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RBI POLICY: A BALANCED APPROACH TOWARDS GROWTH WHILE STAYING VIGILANT ON THE INFLATION BATTLE

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The RBI Monetary Policy Committee (MPC) decided by a 4 to 2 majority to keep the policy repo rate unchanged at 6.50 per cent in the Aug'24 monetary policy. Subsequently, the standing deposit facility (SDF) rate remains at 6.25 per cent and the marginal standing facility (MSF) rate and the Bank Rate at 6.75 per cent. The MPC also decided by a majority of 4 out of 6 members to remain focused on withdrawal of accommodation to ensure that inflation gradually aligns to the target, while supporting growth.

The International Monetary Fund (IMF) in its latest World Economic Outlook (WEO) update released on 16th July 2024, maintained the global growth forecast for 2024 at 3.2 per cent and revised up the growth forecast by 10 basis points (bps) to 3.3 per cent for 2025. Since the last RBI MPC meeting, the UK, Canada, Switzerland and Czech Republic, among advanced economies (AEs) and China, Chile, Columbia, Hungary, Romania and Sri Lanka among emerging market economies (EMEs) have cut their policy rates. Japan and Russia, on the other hand, raised their benchmark rates.

In India, manufacturing activity continues to gain ground on the back of improving domestic demand. The index of industrial production (IIP) growth accelerated in May 2024. The purchasing managers' index (PMI) for manufacturing at 58.1 in July'24 remained elevated. Services sector maintained buoyancy as evidenced by the available high frequency indicators. E-way bills increased by 16.3 per cent in June 2024, GST revenues at Rs. 1.82 lakh crore increased by 10.3 per cent and toll collections grew by 9.4 per cent during July'24. Domestic air cargo and port cargo posted a strong growth of 10.3 per cent 6.8 per cent, respectively, in June 2024.

Real GDP growth for 2024- 25 is projected at 7.2 per cent.

Quarters [2024-25]	Real GDP Growth Projections (%)
First Quarter (Q1)	7.1
Second Quarter (Q2)	7.2
Third Quarter (Q3)	7.3
Fourth Quarter (Q4)	7.2
2025-26	
First Quarter (Q1)	7.2

 # Real GDP growth for the first quarter (Q1) in 2025-26 is projected at 7.2 per cent.

Higher than expected food inflation has pushed the *Headline CPI inflation* at 5.1 per cent in June 2024, whereas the fuel continued to remain in deflation for the tenth succeeding month. Core inflation moderated to a historic low during the (May- June) 2024, for instance, it moderated from 3.2 per cent in April to 3.1 per cent in May-June 2024, a new low in the current CPI series.

On the other hand, the food inflation, with a weight of around 46 per cent in the CPI basket, contributed to more than 75 per cent of headline inflation in May and June'24. Vegetable prices have increased sharply and contributed about 35 per cent to inflation in June'24.

Inflation has increased across other major food items, tomatoes increased by 48.7 per cent (m-o-m) in June, CPI onion by 24.2 per cent (m-o-m) and potatoes by 12.2 per cent (m-o-m), resulting in a year-on-year (YOY) inflation of 29.3 per cent for vegetables. Overall, vegetables with a weight of 6.0 per cent in CPI basket contributed 34.9 per cent to inflation in June'24.

The RBI statement has most importantly emphasized the possibility of wage-price spiral that might propagate inflation further going forward, in the absence of proper monitoring of the food inflation. In this context, the following quote assumes importance:

"*High food inflation adversely affects household inflation expectations, which have a significant impact on future trajectory of inflation. Household inflation expectations, after witnessing a moderating trend between May 2022 and September 2023, have edged up on the back of high food inflation since November 2023. Persistently high food inflation and unanchored inflation expectations – if they materialise – could lead to spillovers to core inflation through pick-up in wages on cost-of-living considerations. This, in turn, could be passed on by firms in the form of higher prices for services as well as goods, especially in a scenario of strong aggregate demand. Third, these behavioural changes can then result in overall inflation becoming sticky, even after food inflation recedes*."

