RBI Monetary Policy, April 2024: Analysis

BWR Economic Brief, **April 2024**

RBI holds repo rate unchanged at 6.5%; Maintain GDP growth forecast at 7.0% for FY 2024-25. Emphasize that food price uncertainties continue to weigh on inflation outlook

Key Takeaways from RBI's Monetary Policy Meeting in April 2024:

- The Reserve Bank of India's (RBI) monetary policy committee (MPC) kept repo rate unchanged at 6.5% in the seventh consecutive meeting along with the marginal standing facility (MSF) and standing deposit facility (SDF) rates unchanged at 6.75% and 6.25%, respectively. The focus continues to be to tape the inflation elephant and send it back to the forest.

- RBI maintain its stance on withdrawal of accommodation and stand firm on its commitment to align inflation to the target, while supporting growth.

- Domestic economy, which is witnessing strong growth momentum, is projected to grow at a robust 7% in FY 2024-25 with Q1 FY 2024-25 at 7.1%, Q2 at 6.9%, Q3 at 7.0% and Q4 at 7.0%.

- Maintain India's retail inflation projection for FY 2024-25 at 4.5%; while revised estimates for Q1 at 4.9%, Q2 at 3.8% and Q4 at 4.5%. However, it sticks to inflation estimate of 4.6% in Q3 FY 2024-25.

- Stressed that food price uncertainties continue to weigh on the inflation outlook after heightened food inflation in February 2024, thus interrupting the ongoing disinflation process.

Real GDP Growth Estimates

Period	Current Forecast	Previous Forecast in February 2024
FY 2024-25	**7.0%**	**7.0%**
Q1	7.1%	7.2%
Q2	6.9%	6.8%
Q3	7.0%	7.0%
Q4	7.0%	6.9%

Inflation Estimates

Period	Current Forecast	Previous Forecast
FY 2024-25	**4.5%**	**4.5%**
Q1	4.9%	5%
Q2	3.8%	4.0%
Q3	4.6%	4.6%
Q4	4.5%	4.7%

- RBI state global economic growth is expected to remain steady in 2024 with faster trade growth, However, it outlines that continuing geopolitical conflicts along with disruptions in trade routes and high public debt burden pose challenge to overall global economic outlook.

- Agricultural outlook is assumed to remain upbeat on the back of good rabi wheat crop with record wheat production in 2023-24, pick-up in rural demand with the hope of a normal south-west monsoon which augurs well for kharif crops.

- Investment activity is assumed to remain strong and prospects going ahead remain bright in the wake of upturn in the private capex cycle and robust government capital expenditure.

- Private consumption should get a boost from sustained growth momentum in manufacturing and services sector.

- Foreign portfolio investment (FPI) inflows are expected to remain robust with net FPI inflows of $ 41.6 billion during 2023-24 as against net outflows of $ 14.1 billion in 2021-22 and $ 4.8 billion in 2022-23.

- Elevated levels of debt in many Countries and considerable uncertainty in food inflation in the wake of adverse weather conditions remains a concern.

RBI maintain status quo on interest rates

As expected, the Reserve Bank of India (RBI) maintained status quo on interest rates for the seventh consecutive time by keeping the repo rate at the current levels of 6.5%. Also, the Marginal Standing Facility (MSF) and Standing Deposit Facility (SDF) rates were kept unchanged at 6.75% and 6.25%, respectively. Repo rate was kept steady in the wake of global uncertainties and higher domestic inflation.

Domestic economic activity continues to remain strong; projects 7% GDP growth for FY 2024-25

RBI states that domestic economic activity remains strong as reflected in PMI showing sustained expansion, continued strong growth in services sector, moderating inflation and robust GDP growth. While, the manufacturing sector is showing sustained expansion, the services sector activity is expected to remain resilient and expected to grow above the pre-pandemic trend. However, increasing geo-political tensions, which is disrupting supply chain remains a concern for the RBI. Further, elevated level of debt in many Countries, hurting global economic growth, is adding to the woes.

Hence, the RBI has maintained the real GDP growth forecast for FY 2024-25 at 7%. Further, the domestic economic growth in Q1 FY 2024-25 is projected at 7.1%, Q2 at 6.9% and Q3 and Q4 at 7%, each aided by sustained thrust on government capex coupled with revival in private investment, gaining virtuous investment cycle, strengthening of rural demand and increasing capacity utilization. Further, improving global growth and trade bodes well for the domestic economic growth outlook.

RBI acknowledge that strong growth momentum and robust growth outlook for 2024-25 provides the central bank the policy space for price stability.

