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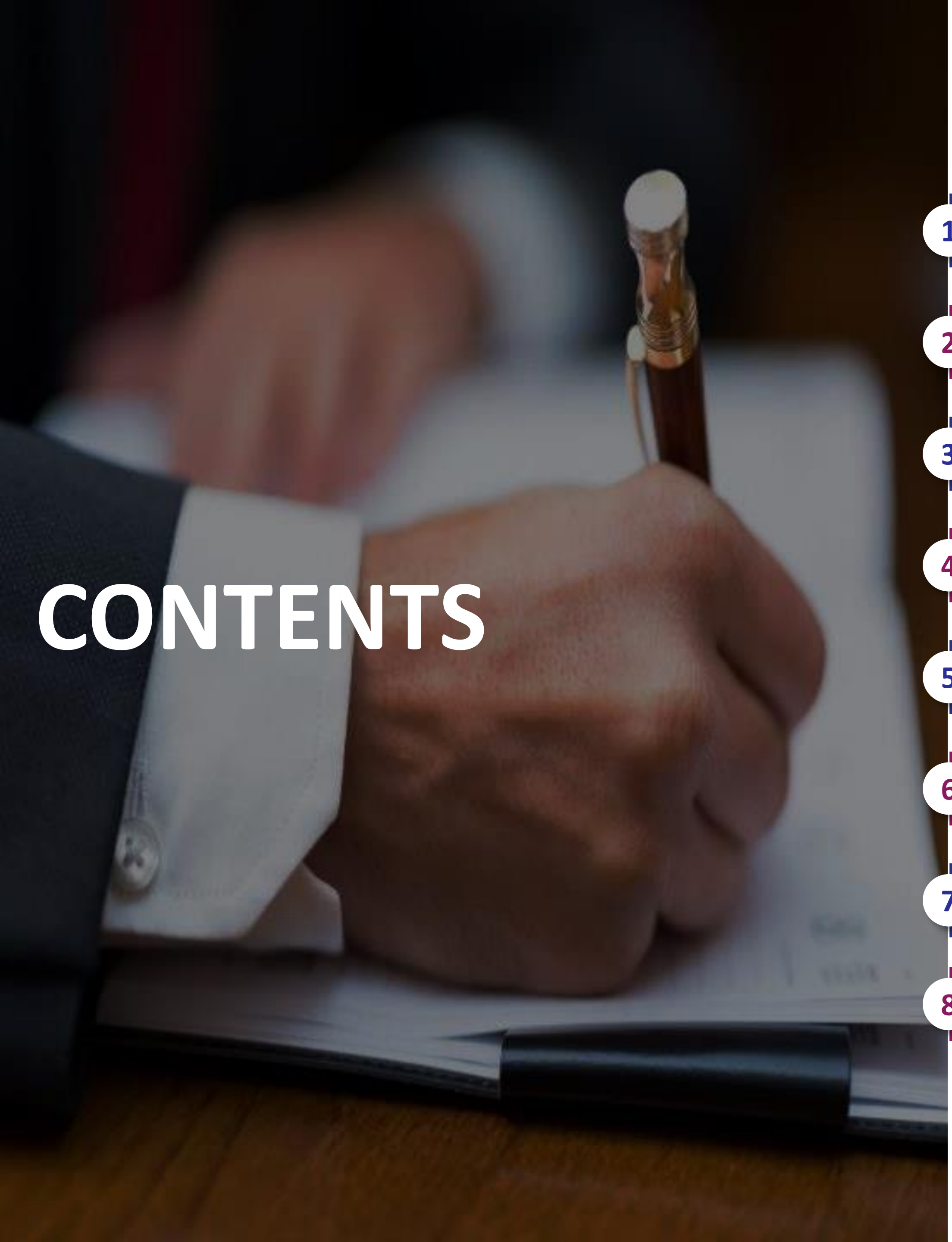
RBI MONETARY POLICY

CAUTIOUS OPTIMISM ON GROWTH, OPTIMISTIC CAUTION ON INFLATION

February 2024



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EXECUTIVE SUMMARY (1/2)

- The RBI has navigated the hard times ably, steering the economy through the roughs of the pandemic and continued volatility over the past 4 years. The question now arises is that whether this oasis of sound growth and declining inflation can be durably sustained through monetary policy. The RBI's answer to this has been to stay focused on the risks, resisting from reveling in the exuberance, nimbly balancing inflation-targeting, currency stability, systemic risk, and growth. The fruits of these efforts to ensure macroprudential stability will bear fruit in the times to come. This was the theme of the Feb'24 policy, where we could observe **cautious optimism on growth, and optimistic caution on inflation**

- No changes were expected in the rates, and accordingly, the **MPC decided to keep its policy repo rate unchanged at 6.50%. It is important to note that the vote this time was 5-1, and not unanimous, indicating that some in the MPC are ready for a cut.** All other policy rates such as MSF, bank rate, and SDF also remained unchanged. Besides domestic factors, playing on the MPCs mind will be the trajectory of global Central Banks in CY24, particularly the US Fed – the current market projections of 2-3 cuts in CY24 give RBI sufficient wiggle-room. ***We now expect the first rate cut not before Aug'24***, given the inflation-growth dynamics currently expected

- The MPC retained its stance of being focused on withdrawal of accommodation, by a similar 5-1 vote as last time. The Governor also made an **important caveat that the stance primarily refers to the MPC's intent on controlling inflation and with reference to ongoing transmission of rates, and not necessarily to liquidity conditions**. This is consistent with the actions of the RBI, which has resorted to nimble operations to maintain liquidity and short-term rates in a small range, especially in recent weeks when a pickup in government spending ensued. Currently, policy transmission to lending rates remains incomplete and the RBI's inflation projections do not indicate quick alignment with 4%. Thus, by disjointing the stance from liquidity concerns, the MPC has effectively paved the way to keep it unchanged until inflation and transmission align – this ***impacts expectations of the timing of a stance change***

