Press Release

Not an easy cup of tea for MPC

Weaker growth indicators along with escalation of Middle East conflict pose challenges

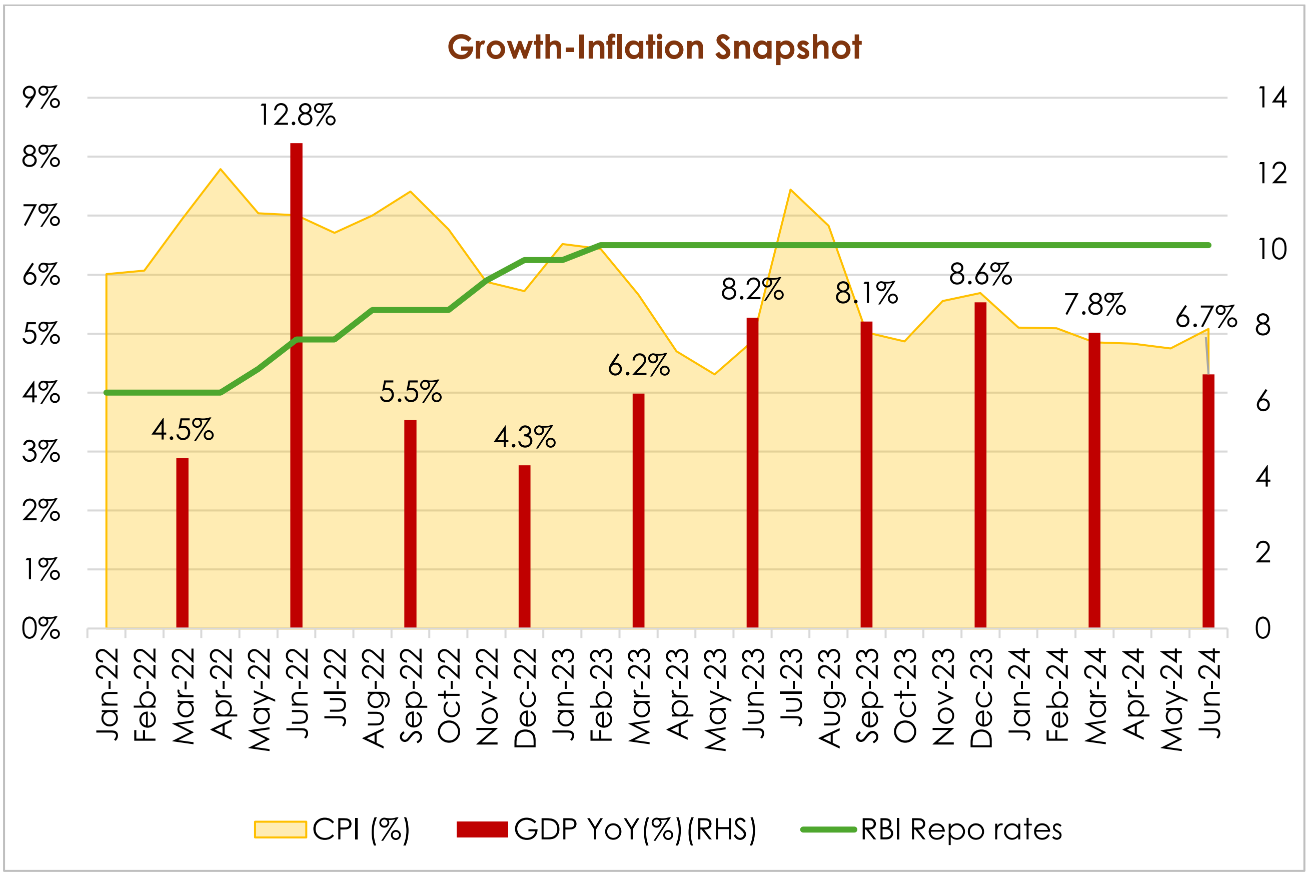
October 7, 2024

With the U.S. Federal Reserve delivering an outsized 50bps cut in Sept-24, the expectation of a rate cut or a change in tight monetary stance by RBI MPC has clearly increased in the near term among the market forecasters. Some of them have predicted that RBI will pivot in the upcoming MPC meet itself. In our opinion, the current circumstances are not really conducive for RBI to opt for any affirmation action towards an easier monetary policy. While the fear of the inflation "elephant" may have subsided with the CPI headline print well within 4.0% over the last two months and a favourable monsoon, the concerns around the stability of food inflation still linger among policy makers. Secondly, there has been a sudden escalation of the chronic geo-political conflict in West Asia with a direct confrontation between Israel and Iran which has the potential to spike global oil prices and raise the uncertainty around the inflation outlook. To make matters further complicated, the latest economic indicators don't look encouraging; PMI indices are at a multi-month low in Sep-24 and the core sector output has seen a contraction after 42 months. We expect RBI-MPC to opt for the "wait and watch" mode till Dec-24 or even longer till Feb-25 if the inflationary expectations don't settle down. However, the central bank may keep the system liquidity at a comfortable level to ensure there is no volatility in the prevailing interest rates.

Against the backdrop of persistent inflationary pressures and aggressive monetary policy actions taken by the global central banks, the RBI had raised its repo rate from 4.00% in May 2022 to 6.50% by Feb 2023 and has since maintained the status quo. Consequently, the standing deposit facility (SDF) rate stands at 6.25%, and the marginal standing facility (MSF) rate at 6.75%. Further, there has been no revision in the policy stance since Feb-23, with RBI focused on "withdrawal of accommodation", indicating that the MPC is still watchful of the inflation trajectory.

India's CPI inflation eased to a near 5-year low of 3.65%YoY in August 2024 and is largely expected to stay below 5.0% for the rest of the fiscal year, even with the slight upticks expected in the headline print in the next quarter. For FY25, inflation is expected to be comfortably within the RBI's target range of 4-6%. We project that the CPI will average at 4.6% this fiscal year.

Meanwhile, GDP growth slowed to a 5-quarter low of 6.7% YoY in Q1 FY25, down from 7.8% in the previous quarter. While this moderation was anticipated due to factors like the general election, adverse weather, and a high base effect, the actual figures were still slightly below market expectations. While GVA growth rose to 6.8% YoY in Q1 FY25, up from 6.3% in Q4 FY24, the high frequency indicators in the second quarter indicate some moderation in the growth momentum. In August 2024, the eight core industries experienced an unexpected contraction in output of 1.8% YoY which is the first contraction in core sector output in 42 months since the Covid period. Further, for the first time in the current fiscal year, there are signs of cracks in the PMI indices which had otherwise demonstrated significant resilience since the previous year. India Manufacturing PMI dropped to an eight month low in Sep-24 and importantly, there has been a steady albeit gradual downtrend in the index from July 2024. Also, the PMI Services index saw a sharp drop to a 10 month low in Sep-24 after being above the threshold of 60 since Jan-24. While we continue with our growth forecast of 7.0% for FY25 on the back of an improving rural consumption trend and a strong pick up in both public and private capital expenditure in the second half of the year, the growth indicators need to be monitored closely.



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