This can be exhibited as follows:

High food inflation → Household inflation expectations Increases ↑

↓

Cost of Living Increases

↓

Wage-Price Spiral Impact

↓

Inflation Increases due to wage-price spiral impact

The MPC has emphasized that with a 46 per cent weight of the food in the headline Inflation, the inflation that is emanating from the food prices cannot be ignored. Nonetheless, the MPC has highlighted some potential relief in food inflation which is expected from the pick-up in the south-west monsoon and healthy progress in sowing.

Further, the buffer stocks of cereals continue to be above the norms. Global food prices showed signs of easing in July'24, after registering increases since March 2024, e.g. the FAO food price index, after registering an increase during March-June 2024, declined in July, with a month over-month change of (-) 0.18 per cent.

Therefore, assuming a normal monsoon, and considering the 4.9 per cent inflation print in Q1, **CPI inflation for 2024-25 is projected at 4.5 per cent**, with Q2 at 4.4 per cent; Q3 at 4.7 per cent; and Q4 at 4.3 per cent. The CPI inflation for the first quarter (Q1) 2025-26 is projected at 4.4 per cent.

The system liquidity, as measured by the net position under the liquidity adjustment facility (net LAF) was, on an average, in deficit of about ₹0.45 lakh crore during June'24 but turned into surplus of about ₹1.1 lakh crore during July'24. After that, it continued to be in surplus of about ₹2.7 lakh crore in Aug'24 (up to 6th August 2024). The transition from surplus in early June to deficit conditions during the latter half of the month was due to the liquidity leakage from the banking system because of the advance tax payments and goods and services tax (GST) related outflows.

The RBI injected liquidity through variable rate repo (VRR) operations during the second half of June'24 but wiped surplus liquidity through variable rate reverse repo (VRRR) auctions as liquidity conditions eased in July'24.[1] A 3-day VRR auction was conducted instead of the main 14-day operation on June 28 as liquidity conditions were expected to improve imminently with the usual increase in government spending at the month end.

In response to the cumulative policy repo rate hike of 250 bps since May 2022, the weighted average lending rates (WALRs) on fresh and outstanding rupee loans of the Scheduled Commercial Banks (SCBs) have increased by 181 bps and 119 bps, respectively, during May 2022 to June 2024, while the weighted average domestic term deposit rate (WADTDR) on fresh and outstanding deposits of SCBs increased by 243 bps and 188 bps, respectively, during the same period.

With credit growth outpacing deposit growth, banks have raised their term deposit rates in addition to mobilising funds through higher issuances of Certificate of Deposits (CDs). In 2024-25 (up to July), CD issuances amounted to ₹3.2 lakh crore as compared to ₹1.9 lakh crore in the corresponding period of 2023-24.

[1] During June 10-28, one main and 4 fine-tuning VRR auctions (3 to 6 days maturity) injected liquidity cumulatively amounting to ₹3.5 lakh crore, while 2 main and 23 fine-tuning VRRR operations (1 to 7 days maturity) absorbed liquidity to the extent of ₹7.1 lakh crore during July-August (up to August 6).

The Reserve Bank increased risk weights on unsecured consumer credit and bank credit to NBFCs on November 16, 2023, to pre-empt build-up of any potential risk in these segments. Consequently, the total consumer loan growth in the sectors where risk weights were increased moderated from 23.3 per cent in November 2023 to 13.9 per cent in June 2024. In parallel, bank credit to NBFCs declined from 18.5 per cent to 8.2 per cent during the same period.

The RBI Governor has highlighted that the issue of excessive leverage through retail loans, mostly for consumption purposes, needs careful monitoring from macro-prudential point of view.[2] Another important aspect is that the home equity loans, or top-up housing loans have been increasing at a quick pace. Banks and NBFCs have also been offering top-up loans on other collateralised loans like gold loans. The RBI has observed that the regulatory prescriptions relating to loan to value (LTV) ratio, risk weights and monitoring of end use of funds are not being strictly adhered to by certain entities. Such practices may lead to loaned funds being deployed in unproductive segments or for speculative purposes.

