions to absorb excess liquidity, including four main (amounting to Rs.20 lakh crore) and 23 fine-tuning operations (Rs.4.25 lakh crore), but the response was tepid, with the central bank being able to absorb only Rs.9.2 lakh crore. The RBI also continued with OMO sales that it had also resorted to in July, amounting to Rs.10 thousand crores between 12 Aug- 29 Sep.
- Banks preferred to park funds under the standing deposit facility (SDF). In the interim period between MPC meetings in June and August, average daily placement of funds under SDF was Rs.0.77 lakh crore, which has increased to Rs.0.97 crore since the last MPC meeting (till October 3). For the same periods, average daily borrowings under the marginal standing facility (MSF) eased to Rs.0.07 lakh crore from Rs.0.08 lakh crore.
- Despite the volatility in liquidity conditions in September, core or durable liquidity that excludes the impact of government cash balances, continued to remain in surplus and, in fact, improved. As of 20 Sep, core liquidity surplus stood at Rs.4.2 lakh crore, up from Rs.3.9 lakh crore since the last MPC meet.

Liquidity largely in surplus since last MPC meet



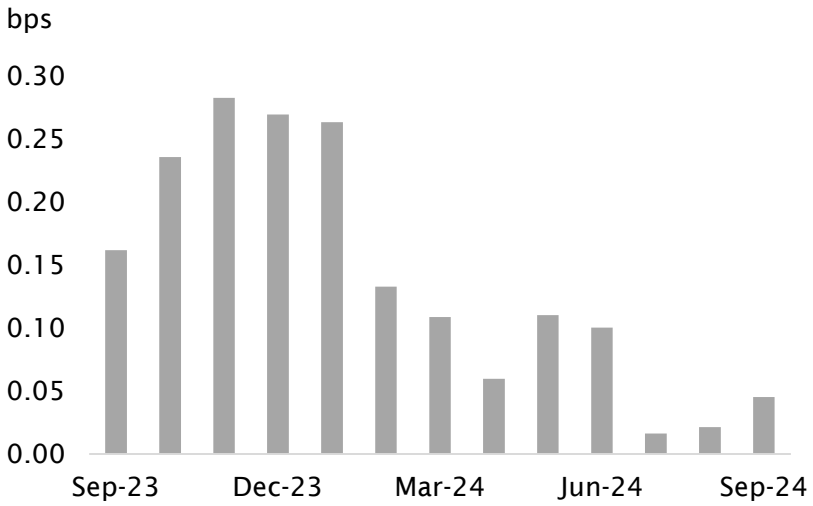
Core liquidity surplus higher since last MPC meet



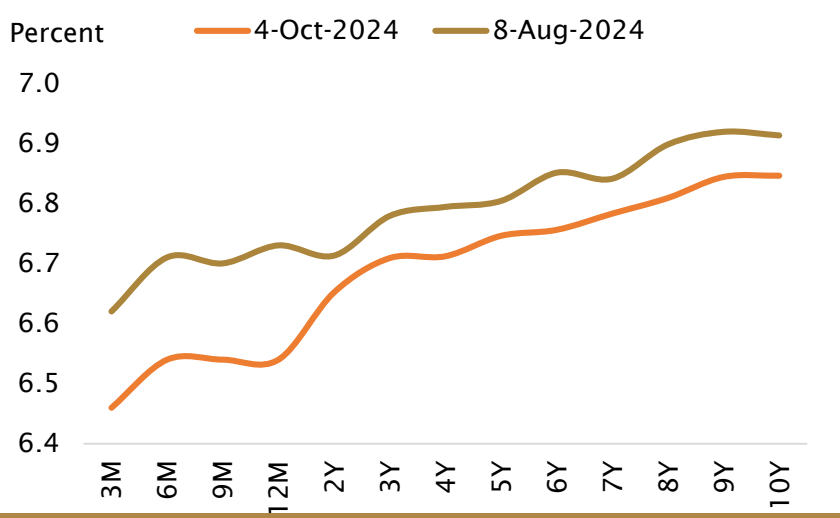
Yields have softened across the curve since last MPC meet