- Accordingly, the tone on inflation was cautious, with the primary focus on food prices, which could generalize and cause havoc. The RBI remains vigilant of continued geopolitical shocks, supply chain disruptions, and erratic weather. Nevertheless, it kept its FY24 CPI estimate unchanged at 5.4%, inching down its Q4 forecast. Importantly, it projects FY25 CPI at 4.5%, which is above the oft-repeated target of 4%. The downward revision in quarterly trajectory, however, will be a positive for the markets. Further, it is important not to overstate the case for tightness, as the RBI is by no means tied down, given positive real rates prevail, and considerable progress has been made on core inflation. Rather, **RBI's actions must be interpreted in its desire to build considerable countercyclical buffers**

EXECUTIVE SUMMARY (2/2)

- The RBI was **sanguine on growth prospects, pencilling in 7% y/y real GDP growth for FY25**, pulling up the projections for Q1 and Q2 sharply. Confidence was shown in structural drivers of domestic growth, backed by consumption. While acknowledging the role of government capex, the Governor pointed out that investment intention of the private sector remains upbeat. India thus remains the polestar even in a firmament where the stars have aligned more favourably for global growth. The latter is based on the continued impact of pandemic era relief efforts, and thus the optimism was laced with a word of caution on the as the high debt/GDP of many countries poses a major risk to their fiscal maneuverability, and thus, their ability to consume
- The global positivity will help the external sector. India is expected to be the largest recipient of inward remittances, at USD 135 bn in CY24. Further, with 10.2% share in the global software market, net balances in services and remittances is expected to be in a large surplus, offsetting merchandise trade deficit. Thus, the RBI expects current account deficit to be eminently manageable in FY24 and FY25. We ***expect CAD to close at 1% of nominal GDP in FY24, in line with our earlier estimate.*** The meaty forex buffers would largely take care of any fluctuations in global prices impact merchandise imports or a slowing of software exports
- Since the policy was broadly on expected lines, the bond markets remained calm, with 10Y G-sec yields unchanged at 7.07%. The trajectory in the future will be driven by the Union's commitment to fiscal discipline, timing of RBI's rate cuts, and expected inflows from induction into global bond indices. Given these are all downward pulls, ***we expect the 10Y G-sec rate to dip below 7% in the coming months.*** Further, with government spending to normalize liquidity, and RBI performing two sided actions in a timely fashion, ***short term rates would also remain rangebound***

RBI KEEPS POLICY RATE UNCHANGED AS EXPECTED

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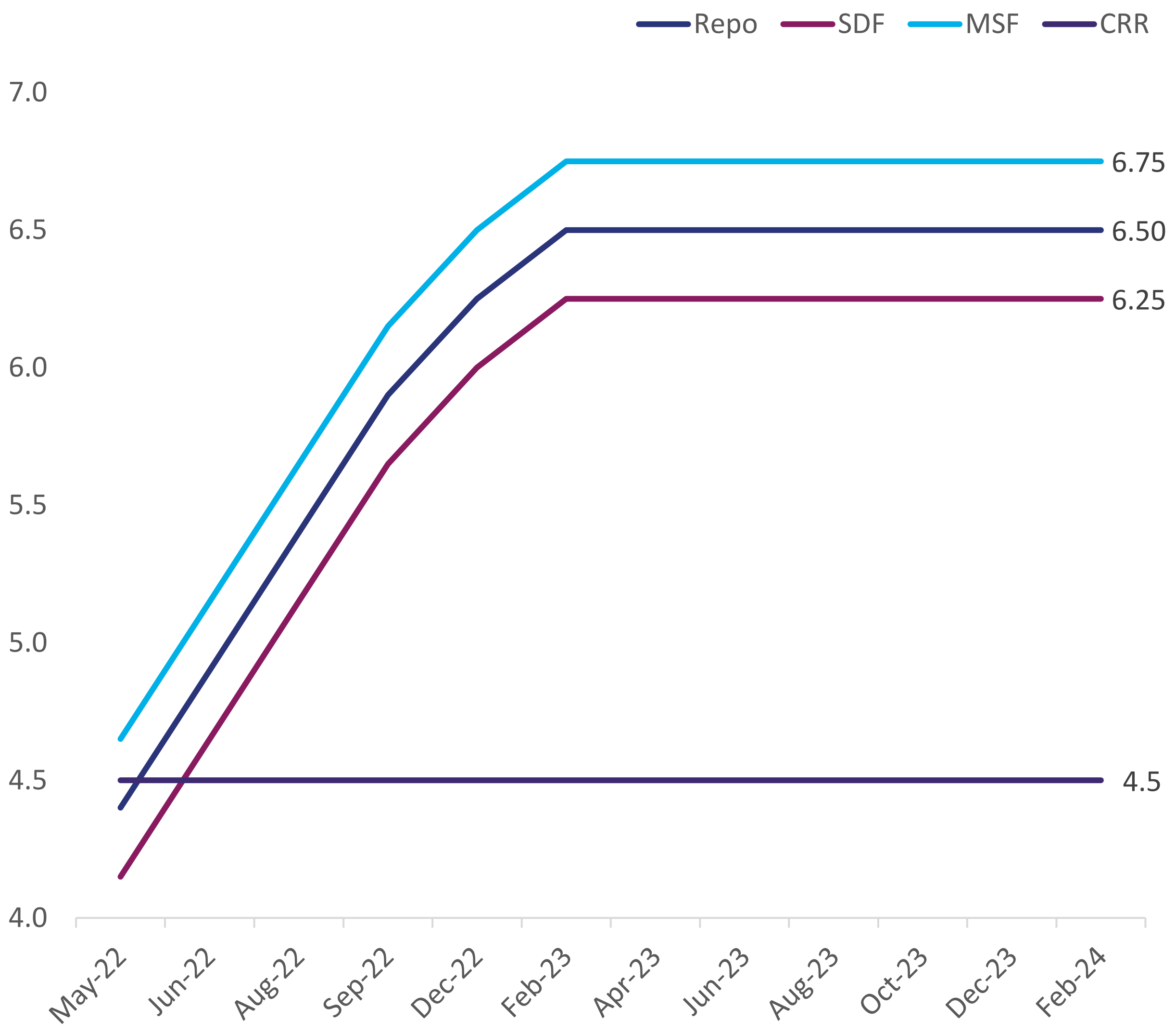
KEY RATES (%)



