Brickwork Ratings

As Expected, RBI Keeps the Key Policy Rates Unchanged and Focuses on Withdrawal of Accommodation

*-- Dr Kaveri R Deshmukh**

BWR Economic Brief

As Expected, RBI Keeps the Key Policy Rates Unchanged and Focuses on Withdrawal of Accommodation

The monetary policy announced by the RBI today has kept the key policy rates unchanged. It has reiterated to withdraw accommodation and bring inflation closer to target while not adversely impacting on growth.

The Monetary Policy Committee (MPC) at its bi monthly meeting (December 6 - 8, 2023) kept **the policy repo rate under the liquidity adjustment facility (LAF) unchanged at 6.50%.** Accordingly, the standing deposit facility (SDF) rate too stands unchanged at 6.25% and the marginal standing facility (MSF) rate and the Bank Rate stand at 6.75%. By a majority of 5 out of 6 members the MPC has decided to "*remain focused on withdrawal of accommodation to ensure that inflation progressively aligns to the target, while supporting growth".*

The rationale behind these decisions lies in the easing of inflation concerns during the bi-monthly period extending from October to December 2023. The CPI inflation eased to 4.9% in October from 7.4% in July with easing being observed in all components of CPI, viz. food, fuel, and core. The food inflation that stood in double digits in July receded to 6.2% in October. Further, broad-based easing in core inflation points to the effect of onset of disinflation led by monetary policy actions.

RBI's take on inflation and growth reflects optimism about growth trajectory along with a realistic assessment of macro-economic environment. The MPC has stated that its objective is to achieve the medium-term target for consumer price index (CPI) inflation of 4% within a band of +/- 2%.

The MPC has maintained its CPI inflation forecast at 5.4% in FY 2023-24, at 5.6% during Q3, and at 5.2% during Q4 FY of FY 2023-24. On assumptions of a normal monsoon next year, the MPC has also maintained its CPI inflation forecast at 5.2% for Q1 FY 2024-25 while it forecasts the inflation rate of 4% and 4.7% during Q2 and Q3 of FY 2024-25 respectively.

The MPC has revised upwards it GDP growth forecast for FY 2023-24 to 7% from 6.5% projected in October. With the higher than projected second quarter estimate of GDP at 7.6% released by the Ministry of Statistics and Programme Implementation a few days ago, this revision by RBI was expected. It has also enhanced the GDP forecast for Q3 to 6. 5% from 6% and for Q4 of FY 2023-24 to 6% from 5.7% projected earlier. GDP forecast for Q1 FY 2024-25 stands elevated at 6.7% from 6.6% projected earlier. The GDP forecasts for Q2 FY 2024-25 and Q3 FY 2024-25 stand at 6.5% and 6.4% respectively.

RBI's decision rests on consideration of factors that include easing inflation, buoyant economic activity driven by strong domestic demand, 7.6% y-o-y GDP growth clocked in Q2 FY 2023-24, two-thirds of rabi sowing being completed (as of December 1, 2023), recovery in the manufacturing and construction seen in the second quarter, and robust growth of core industries in October. Factors such as household consumption staying positive and investment activity staying upbeat on high government capex have also influenced the projections. Further, the MPC is watchful of the ongoing effects of rate hikes initiated till now.

Outlook

While the RBI has rightly considered the risks to domestic food inflation and the possibility of related impact on headline inflation, it has also considered volatility in crude oil prices and financial markets and global uncertainties to impact inflation outlook. The MPC statement suggests that though the macro economic situation is positive, it would exercise constant vigil to stay *"actively disinflationary"* to fix any possibilities of inflation.

The policy statement, however, also poses concerns over inflation targeting trajectory. While the RBI, in its October policy statement reiterated that *"… our inflation target is 4 per cent and not 2 to 6 per cent"*, its current projections show that the target of 4% is not likely to be reached before the second quarter of FY25. The risks of elevated levels of food prices, volatility in oil prices, and geo-political developments impacting the headline inflation are real and RBI will have to continue its vigil.

** Views are personal.*

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