RBI MPC: Rate cuts likely to be 'later rather than sooner'

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Status quo policy, in line with our expectations

In line with our and market expectations, the Monetary Policy Committee (MPC) voted for status quo on repo rate at 6.5% and policy stance as withdrawal of accommodation. It was a 5:1 decision with Prof. Varma the only dissenter for both rates and stance.

Strong growth outlook providing space to assess durable decline in inflation

The MPC broadly maintained growth and inflation outlook with slight modification in quarterly numbers. FY25 real GDP projection maintained at 7.0% with risks evenly balanced *(details in Fig 1)*. More importantly, the MPC expects growth outlook to remain resilient, which helps provide space to assess the durable decline in inflation towards the 4% target. With regard to inflation, the FY25 forecast was kept unchanged at 4.5% with a downward bias across most quarters *(details in Fig 1)*. While the real rate of 200 bps in FY25 is likely to open a small window for rate cuts, the MPC is likely to guard caution regarding inflation risks especially in food (lagging seasonality in vegetables, elevated cereals price pressures, heatwave impact, low reservoir levels etc). Going forward, monsoon trends will remain on close watch along with oil prices which are back above the discomforting USD 90/bbl mark recently.

Financial stability - the key word used "six" times by the Governor today

In this regard, we highlighted in our MPC preview regarding the concerns on credit excesses building up in the financial system. Since Nov'23, the RBI has come up with several macro prudential norms, specifically for unsecured retail credit, NBFCs etc to keep a control on bank lending to these segments. Hence, in an attempt to ensure a sustainable credit cycle which has started after a decade, the RBI may continue to stay cautious and defer shift of policy / liquidity stance.

Additionally, RBI has decided to undertake a comprehensive review of the Liquidity Coverage Ratio (LCR) as a buffer against frictional moves in an individual banks' liquidity.

RBI is likely to stay nimble with liquidity management

The key announcement to watch for in this policy was the RBI's guidance on liquidity management as it has switched to surplus in Apr'24 from deficit since Sep'23. In line with our expectations, the RBI Governor asserted that they will continue to manage liquidity by use of fine-tuning operations (VRRRs / VRRs) to help align overnight call rate with repo rate. Having said that, if the liquidity surplus rises sharply in the coming months on a flush of FX flow and / or government spending, we will watch out for use of any permanent liquidity absorption tools by the RBI like FX swaps among others.

We expect rate cuts "later rather than sooner" in FY25

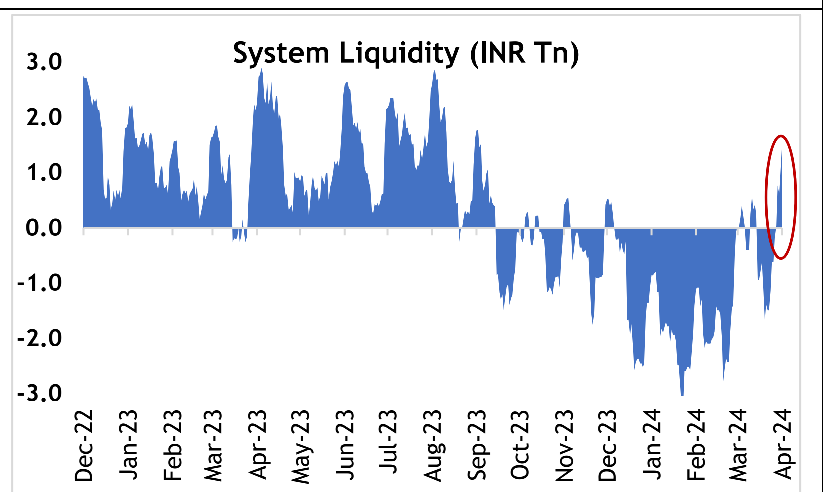
Going forward, while the near-term inflation projections have been revised lower, we maintain our call of rate cuts 'later rather than sooner' in FY25. On balance, we expect a shallow 50bps rate cut cycle in H2-FY25 likely starting from October.

Our view is premised on four factors: i/ High real rates likely in FY25, ii/ Strong growth dynamics reduce the need for policy easing in short term, iii/ Financial stability concerns are likely to keep the RBI vigilant and iv/ Inflation risks especially in food are likely to stay on close watch.

Fig 1: Revision in GDP / CPI projections

% y/y	GDP		CPI	
	Prior	Post	Prior	Post
FY25	7.0	7.0	4.5	4.5
o/w: Q1	7.2	7.1	5.0	4.9
Q2	6.8	6.9	4.0	3.8
Q3	7.0	7.0	4.6	4.6
Q4	6.9	7.0	4.7	4.5

Fig 2: Liquidity has switched to surplus in April



Source: RBI, Bloomberg and UBI research

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