STANCE OF POLICY

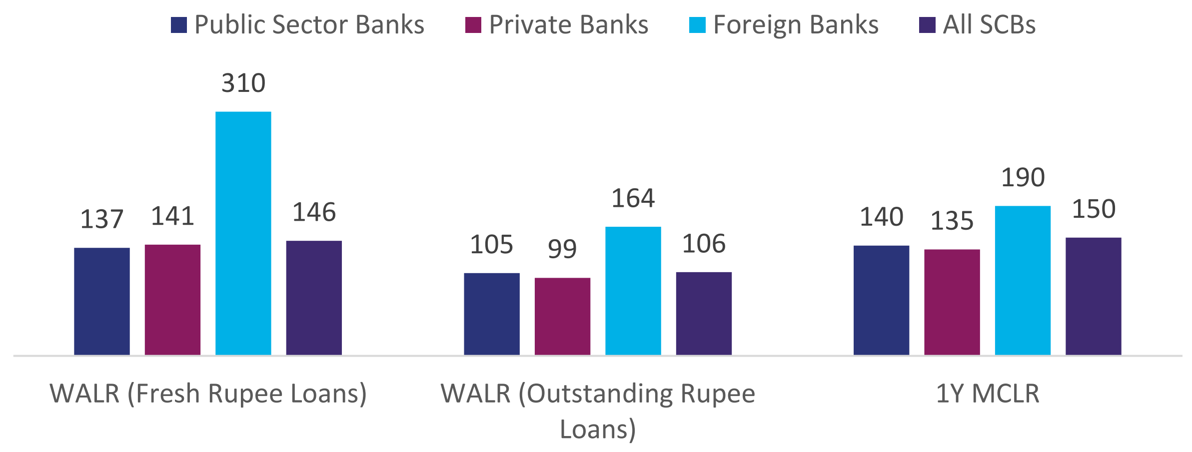
Date	Stance	Vote
04-May-22	Remain accommodative, while focussing on withdrawal of accommodation	6-0
08-Jun-22	Withdrawal of Accommodation	6-0
05-Aug-22	Withdrawal of Accommodation	6-0
30-Sep-22	Withdrawal of Accommodation	5-1
07-Dec-22	Withdrawal of Accommodation	4-2
08-Feb-23	Withdrawal of Accommodation	4-2
06-Apr-23	Withdrawal of Accommodation	5-1
08-Jun-23	Withdrawal of Accommodation	5-1
10-Aug-23	Withdrawal of Accommodation	5-1
06-Oct-23	Withdrawal of Accommodation	5-1
08-Dec-23	Withdrawal of Accommodation	5-1
08-Feb-24	Withdrawal of Accommodation	5-1

- RBI's MPC kept the repo rate unchanged at 6.50%, in line with market expectations, while it remains watchful of the fragile global environment marred by geopolitics.
- Notably, the vote for the decision stood at 5-1, reflecting change of sentiments in the MPC.
- The stance was retained as **withdrawal of accommodation**. The vote for the stance was 5-1, as was the case in previous MPC too

