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MONETARY POLICY EXPECTATIONS- HOLDING THE RATES STEADY

04 June 2024

The RBI's Monetary Policy Committee (MPC) meeting on June 7, 2024 will be held in the aftermath of the momentous Lok Sabha election results on June 4, 2024. With the BJP poised to romp home, there is likely to be an air of expectation and excitement and a spring in the step. In view of multiple factors, including inter-alia, the global and domestic context, and the emerging inflation scenario, the RBI is likely to maintain a status quo on interest rates during this meeting.

Why do we say so? Our view is that both the Government and the RBI will prefer to take stock of the macro-level geopolitical uncertainty caused by an escalation of the recent conflict in the Middle East, financial stress, persistent inflation and slowdown in international trade, the future of globalization, overarching macro-environment, the priorities of the Government and the fiscal glide path aimed at gradually reducing the fiscal deficit.

The macroeconomic setting is characterized by softening CPI inflation from 5.7 % in December 2023 to 5.1 % during January and February 2024 and easing to a 10-month low of 4.85% in March 2024 on an annual basis and further to 4.8 % in April 2024. These steadily dipping retail inflation numbers need to be examined against real GDP growth at 7.6 % for FY 24 and real GDP growth for FY 25 are seen at 7 % because of manufacturing growth and rising services exports (10% of GDP) and demonstrate resilience amid geopolitical challenges and supply chain pressures.

With core inflation declining steadily over the past three quarters, we expect the retail inflation to be contained well within the MPC's upper threshold level of 6 %. The RBI has projected consumer price based inflation (CPI) to ease to 3.8 % in the July-September quarter. For FY25, inflation is projected at 4.5 %.

The 'State of the Economy' article published in the RBI's May 2024 Bulletin maintained "it is only in the second half of the year that a durable alignment with the target may recommence and sustain till numbers closer to the target are sighted during the course of 2025-26".

There was pressure on liquidity in March 2024 but this pressure eased in April and May 2024 for various reasons, including the historical year-end scramble for funds, particularly in case of public sector banks (PSBs). During FY 24, the RBI took a slew of stern regulatory action against JM Financial, Paytm, Bajaj Finance, Mahindra & Mahindra and HDFC Bank. Hence, because of these and other factors, credit growth could dip from 16 % in FY 24 to 13.5 % in FY 25.

Global economic uncertainty marked by geopolitical tensions in a rapidly changing and increasingly interconnected global landscape (global growth is projected at 3.1 % in 2024, and 3.2 % in 2025) make Policy formulation increasingly complex. The IMF's Global Debt Monitor reported total global debt, private plus public, to have risen to USD 235 trillion, equivalent to 238 % of the global GDP.

There are also other factors like inflation, and volatile commodity markets, which also influence the adoption of a 'wait and watch mode'. Domestically, given the state of current indicators, such as, inflation rates, GDP growth, consumer spending patterns and the liquidity scenario, the RBI is likely to refrain from any tinkering with the key policy rates.

Rate Stance

Our sense is that in the upcoming RBI MPC meeting on June 7, 2024, the RBI will maintain its current rate stance (the MPC has kept the Repo rate, i.e., key lending rate unchanged at 6.50% since February 8, 2023) to ensure better transmission of the 250 basis points rate hikes implemented so far in this rate hiking cycle.

High food inflation remains a persisting concern because of the vagaries of the monsoon. Although the IMD forecasts a normal monsoon, which could reduce food inflation through timely kharif sowing, this could take some time. Thus, with the avowed pursuit of a data-driven and evidence-based policy, we see the RBI cutting interest rates from October 2024.

Going ahead, there could be cumulative interest rate cuts of 65-75 bps in FY 25. These policy rate cuts may occur in a gradual and calibrated manner in FY 25 because of downward trending inflation trajectory and the trade-off between growth and inflation.

Dovish Monetary Policy

It is expected that the language of the RBI's upcoming Monetary Policy on June 7, 2024, will be 'dovish' to signal the RBI's preparedness to maintain its current rate stance in the short term but remains open to adjusting policies should economic conditions improve or inflationary pressures subside. This approach would provide the necessary support to the economy while ensuring that previous rate hikes continue to work through the system effectively.

GDP Growth and Inflation Projections

The RBI will maintain its previous GDP growth projection of 7% for the current fiscal year 2024-25. This projection stems from stable factors identified in the previous MPC meeting. The RBI's quarterly projections, anticipating growth rates of 7.1% in Q1, 6.9% in Q2, and 7% in both Q3 and Q4, reflect a steady, robust and resilient economic outlook.

Given that there have not been significant changes in the underlying economic setting; the RBI is likely to reaffirm its optimistic growth forecast. The inflation projection could be between 4.5% and 4.75%. But as Mr. Shaktikanta Das, RBI, Governor justifiably stressed "inflation is on a declining trajectory and GDP growth is buoyant. At this juncture, we should not lower our guard but continue to work towards ensuring that inflation aligns durably and sustainably to the target". Clearly, then, persisting upside inflation risks need close and careful monitoring so that we are not in for any nasty surprise or are caught off-guard.

Ideate, Innovate and Inspire-India At a Tipping Point

Going forward, India in its pursuit of transform to outperform will consolidate its position by important transformative triggers and drivers. The demand side is boosted by consumer boom, ascendant middle class and green transition.

Demographic dividend, corporate sector's return on equity exceeding the global average, greater access to finance, the coming to age of the financial sector and streamlining of physical infrastructure (national road network grew by 60% over ten years, twice the previous decadal rate) and digital infrastructure, digital transfer-payments, modern capital markets and banks, and a unified digital tax system drive the supply side. The IMF has revealed that "digitalization-driven productivity gains" (e.g., monthly use of payment system by 300 million) in India have acted as a force-multiplier. This trend of *digital transformation success h*as been reinforced by macroeconomic growth, robust democratic and business frameworks, demographic dividend, sustained policy reforms, rising global significance, "military-industrial complex", space technology, logistics, fintech and AI.

In view thereof, the focus will shift to providing an impetus to the process of growth by lowering the key benchmark rate in the subsequent Policy pronouncements in this financial year and the playing out of the growth-inflation trade off.