

RBI MPC unanimously changed stance to neutral; kept policy repo rate unchanged at 6.5% by 5:1 vote

October 12, 2024

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Key takeaways: RBI MPC meeting, October 2024

- The RBI MPC kept the policy repo rate unchanged at 6.5% by 5:1 majority vote. Accordingly, the standing deposit facility (SDF) rate remained unchanged at 6.25% and the marginal standing facility (MSF) rate and the Bank Rate at 6.75%.
  - The dissenting vote was from the new external member, Dr. Nagesh Kumar, who voted in favor of 25bp rate cut. Until the previous MPC meeting, the voting pattern for policy rate was 4:2, with two of the earlier set of three external members voting for 25bp rate cut.

- The MPC changed the policy stance to 'neutral' from 'withdrawal of accommodation' by a unanimous vote but remained prudent by noting that it would "remain unambiguously focused on a durable alignment of inflation with the target, while supporting growth".
  - In explaining the rationale for change in stance, the MPC noted 1) improved balance in growth-inflation dynamics and 2) the need to have flexibility in policy making to respond to risks from uncertainties pertaining to adverse weather events, geopolitical risks, and financial market volatility.

- The policy statement and remarks from MPC members in the post-policy conference suggest higher probability of the start of a shallow rate cut cycle from February. However, results from the RBI's latest survey of professional forecasters show median expectations of a 75bp rate cut cycle, starting in Q3-FY25, indicating chances of the first cut at the December MPC meet.
- The MPC kept FY25 forecasts for growth and inflation unchanged at 7.2% and 4.5%, respectively, amid minor tweaks to quarterly projections.
- While addressing the section on financial stability, the RBI Governor noted concerns regarding business practices of some outlier NBFCs that are aggressively pursuing growth and returns. The central bank noted that will continue to monitor the sector and take appropriate action, if required.

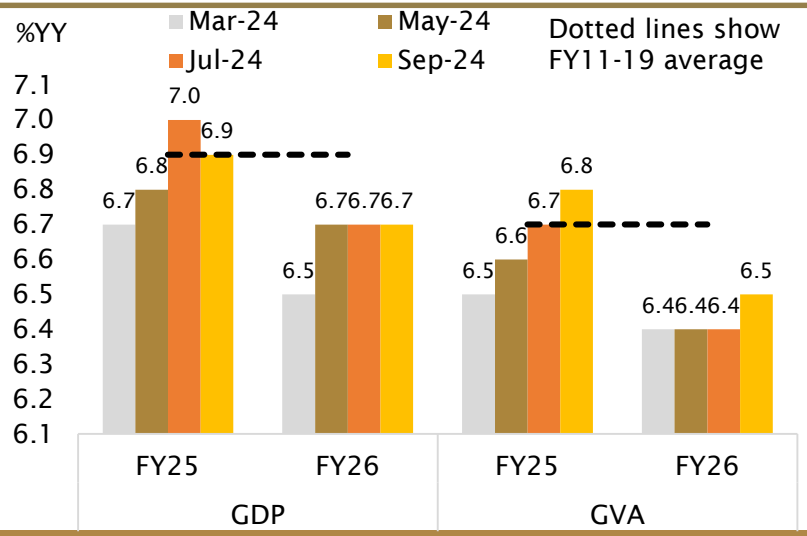
FY25 outlook unchanged amid quarterly revisions

Real GDP %YY	Apr-24	Jun-24	Aug-24	Oct-24
Q2:FY25 F	6.9	7.2	7.2	7.0
Q3:FY25 F	7.0	7.3	7.3	7.4
Q4:FY25 F	7.0	7.2	7.2	7.4
FY25 F	7.0	7.2	7.2	7.2
Q1:FY26 F			7.2	7.3
CPI %YY	Apr-24	Jun-24	Aug-24	Oct-24
Q2:FY25 F	3.8	3.8	4.4	4.1
Q3:FY25 F	4.6	4.6	4.7	4.8
Q4:FY25 F	4.5	4.5	4.3	4.2
FY25 F	4.5	4.5	4.5	4.5
Q1:FY26 F			4.4	4.3

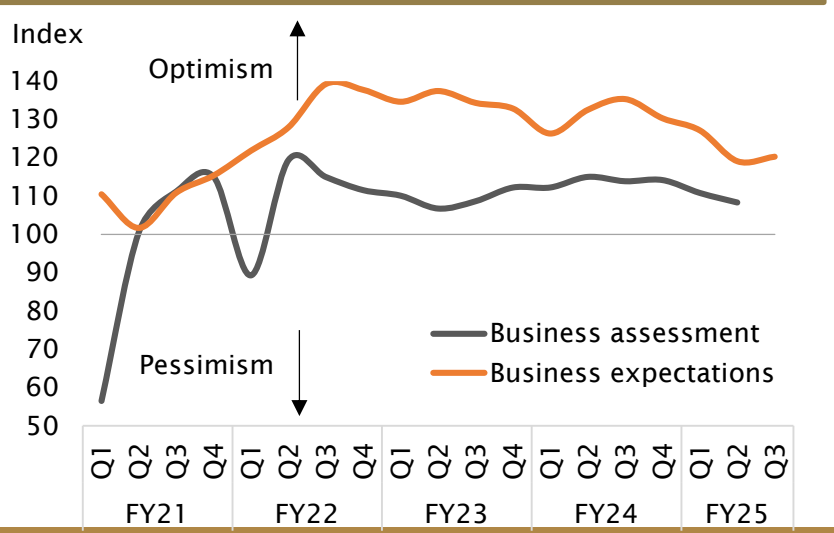
RBI MPC remains optimistic about domestic growth prospects