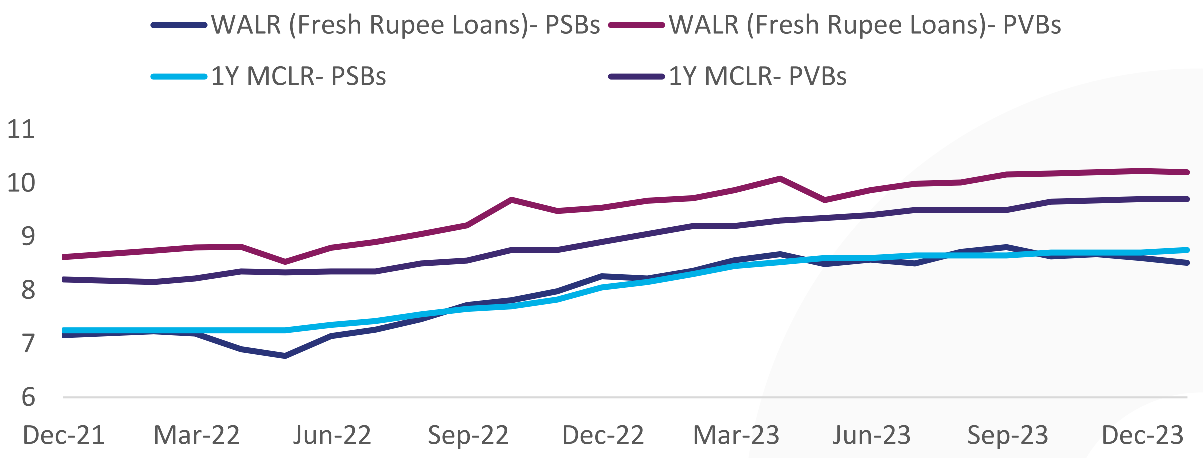
Source: RBI, SBICAPS

ADDITIONAL PROGRESS IN RATE TRANSMISSION TO BE MADE

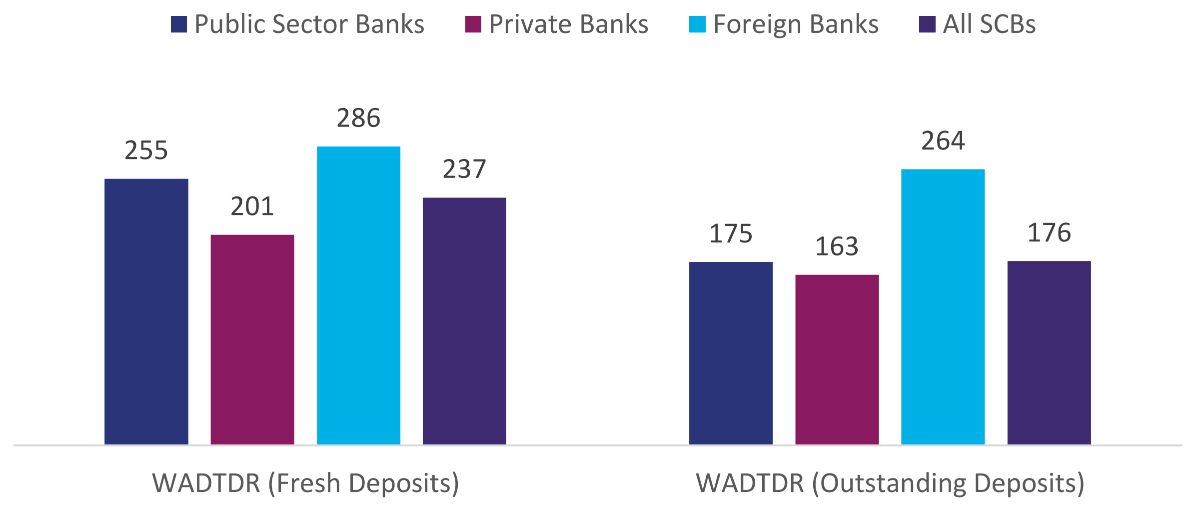
TRANSMISSION TO LENDING RATES FROM MAY'22 TO DEC'23 (BPS)



LENDING RATES OF DOMESTIC BANKS (%)



TRANSMISSION TO DEPOSIT RATES FROM MAY'22 TO DEC'23 (BPS)



- 250 bps of rate hikes have not been fully transmitted to lending rates. This assumes importance as it was highlighted as a variable for policy stance
- Transmission to deposits is more complete, due to credit growth consistently outpacing deposits growth

Source: RBI, SBICAPS

DOMESTIC BUOYANCY AND GLOBAL SOFT LANDING BOOST GROWTH

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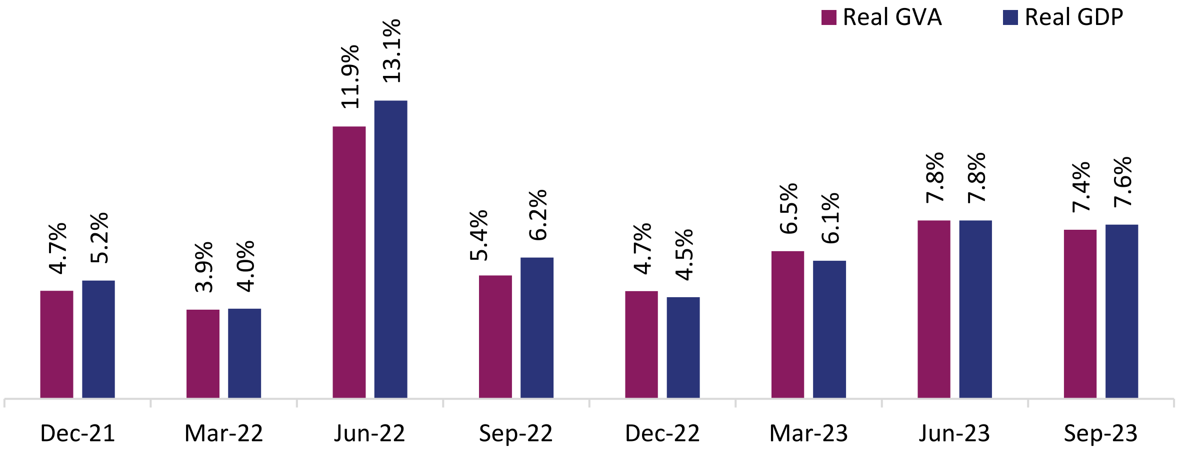
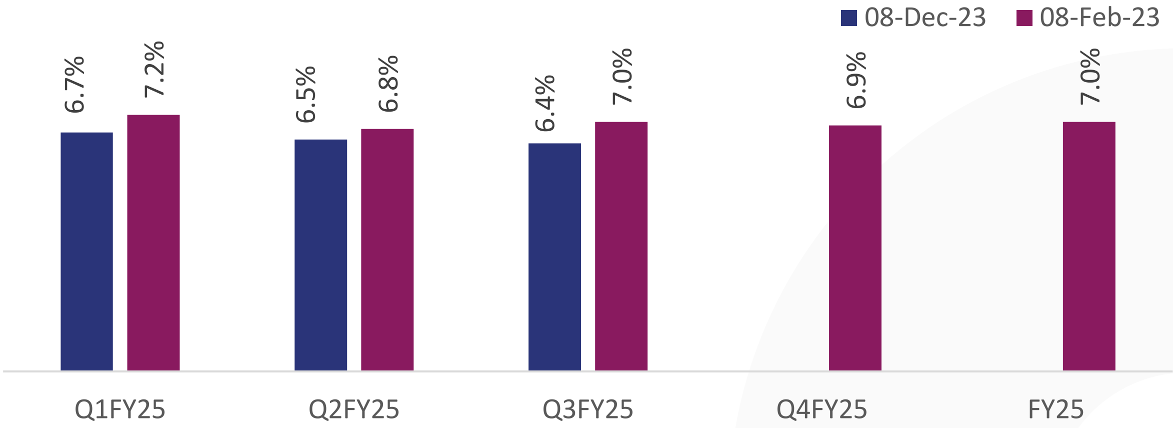
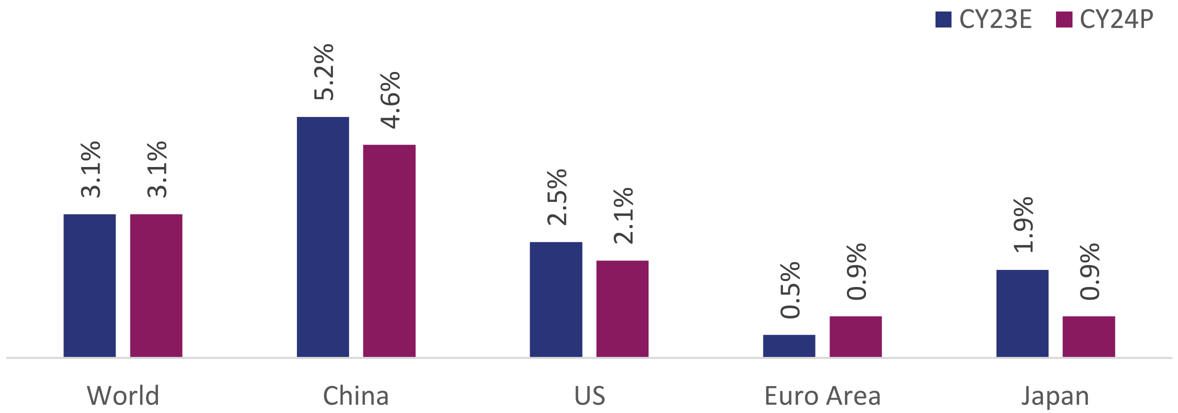
QUARTERLY REAL GDP & GVA GROWTH RATES (IN %Y/Y)