- Surplus liquidity conditions since end-June could be attributable to a pick up in government spending post general elections and portfolio flows due to JPMorgan bond index inclusion that started in June. Due to excess liquidity, weighted average call rate, which is the operating target of monetary policy, has remained subdued, with its differential vis-à-vis the repo rate remaining low. The tri-party and market repo rates averaged 13 basis points and 4bps, respectively, below the repo rate since the last MPC meet (till end-Sep).
- Since the last MPC decision, yields have softened across the curve, particularly at short end. In the money market, yields on 3-month CP issued by NBFCs and 3-month t-bills have eased. On average, rates on these were lower by 8bps and 16bps, respectively since last MPC meeting in August (till end-Sep) versus previous inter-meeting period. However, yields on 3-month CD were higher by 8 bps. The average risk premium (spread between 3-month CP and t-bill rates), was 107bps, 8bps above the previous inter-meeting period.
- In end-September, the RBI released calendar for issuance of central government dated securities for H2-FY25. The gross borrowing of Rs.6.61 lakh crore was in line with the budget target. Net borrowing will amount to Rs.4.95 lakh crore. The share of borrowing under different maturities will be up to 5 years (5.3%), 5-9 years (18.2%), 10-14 years (24.8%), 15-19 years (13.2%) and beyond 20 years (38.6%). The RBI lowered weekly auction amount of t-bills to Rs.19,000 crore for Q3-FY25 from Rs.20,000 crore in Q2. This could support further softening of yields at the short end of the curve.