- The policy statement continued to exude confidence regarding domestic growth, with real GDP forecast kept unchanged for FY25 at 7.2% amid tweaks to quarterly projections. The estimate for Q2 was trimmed 20bps to 7%, while that for Q3 and Q4 were raised by 10bps and 20bps, respectively to 7.4% for each quarter.
- Some of the main reasons for the MPC's optimism include: 1) improved prospects of farm output due to better monsoon this year that is expected to support the ongoing recovery in rural consumption 2) rebound in government spending after a contraction in Q1 and a pick up in private investment 3) sustained buoyancy in services sector activity.
- In Q1, real GDP growth was sub-7% and undershot the RBI MPC forecast. In recent months, some of the high frequency indicators of economy activity have turned mixed, prompting some of the market participants to lower their growth forecasts for the fiscal year. In the latest round of survey of professional forecasters, median estimate of real GDP growth for FY25 stood 10bps lower than the previous round and slightly below 7% at 6.9%, even as median estimate of real GVA growth, a relatively better gauge of economic activity that is devoid of tax and subsidy calculations, was marginally higher at 6.8% from 6.7% in the earlier round.
- In another encouraging sign, business confidence perked up in the latest round of RBI's industrial outlook survey after moderating for three successive rounds. Consumer confidence also improved in the latest round of survey after posting the steepest sequential decline since early 2022 in the previous round.

SPF median forecasts of real GDP and GVA growth



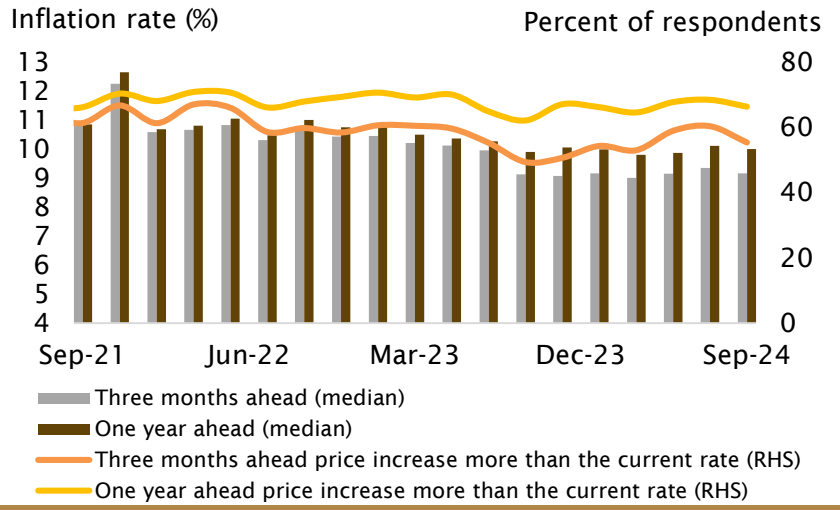
Business confidence from RBI industrial outlook survey



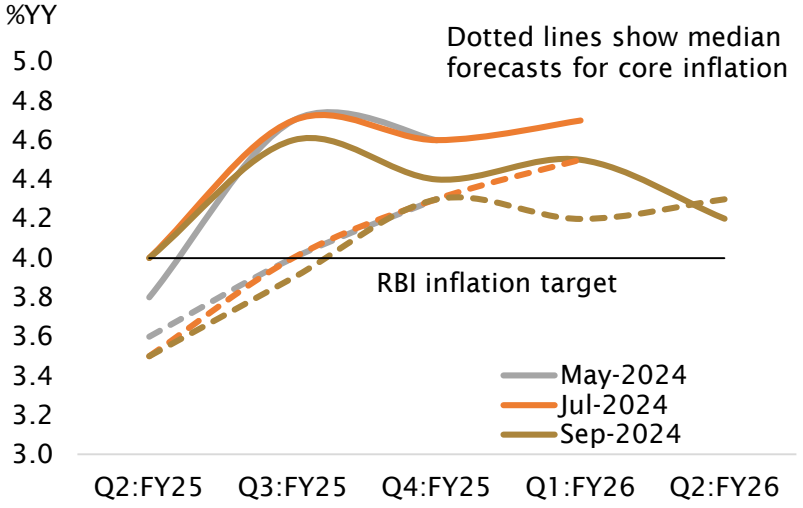
RBI MPC confident about navigating last mile of disinflation

