RBI Monetary Policy Committee Update – Dec 2023

The Monetary Policy Committee (MPC) of the Reserve Bank of India (RBI) has unanimously opted to maintain the key policy repo rate at 6.5%, marking the fifth consecutive meeting with a decision to keep the status quo on the rate. The MPC's last adjustment was an increase of 25 basis points to 6.50% during its February 2023 meeting. The monetary policy committee voted 5-1 to keep a stance of accommodation withdrawal. This is in line with our view and the market consensus.

Three key takeaways from the MPC Meeting:

- An upward revision to GDP forecast: Given stronger-than-expected GDP readings this fiscal year the RBI raised its growth forecast for the year to 7% from 6.5%.
- No Open Market Operations (OMO) sales: There has been a serious signaling effect since the October policy as RBI talked about OMO Bond sales to manage liquidity and the possibility of a deeper liquidity deficit. This may ease somewhat after Dec's MPC announcement as the RBI specifically pointed out that there has been no need till now for OMO sale of Government Bonds as liquidity has been in the negative zone. Markets will take it as a reversal of the hawkish signal given previously though overall RBI is expected to be very nimble in liquidity management.
- No change in inflation projections: The RBI kept its inflation forecast for fiscal 2024 at 5.4%. The inflation projection for Q2 FY 20225 is at the targeted number of 4%. There is acceptance of the view that inflation will likely pick up over the next few months after its recent slide as adverse rainfall pushes up vegetable prices but MPC can look through these one-off shocks.

GDP Forecast, as per MPC on			
Period	10th Aug 23	6th Oct 23	8th Dec 23
QI FY24	8.0%		
Q2 FY24	6.5%	6.5%	
Q3 FY24	6.0%	6.0%	6.5%
Q4 FY24	5.7%	5.7%	6.0%
FY2023-24	6.5%	6.5%	7.0%
QI FY25	6.6%		6.7%
Q2 FY25			6.5%
Q3 FY25			6.4%

In the MPC meeting, RBI Governor revealed an updated Gross Domestic Product (GDP) growth projection for 2023-24 at 7%, an increase from the previous estimate of 6.5%. The GDP is expected to grow at 6.5% in Q3 and 6% in Q4. The projection for real GDP growth in the first quarter of 2024-25 is 6.7%, followed by 6.5% in Q2 and 6.4% in Q3. The risk outlook appeared to be balanced in the announcements. In the October MPC announcements, RBI had projected a GDP growth of 6.5%, with Q2 at 6.5%, Q3 at 6%, and Q4 at 5.7%. The real GDP growth projection for Q1 2024-25 was 6.6%.

CPI (Inflation) Forecast, as per MPC on			
Period	10th Aug 23	6th Oct 23	8th Dec 23
QI FY24	4.6%		
Q2 FY24	6.2%	6.4%	
Q3 FY24	5.7%	5.6%	5.6%
Q4 FY24	5.2%	5.2%	5.2%
FY2023-24	5.4%	5.4%	5.4%
QI FY25	5.2%	5.2%	5.2%
Q2 FY25			4.0%
Q2 FY25			4.7%

In the final monetary policy statement of 2023, the MPC has projected Consumer Price Index (CPI) inflation to remain at 5.4% for the fiscal year 2023-24 (FY24), consistent with the previous estimate. The forecast for Q3FY24 (Oct-Dec) has been maintained at 5.6%. The outlook for Q4FY24 (January-March) remains unchanged at 5.2%. Looking forward to the first quarter (April-June) of the fiscal year 2024-25, the RBI maintains its inflation forecast at 5.2%. The CPI inflation projection for July-September 2024 stands at 4.0%, and for October-December 2024, it has been forecasted at 4.7%.

Source : RBI

The RBI's assessment of inflation-growth dynamics still points to a continued hold and need to have a disinflationary policy to ensure that inflation eases back to its medium-term target of 4%

Interest Rate Outlook

The year 2023 has witnessed the culmination of synchronized rate hikes by global central banks to address the unacceptably high inflation having origins in imbalances between supply and demand that have persisted since the pandemic.

Inflation in the US surged to a 40-year high earlier in 2022 and with the highest reading for the year at 6.4% on Jan 23. Since then, we have seen the inflation rate fall to nearly 3%. This is a significant decline though the headline number still higher than the Fed's target 2%.

The Fed policy expectations have become more dovish as the lagged effect of sharp rate rise is expected to take a toll on incoming growth data. In the last month, the market-implied odds of another quarter-point hike have eroded, the amount of easing priced in for 2024 increased to more than 100bp and the anticipated start date of cuts has moved forward to the first quarter of FY 2025. The 2-year to 30-year rates have dropped by ~60 to 75 bps in US from the peak seen in Oct 23.

In domestic markets, prudent macroeconomic policy response and relatively stable economic parameters meant India could afford to have divergence in monetary policy management, unlike many other economies. RBI had stopped raising rates since Feb 23 with only a quarter basis raise this year whereas FED continued to raise the policy rate by 100 bps even when multiple economic crises erupted in the US as a direct result of sharpest rate raise in history.

The rally in domestic Government bonds has been tepid even though multiple positives have emerged in form of near target core inflation, reduced political risk, and expectation of flows post-bond inclusion. This is because as the growth impulse remains strong near to long-term potential, possible food inflation surprises on the upside, and the rate gap with the US which remains near the narrowest on record.

The RBI is in a wait-and-watch mode with a hawkish pause and liquidity management as the interim focus. A synchronized global growth downturn, an eventual slowdown in India's domestic demand, and contained core inflation staying in the 4.0-4.5% range over the coming year will mean the policy focus may shift from inflation control to supporting growth gradually. A lot of this view hinges upon the timing of the rate cuts in the US.

The rate cycle has peaked and we may be nearer to the point where the visibility of the reversal of the interest rate cycle has improved but there are always potential risks to the view. We advise investor to increase the duration in their Fixed Income portfolios but focus on the 5 year segment of Yield curve for better risk-adjusted positioning with 1 to 2 year Investment horizon.

Source : RBI