On the external front, India's current account deficit (CAD) moderated to 0.7 per cent of GDP in 2023- 24 from 2.0 per cent of GDP in 2022-23 due to a lower trade deficit and robust services and remittances receipts. In the first quarter (Q1) of 2024-25, the merchandise trade deficit widened as imports grew faster than exports. Strong services export as well as remittance receipts are expected to keep CAD within sustainable level in Q1:2024-25.

On the external financing side, foreign portfolio investors turned net buyers in the domestic market from June 2024 with net inflows of US$ 9.7 billion during June August (till August 6) after witnessing outflows of US$ 4.2 billion in April and May'24.

External commercial borrowings to India moderated to US$ 1.8 billion during April-June 2024-25 as compared with an inflow of US$ 5.7 billion a year ago. Non-resident deposits recorded a higher net inflow of US$ 2.7 billion in April-May 2024-25 than US$ 0.6 billion a year ago. India's foreign exchange reserves reached a historical high of US$ 675 billion as of August 2, 2024. As on 2nd August 2024, India's foreign exchange reserves stood at US$ 674.92 billion.

The capital-to-risk-weighted assets ratio (CRAR) and the common equity tier 1 (CET1) ratio of scheduled commercial banks (SCBs) at 16.8 per cent and 13.9 per cent, respectively, at end-March 2024 are well above the regulatory thresholds. On the other hand, SCBs' gross non-performing assets (GNPA) and net non-performing assets

[2] Credit growth in unsecured personal loans such as 'credit card outstanding' though declining, remained high at 23.3 per cent in June 2024 as compared to 34.2 per cent in November 2023.

(NNPA) ratios have declined to 2.8 per cent and 0.6 per cent, respectively, at end-March 2024.

Further, the SCBs ratio of NNPAs with total equity has dipped to an all-time low of 4.1 per cent in March 2024 from the peak of 43.9 per cent in March 2018. The macro stress tests done by the Reserve Bank also reveal that the banking sector will continue to remain resilient even under stress scenarios (Financial Stability Report, June 2024).

On the regulatory front, *the RBI proposes to create a public repository of Digital Lending Apps (DLAs) installed by its regulated entities*. The regulated entities (REs) will report and update information about their DLAs in this repository. This measure will help the consumers to identify the unauthorised lending apps.

It further proposed to increase the frequency of reporting of credit information to a fortnightly basis or at shorter intervals. Consequently, borrowers will benefit from faster updation of their credit information, especially when they repay their loans. The lenders, on their part, will be able to make better risk assessment of borrowers.

At present, the transaction limit for UPI is ₹1 lakh except for certain category of payments which have higher transaction limits. *It has now been decided to enhance the limit for tax payments through UPI from ₹1 lakh to ₹5 lakh per transaction.* This will further ease tax payments by consumers through UPI.

It is further proposed to introduce a facility of "Delegated Payments" in UPI, which would enable an individual (primary user) to allow another individual (secondary user) to make UPI transactions up to a limit from the primary user's bank account without the need for the secondary user to have a separate bank account linked to UPI. This will further deepen the reach and usage of digital payments.

At present, cheque clearing through Cheque Truncation System (CTS) operates in a batch processing mode and has a clearing cycle of up to two working days. *It is proposed to reduce the clearing cycle by introducing continuous clearing with 'on-realisation-settlement' in CTS, which means that cheques will be cleared within a few hours on the day of presentation. This will speed up cheque payments and benefit both the payer and the payee*.

In the last few days, global financial markets have seen turbulence on concerns of growth slowdown in a major economy, flare up in geopolitical tensions in the Middle East and the unwinding of the carry trade. These developments have implications for emerging market economies. In this context, India's macro fundamentals remain strong and resilient.