Spread of WACR over policy repo rate remains narrow



Yields have softened across curve since last MPC meet

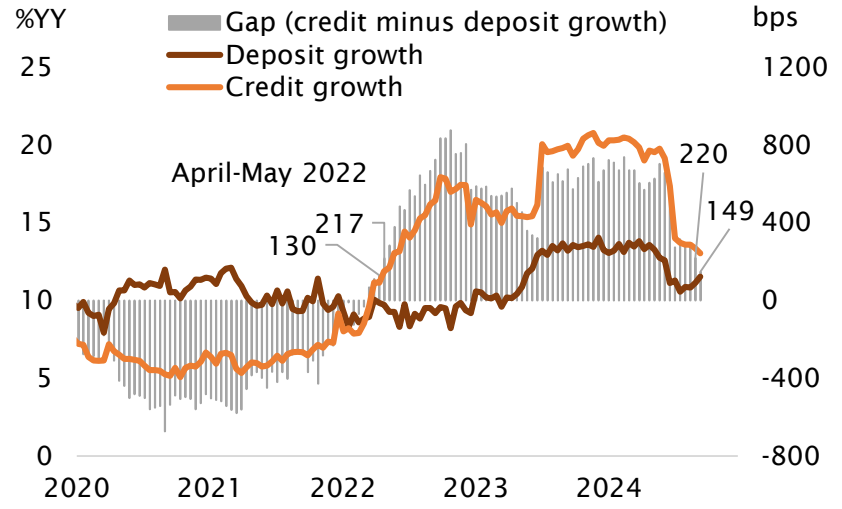


Credit-deposit gap has narrowed; RBI likely to stay wary of new risks

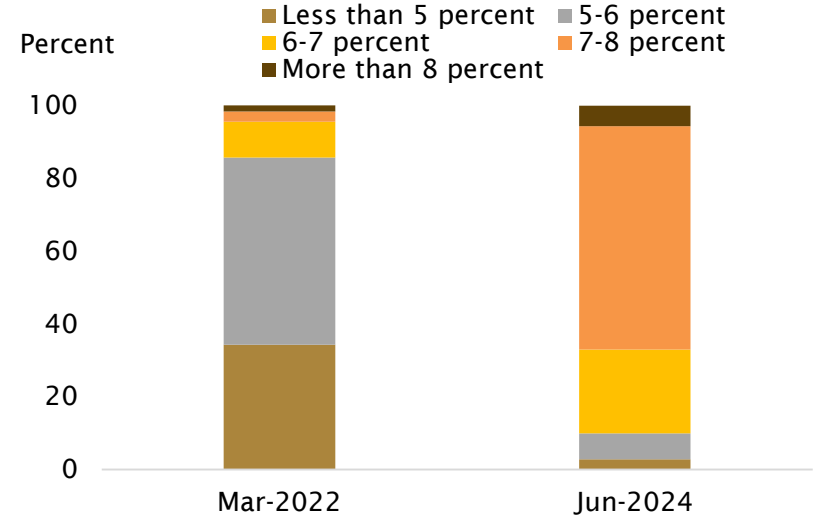
- For the week ending Sep 20, the credit-deposit growth gap slipped below 200bps to the lowest level since April-2022, just before the RBI started hiking the policy rate. In case of scheduled commercial banks, policy transmission has been the strongest in case of fresh deposits. As a result, accruals to term deposits have increased and the share of savings deposits in total deposits has moderated. With higher transmission of rate hikes to deposit rates, more than two-thirds of term deposits were earning 7% and above as of June 2024, up from 5% in March 2022 before the central bank started policy tightening.

- To curb excessive credit growth, particularly in the unsecured consumer loan category, the central bank raised risk weights for consumer credit and bank credit to NBFCs in November 2023. As a result, year-on-year growth in personal loans has moderated from its recent peak of 21.3% in June 2023 to 16.9% in August 2024. However, in the RBI's latest monthly bulletin, authors of the 'state of the economy' article noted asset quality issues faced by microfinance institutions and concerns regarding resilience of private credit in a downturn. These suggest that despite a slowdown in consumer credit growth, the central bank is likely to remain vigilant to new risks that could upend financial market stability.

Credit-deposit gap slipped below 200bps recently



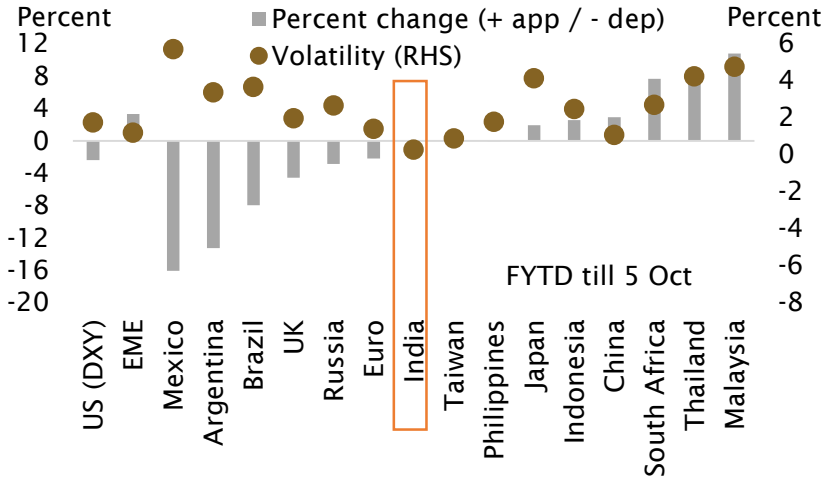
More than two-thirds of term deposits earning 7% and above