PROJECTED REAL GDP (IN % Y/Y) AS PER RBI



REAL GDP (IN %Y/Y) AS PER IMF

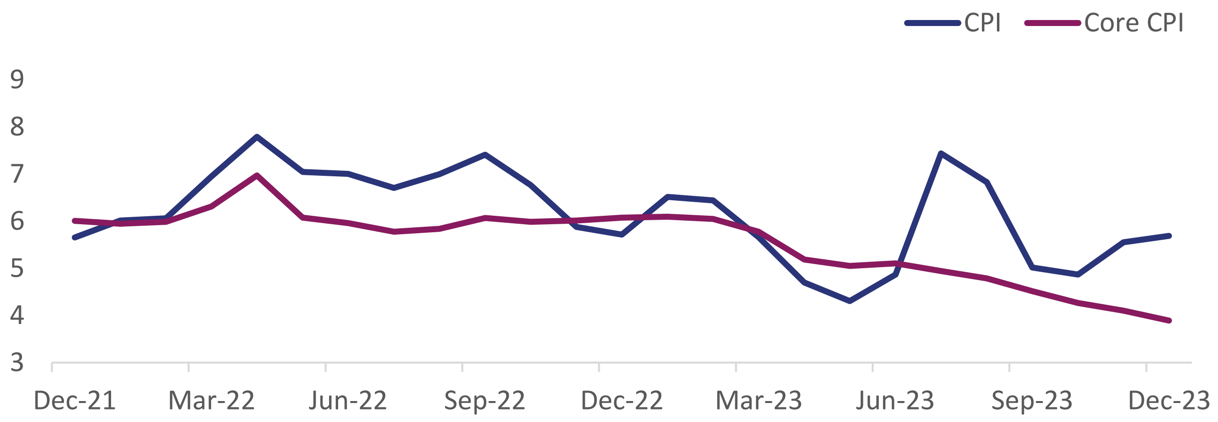


- Moderating of inflation and unwinding of supply-side issues has led to steady economic growth around the world evidenced by the resilience of the US economy and high growth in EMs, despite tight monetary conditions.
- India remains a global outlier with strong domestic demand, government spending and steadily declining inflation coupled with fiscal prudence. Soft landing globally means that even in FY25, the benefits of rapid growth shall sustain
- RBI has pegged domestic growth at 7% for FY25, with upward revisions for all quarters, indicating sustained momentum

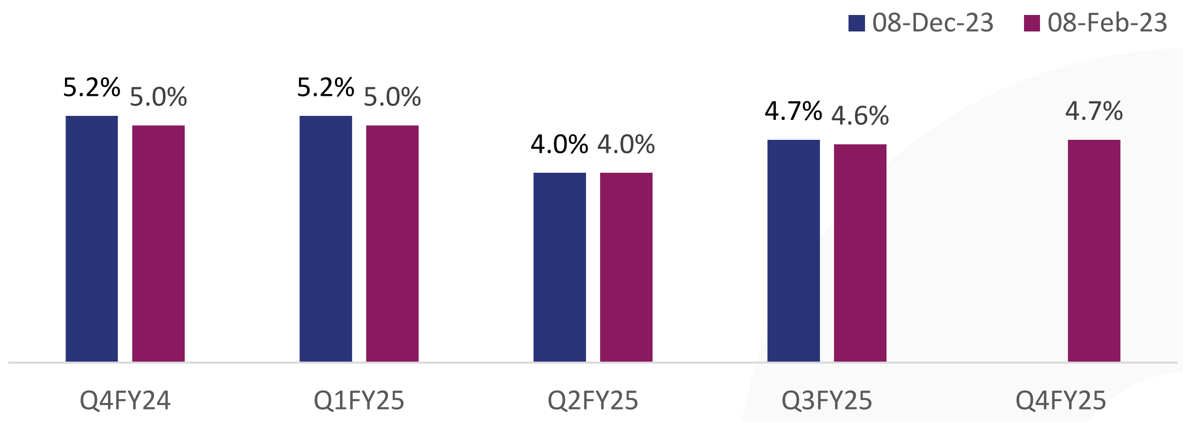
Source: CEIC, RBI, IMF, SBICAPS

DISINFLATIONARY ENVIRONMENT GIVES RBI COMFORT

CPI AND CORE CPI (IN % Y/Y)