- The Governor's statement noted that since the last MPC meeting, there had been further progress in the disinflation process in terms of moving towards a durable alignment to the target. The MPC retained the FY25 inflation forecast at 4.5% amid minor changes to quarterly projections. It lowered Q2 forecast by 30bps to 4.1%, and Q4 by 10bps to 4.2%, but raised Q3 estimate by 10bps to 4.8%.
- Even as better monsoon this year has raised prospects of higher farm output, and therefore, lower food inflation, there are upside risks to inflation from the recent uptick in global food and metal prices, unexpected weather events, and worsening of geopolitical conflicts.
- Results from the latest round of survey of professional forecasters shows median forecasts of both headline and core inflation above 4% even in Q2-FY26, but with headline CPI projected to ease to 4.2% in Q2-FY26, which also marks the quarter when core inflation is expected to rise above the headline print. In an encouraging signal though, households' inflation expectations eased in the latest round of RBI's survey.
- In the RBI's latest monetary policy report, published bi-annually, there was a fractional increase in Q4-FY26 headline inflation forecast to 4.1% from 4.0% in the previous report. Under the baseline assumptions, the RBI lowered crude oil (Indian basket) price to USD80/bbl from USD85/bbl. The report noted that 10% increase in oil price above baseline could raise domestic inflation by 30 bps and lower growth by 15 bps. Conversely, if crude oil prices fell 10% relative to the baseline, inflation could ease by 30 bps and boost growth by 15 bps.

Households' inflation expectations



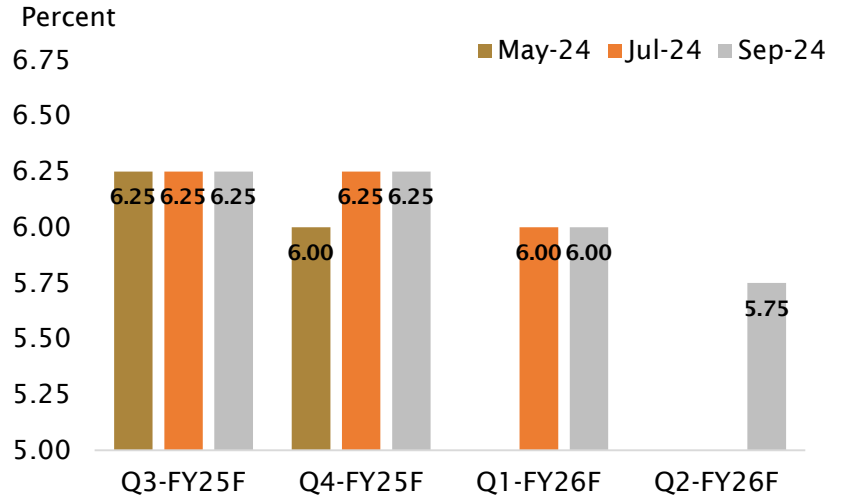
SPF median forecasts of headline CPI inflation



Rationale for stance change; NBFC business practices on the radar

- The MPC cited two main reasons for changing stance to neutral:
  - The current and expected inflation-growth dynamics had moved into better balance, thereby creating congenial conditions for a change in stance.
  - The external environment had turned more uncertain since the last MPC meeting and a change in stance would equip the committee with the required flexibility to respond to evolving conditions and deal with risks stemming from: 1) heightened global geopolitical risks 2) financial market volatility 3) adverse weather events 4) recent uptick in global food and metal prices.
- The policy statement acknowledged progress in disinflation and confidence its alignment to the RBI's target in the later part of the current fiscal year. However, in the post-policy conference, one of the MPC members stated that the committee would prefer to see off the expected near-term hump in inflation in Q3 before considering further policy moves. This suggests a greater likelihood of the MPC starting to cut rates from its February meeting, when it would have the required data points to assess the inflation trajectory.
- In the previous round of survey of professional forecasters, median forecast was of a 50bp easing cycle, with one 25bp cut in Q3-FY25 and another in Q1-FY26. But in the latest round, the median forecast is of 75bp easing, starting with one 25bp cut in Q3-FY25, followed by two more of 25bp each in Q1-FY26 and Q2-FY26.
- While noting stability in overall health of the financial system, the Governor's statement acknowledged reports of likely buildup of stress in a few unsecured loan segments like loans for consumption purposes, micro finance loans and credit card outstanding, and the need for banks and NBFCs to have robust underwriting standards and post-sanction monitoring. The statement specifically noted concerns over business practices of certain outlier NBFCs – including microfinance institutions (MFIs) and housing finance companies (HFCs) – that were aggressively pursuing growth without building up sustainable business practices, and chasing excessive returns on their equity via unfair business practices. The RBI would remain vigilant and take appropriate action, if necessary.

SPF median quarterly forecasts of policy repo rate



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