Monetary Policy Review: April 2024

5th April 2024

The Monetary Policy Committee (MPC) decided to keep the policy rate and stance unchanged, with a majority vote of 5 to 1. Thus, repo rate was maintained at 6.5% and stance remained *focussed on "withdrawal of accommodation to ensure that inflation progressively aligns to the target, while supporting growth".* Consequently, SDF, MSF and CRR rates were also kept unchanged at 6.25%, 6.75% and 4.5% respectively. Same as last meeting in Feb'24, one of the external MPC member voted for reduction in repo rate by 25 bps and changing the stance to neutral.

In other measures announced, trading of sovereign green bonds on International Financial Services Centre (IFSC), improving ease of access to retail investors to invest in Gsecs via mobile application and permitting Small finance banks to deal in permissible interest rate derivatives could help in deepening of market.

On Growth: The global economy, as per RBI, continues to remain resilient and is likely to grow at a steady pace. After subdued growth in CY23, global merchandise trade is likely to recover in CY24, albeit below pre-pandemic average. India's GDP growth accelerated driven by robust investment spending. Recent high frequency indicators such as PMIs, GST collections, industrial growth, steel & cement consumption, exports, etc. points at growth momentum sustaining.

GDP Growth (%)	Feb-24E	Apr-24E
FY24*	**7.3**	**7.6**
Q1FY25	7.2	7.1
Q2FY25	6.8	6.9
Q3FY25	7.0	7.0
Q4FY25	6.9	7.0
FY25	**7.0**	**7.0**

Source: RBI, *MOSPI

RBI remained optimistic on growth outlook led by the resilient services and urban consumption, low unemployment, rise in consumer confidence, etc. Likelihood of recovery in rural consumption driven by record rabi production and expectations of normal monsoon should also aid growth. Additionally, the uptick in real estate investments, government thrust on capex, and prospects of upturn in private corporate capex augur well for the investment outlook.

On Inflation: CPI moderated over the past couple of months on back of subdued fuel and core inflation. However, food inflation remained at elevated levels driven by vegetables, eggs, meat and fish prices. Inflation is expected to ease, as per RBI estimates, in FY25 driven by moderation in food prices on back of record rabi crop and normal monsoon expectations. Further, the LPG price cuts should ease fuel inflation while core inflation is likely to remain steady. Key risk to inflation emanates from food price uncertainties which could push inflation higher in view of adverse impact on crop production due to lower reservoir levels and weather-related uncertainty. Further, rise in input price pressures, geopolitical tensions impacting supply chain and commodity prices could push up prices.

CPI (%)	Feb-24E	Apr-24E
Q4FY24	5.0	NA
FY24 Average	**5.4**	**5.4**
Q1FY25	5.0	4.9
Q2FY25	4.0	3.8
Q3FY25	4.6	4.6
Q4FY25	4.7	4.5
FY25 Average	**4.5**	**4.5**

Source: RBI

Average inflation forecast for FY25 was kept unchanged at 4.5%, it reduced its inflation estimate by 10 bps, 20 bps and 20 bps for Q1, Q2 and Q4 respectively (relative to its estimate in Feb’24 meeting).

Conclusion and Outlook

In our view, it was a status quo policy with no major announcement on rates, stance and liquidity front. Consequently, bond yields saw minimal movement following the policy announcement. RBI, however, continued to maintain its mildly hawkish tone emphasizing the challenge posed by food prices in achieving the final stage of disinflation and reaching the 4% target. Additionally, the RBI reiterated the importance of an actively disinflationary policy and reaffirmed its determination to align inflation with the target on durable basis. Noteworthy is the RBI's acknowledgment that strong economic growth provides it the flexibility to pursue its inflation objectives.

The outlook for fixed income for FY25 remains favourable in view of the following key drivers:

- Inclusion of India’s sovereign securities in JP Morgan bond index bodes well for demand outlook for G-Sec in next year and can effectively cap any significant rise in yields.
- Core CPI momentum remains subdued on the back of lower input price pressure and benign global commodity prices.
- Government reiterated its commitment of bringing down fiscal deficit to less than 4.5% of GDP by FY26. This should keep market borrowings within manageable levels.
- External sector is likely to be supported by steady services exports, manageable CAD and adequate foreign exchange reserves.
- The rate hike cycle in AEs has ended and expectations of rate cuts are high during the year. RBI is also likely to cut rates in H2FY25, although we expect a shallow rate cut cycle.

However, there are counter balancing factors which can put upward pressure on yields.

- Regular food price shocks can keep headline CPI elevated; sustained growth momentum can result in core inflation reaccelerating.
- High SLR holdings of the banking system and robust credit growth could weigh on incremental demand for G-Secs.
- Recent rise in commodity prices, especially crude oil prices, sustaining due to escalation of geopolitical tensions leading to disruption in supply chain.

Overall, in our view, yields are likely to trade with a downward bias and the long end of the yield curve is likely to outperform over the medium term. Thus, as highlighted in the past, for investors with a relatively longer investment horizon, it is a good time to increase allocation to longer duration funds in line with individual risk appetite. Further, given a flat yield curve and elevated short-term rates along with expectations of rate cuts in the coming year, one may also consider investment in short to medium duration debt funds.

Glossary

BPS	Basis points (1 bps = 0.01%)
CPI	Consumer Price Index
CAD	Current Account Deficit
CRR	Cash Reserve Ratio
GDP	Gross Domestic Product
MSF	Marginal Standing Facility
PMI	Purchasing Manager Index
RBI	Reserve Bank of India
SDF	Standing Deposit Facility
SLR	Statutory Liquidity Ratio
AE	Advanced Economies
GST	Goods and Services Tax