PROJECTED CPI (IN % Y/Y) AS PER RBI



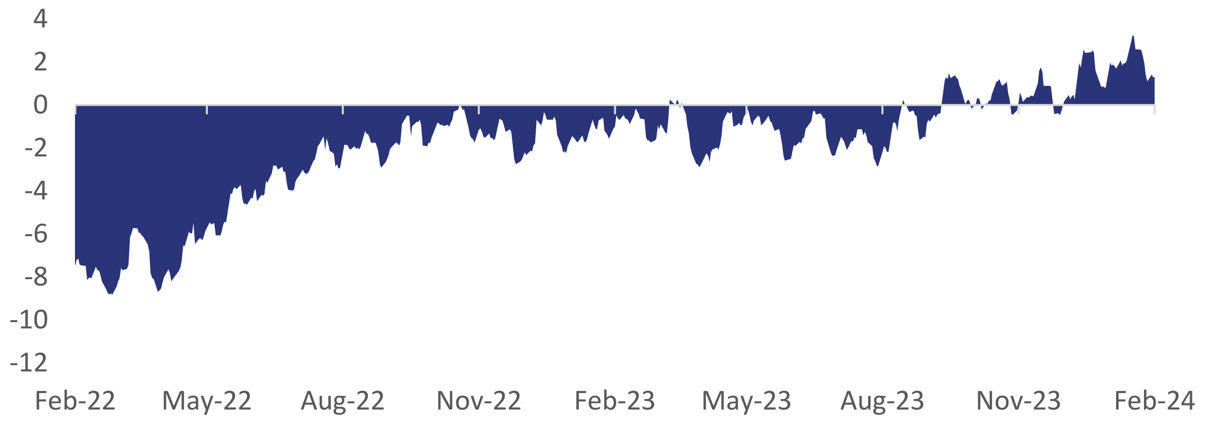
BRENT CRUDE (USD/BBL)

- RBI maintained its inflation expectations of FY24 at 5.4%, while keeping the trajectory unchanged.
- Governor acknowledged the progress made in curtailing inflation, with minor blips expected in the ensuing months owing to transitionary supply side shocks