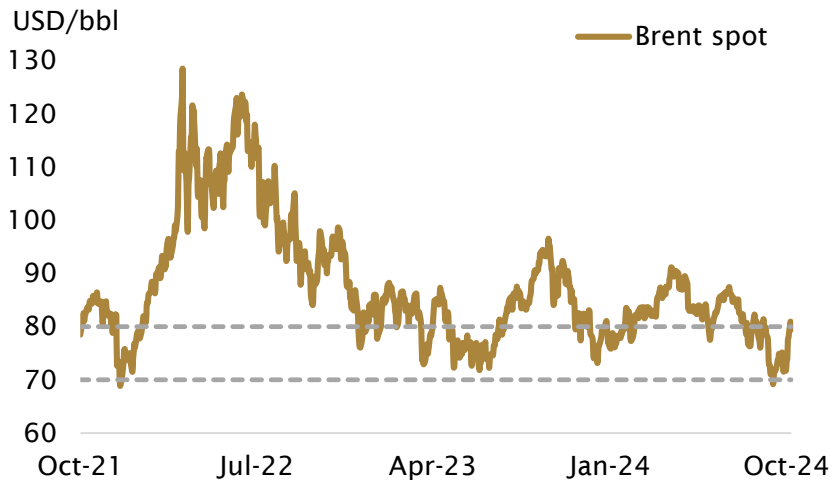
External uncertainties, including geopolitical risks, continue to bite

- **Current account and FX:** India's current account balance slipped back to deficit in Q1-FY25 after briefly posting a surplus in the last quarter of FY24. Though the deficit was slightly steeper at 1.1% of GDP (USD9.8bn) versus 1.0% (USD9bn) in Q1-FY24, there were no major negative surprises. On the FX front, the USDINR is finding strong support at 84 level. Year-to-date volatility remains subdued vis-à-vis other currencies but the INR has been an underperformer relative to its Asian peers. Forex reserves continue to grow, crossing USD700bn in the last week of September, implying an import cover of over 12 months.
- **Yields and monetary policy:** Even as the local g-sec yields have eased in recent weeks, the 10-year yield started to rise towards September-end, mirroring the climb in its US counterpart. The 10Y UST crossed 4% this week for the first time since August, as markets pared Fed rate cut expectations due to surprisingly strong employment data. In September, the US Fed delivered a higher-than-expected 50bp rate cut, the ECB and PBoC also lowered rates, while the BoE and BoJ kept policy unchanged. The sluggishness in disinflation is adding a cautious undertone to policy easing aimed at countering risks to growth. Also, country-specific factors are compelling some central banks to stay hawkish, causing policy divergences.
- **Geopolitical tensions and commodity prices:** Crude oil prices fleetingly slipped below USD70/bbl in September only to breach USD80/bbl less than a month later due to escalating geopolitical tensions. Prices of other commodities such as industrial metals remain vulnerable to incoming economic data, further complicating the central banks' task in terms of assessment of spillovers to domestic inflation.

USDINR less volatile but underperformer vis-à-vis peers



Geopolitical risks continue to impart volatility to crude prices



Select high frequency indicators

Colour codes based on minimum and maximum Z-score values since April 2023 for respective variables; green shows improvement, red indicates weakening. (Reversed for MGNREGA data where a fall implies improved farm activity)