Retain inflation projection for FY 2024-25 at 4.5%: firm on 4% inflation target

RBI has retained the CPI (consumer price index) inflation projection at 4.5% for FY 2024-25. However, it has lowered inflation projection for Q1, Q2 and Q4 FY 2024-25 to 4.9%, 3.8% and 4.5% from the previous estimate of 5.0%, 4.0% and 4.7%, respectively on the back of expectation of normal monsoon. It has retained the Q3 FY 2024-25 inflation estimate at 4.6%.

India's headline inflation is witnessing a downward movement as it has eased to 5.1% in January and February 2024 from 5.7% in December 2023. The RBI states that fuel prices have remained in deflation for the past six consecutive months and this is likely to deepen in the near term, following the cut in LPG prices in March 2024 and cut in prices of petrol and diesel by public sector oil retailers.

Though inflation has come down marginally, it still remains above the 4% target and the RBI sticks to its commitment to progressively align inflation to the target and till then it states that the "Task remains unfinished". However, higher food prices remain a concern for the regulator as the food inflation after easing to 7.6% in January 2024 from 8.7% in December 2023, has risen to 7.8% in February 2024. Considering uncertainties in food prices, which continue to pose challenges and is hampering the ongoing disinflation process. The RBI cautions to remain vigilant to the upside risks to the inflation. Going ahead, RBI stressed that uncertainties in food prices continue to weigh on the inflation outlook, thus interrupting the ongoing disinflation process.

Though RBI has stayed away from providing any indications of any cut in interest rate in the near term, it stated continued emphasis to strike a balance between controlling inflation and supporting economic growth with macroeconomic stability will continue. It however, continue maintain its stance on 'withdrawal of accommodation'. If the monsoon remains normal, the prospects of the rate cur may be seen only in the third quarter of the year.

Committed to flexibility in liquidity management to maintain financial stability

To maintain financial stability, RBI undertook many market operations during January-March 2024. It conducted 14 variable rate reverse repo (VRRR) operations during February and early March and mopped-up ₹4.44 lakh crore to absorb surplus liquidity. Moreover, the central bank injected liquidity by conducting fourteen variable rate repo (VRR) operations amounting to ₹8.0 lakh crore. Going ahead, the Central bank will continue to remain flexible in liquidity management as well.

India's external sector remains resilient

India's external sector remains strong with significant easing in current account deficit (CAD) of India led by robust merchandise and services export growth, strong forex reserves and FPI inflows. During Q3 FY 2023-24, the CAD narrowed to $ 10.5 billion (1.2% of GDP) from $ 11.4 billion (1.3%

of GDP) in Q2 FY 2023-24. During April-December FY 2023-24, the CAD contracted to $ 31.0 billion (1.2% of GDP) as against 2.6% during same period in FY 2022-23.

Further India's forex reserves touched an all-time high of $ 645.6 billion while the net FPI inflow to India stand strong at $ 41.6 billion during 2023-24 as against net outflows of $ 14.1 billion in 2021-22 and $ 4.8 billion in 2022-23. Notably, RBI expects the CAD for 2024-25 to remain manageable on the back of firm inward remittances driven by resilient India's services exports.

Additional regulatory measures announced by the RBI:

- RBI will undertake a comprehensive review of Liquidity Coverage Ratio (LCR) framework for the banks in order to deal with challenges that may arise in situation of instant withdrawal or transfer of money by large number of depositors from their bank accounts. In this regard, RBI will issue a draft circular for consultation.
- The RBI has also proposed to facilitate deposit of cash in Cash Deposit Machines using UPI to make currency handling process at banks more efficient.
- Permitted small finance banks (SFBs) to use rupee interest rate derivate products in order to hedge their interest rate risk.
- The RBI will announce a scheme for trading of sovereign green bonds at IFSC to facilitate wider non-resident participation.
- The RBI proposes to launch a mobile app to access RBI's retail direct scheme for increased participation in G-Sec market.
- The RBI further proposes to allow using of third-party apps (TPAPs) for making UPI payments from prepaid payment instruments (PPI) wallets.

Going ahead, the expectation of a normal monsoon this year and a record rabi wheat production is critical. This could help in bountiful kharif crops and ease food price pressure as well. It could also strengthen the rural demand as indicated from recent indicators like 30.3% y-o-y growth in two-wheeler sales during January-February 2024 along with 9.8% y-o-y decline in MNREGA demand during February-March 2024) and 16.1% increase in retail tractor sales during January-February 2024. A strong urban consumption, traction in rural consumption and signs of upturn in private capex cycle is expected to support economic growth. Meanwhile, high and persistent food inflation in the wake of adverse weather conditions coupled with continuing geopolitical tensions pose upside risk to supply chains and commodity prices. On the positive side, strong domestic economic growth with steady economic activity coupled with easing of inflationary pressures could rebound in agricultural activity. This could help to reduce the interest rates.

** Views are personal.*

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