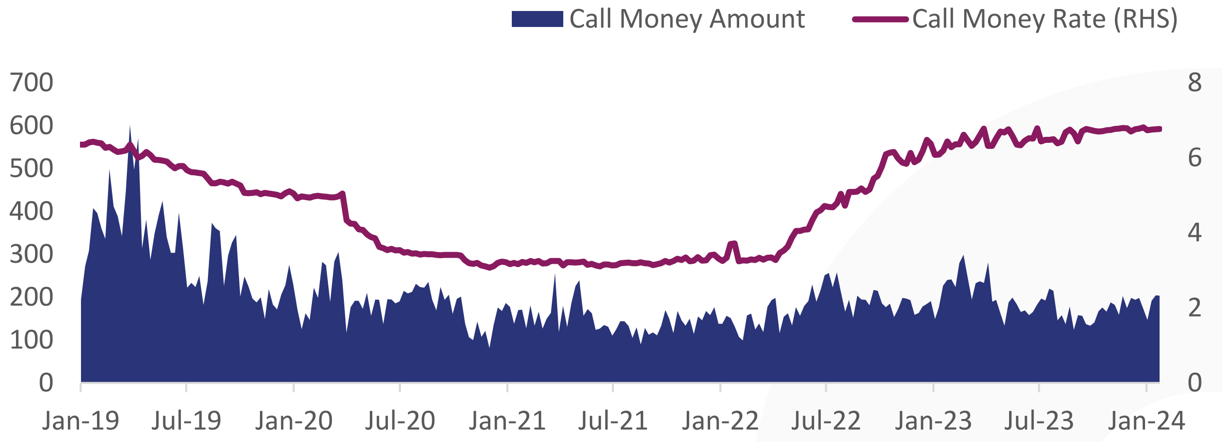
Source: Bloomberg, CEIC, RBI, SBICAPS

RBI FOCUSSES ON NIMBLE LIQUIDITY MANAGEMENT

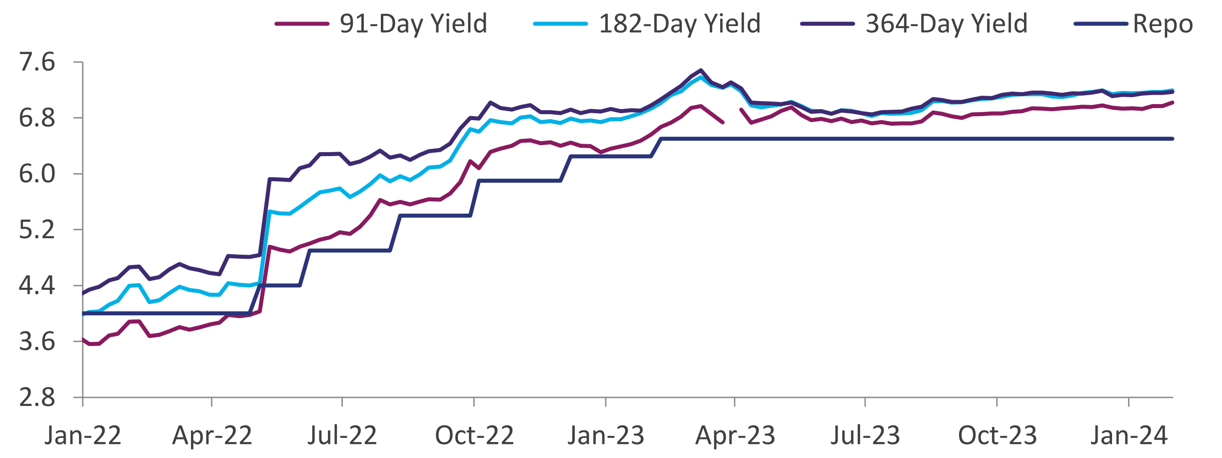
BLOOMBERG INDIA LIQUIDITY INDICATOR (RS. TRN.)



CALL MONEY AMOUNT (RS. BN.) VS CALL MONEY RATE (%)



T-BILL YIELDS VS. REPO (%)

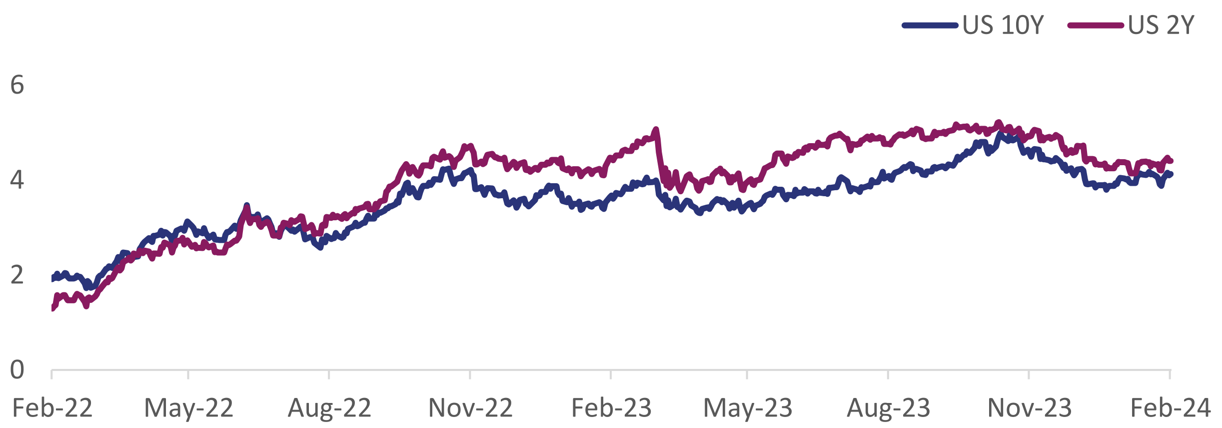


- As focus of the central bank progresses to prudence and financial stability, active management of liquidity has taken forefront
- Banking liquidity has continued to be neutral to moderately tight as it is being consciously managed
- RBI has focussed on nimble liquidity management with VRR and VRRR auctions and is committed to keep the WACR near the repo rate.

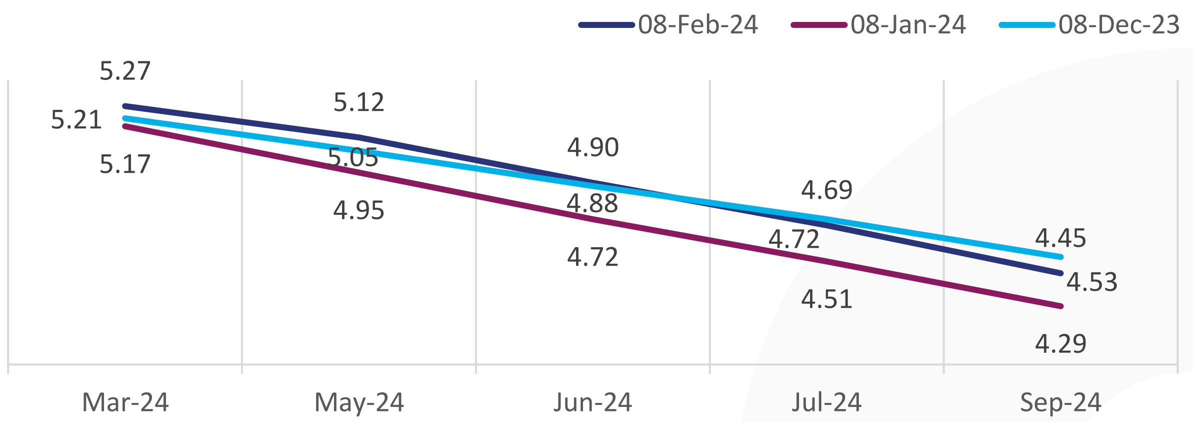
Source: Bloomberg, CEIC, RBI, SBICAPS

US YIELDS INCH HIGHER ON CAUTIOUS FED OUTLOOK

US 10Y G-SEC YIELD (IN %)



MARKET-IMPLIED PATH OF US FED POLICY RATE (IN %)