(%YY, unless mentioned otherwise)		Feb-24	Mar-24	Apr-24	May-24	Jun-24	Jul-24	Aug-24	Sep-24
Agriculture and rural sector	Fertiliser sales	-13.5	0.6	-3.7	10.5	7.3	-1.4		
	Tractor sales	-25.7	-19.5	-2.9	0.5	3.5	1.4	-5.5	
	Tractor registrations	11.0	-3.2	1.4	-1.0	-28.4	-11.9	-11.4	14.7
	Two wheeler sales	34.6	15.3	30.8	10.1	21.3	12.5	9.3	
	Two-wheeler registrations	13.3	5.8	33.6	2.8	4.7	17.2	6.3	-8.5
	Three-wheeler registrations	23.9	21.1	12.9	23.7	5.1	12.9	1.6	0.7
	Household work demand under MGNREGA	0.3	-19.2	-10.6	-14.3	-21.7	-19.5	-39.3	
Industry, construction and urban sector	Industrial production	5.7	4.9	5.0	5.9	4.2	4.8		
	Core sector output	6.7	5.2	6.2	6.3	4.0	6.1	-1.8	
	Cement production	7.8	10.6	0.2	-0.6	1.9	5.5	-3.0	
	Natural gas production	11.1	6.2	7.8	6.7	2.9	-1.4	-3.7	
	Electricity requirement	7.5	9.4	9.0	17.3	8.0	4.0	-5.2	
	Steel consumption	7.0	12.5	9.6	15.9	19.5	14.4	10.0	
	Fuel consumption	5.9	-0.6	7.8	1.9	2.3	7.5	-2.6	
	Passenger vehicle sales	12.9	8.9	1.2	4.3	5.0	-1.9	-1.6	
	Passenger vehicle registrations	12.4	-3.9	18.6	1.5	-6.8	10.2	-4.5	-18.8
Services	Commercial vehicle sales		0.6			3.3			
	Commercial vehicle registrations	4.8	-1.6	6.0	7.7	-4.7	5.9	-6.0	-10.4
	Railway freight traffic	12.6	9.8	5.3	4.4	11.2	4.9	-5.0	-0.2
	Port cargo traffic	2.1	2.7	1.3	3.8	6.8	5.9	6.7	
	Toll collection (volume)	12.2	10.6	7.6	3.6	5.8	9.4	6.8	
	Domestic air cargo traffic	11.5	8.7	0.3	10.4	10.3	8.8	0.6	
	International air cargo traffic	30.2	22.5	16.2	19.2	19.6	24.4	20.7	
	Domestic air passenger traffic	5.8	4.7	3.9	5.9	6.9	7.5	6.7	
	International air passenger traffic	19.3	15.0	16.7	14.6	11.4	8.9	10.9	
	Tourist arrivals	15.8	8.0	7.7	0.3	9.0			
	GST e-way bills (total)	18.9	13.9	14.5	17.0	16.3	19.2	12.9	
	GST revenue collection	12.5	11.2	12.3	10.1	7.6	10.3	10.0	6.5
PMI (Index)	PMI Manufacturing	56.9	59.1	58.8	57.5	58.3	58.1	57.5	56.5
	PMI Services	60.6	61.2	60.8	60.2	60.5	60.3	60.9	57.7

DISCLAIMER:

We are committed to providing completely independent views to help our clients reach a better decision. This document is provided for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. Nothing in this document should be construed as investment or financial advice, and nothing in this document should be construed as an advice to buy or sell or solicitation to buy or sell the securities of companies referred to in this document. The intent of this document is not in recommendary nature. The recipient of this document should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved), and should consult its own advisors to determine the merits and risks of such an investment. The investment discussed or views expressed may not be suitable for all investors. Trust Group has not independently verified all the information given in this document. Accordingly, no representation or warranty, express or implied, is made as to the accuracy, completeness or fairness of the information and opinions contained in this document. The Company reserves the right to make modifications and alternations to this statement as may be required from time to time without any prior approval. Trust Group, its affiliates, their directors and the employees may from time to time, effect or have effected an own account transaction in, or deal as principal or agent in or for the securities mentioned in this document. They may perform or seek to perform investment banking or other services for, or solicit investment banking or other business from, any company referred to in this report. Each of these entities functions as a separate, distinct and independent of each other. The recipient should take this into account before interpreting the document. This report has been prepared on the basis of information, which is already available in publicly accessible media or developed through analysis of Trust Group. The views expressed are those of analyst and the Company may or may not subscribe to all the views expressed therein. Neither the Firm, not its directors, employees, agents or representatives shall be liable for any damages whether direct or indirect, incidental, special or consequential including lost revenue or lost profits that may arise from or in connection with the use of the information. This document is being supplied to you solely for your information and may not be reproduced, redistributed or passed on, directly or indirectly, to any other person or published, copied, in whole or in part, for any purpose.

Copyright in this document vests exclusively with Trust Group.

Trust Group

1101, Naman Centre, Bandra Kurla Complex, Bandra (E), Mumbai -400 051, Maharashtra.

Ph: +91 22 4084 5000 • Fax: +91 22 4084 5052 • www.trustgroup.co.in