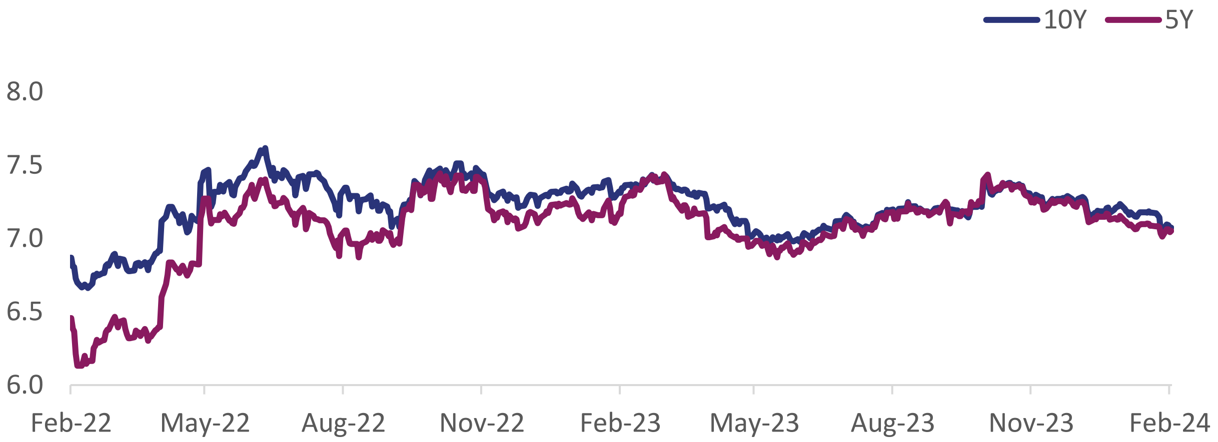


- US bond yields have been inching higher as the US FOMC kept the policy rate unchanged with no expectations of rate cuts until inflation sustainably aligns to the 2% target, despite improving inflation-employment dynamics. Mr. Powell interjected that the Fed would be cautious with rate cuts, likely slower than what the market expects.
- Expectations of rate cuts have somewhat tempered, with the yield curve continuing to remain mildly inverted.
- The impact of global bond price volatilities is not expected to be acute on domestic market

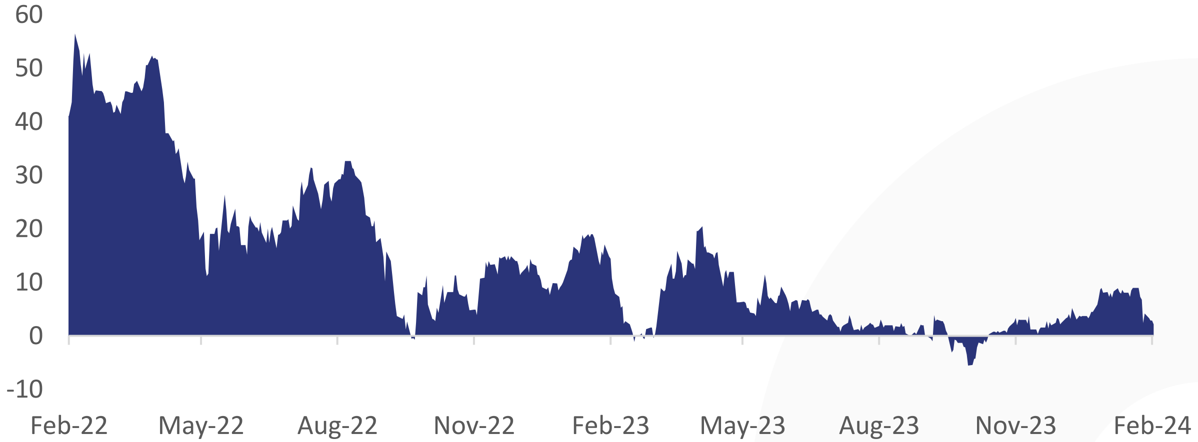
Source: Bloomberg, SBICAPS

INDIAN YIELDS REMAIN STABLE DESPITE GLOBAL VOLATILITIES

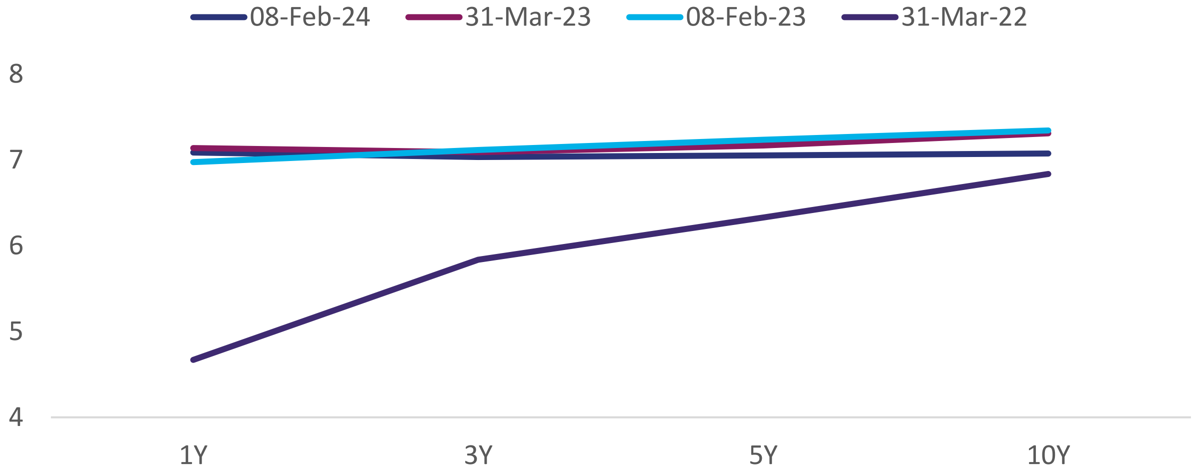
G-SEC YIELD – 10Y (IN %)



10Y-5Y G-SEC SPREAD (IN BPS)



EVOLUTION OF YIELD CURVE (IN %)



- Despite widely oscillating US 10-year yields over the past couple of months, Indian yields have largely remained stable

Source: Bloomberg, SBICAPS

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