RBI MPC preview: Steady as she goes

04th April 2024

Global Perspective: Fed rate cuts deferred yet again

Globally, US growth indicators continue to show strength while inflation numbers are turning sticky showing resistance to move towards the 2% target. The strong Feb'24 NFP number clearly indicated a robust jobs market and a repeat of similar number is expected for March'24. Also, ISM data for March'24 showed that manufacturing moved to expansion territory for the first time in 18 months. On the inflation front, US PCE inflation though moderated in Feb'24 showing disinflation underway yet the 2% target still far away. Overall, the US continues to outperform its global peers despite elevated borrowing costs. Better than expected US growth data and sticky inflation numbers have led to run up in the US yields and deferred rate cut repricing by FOMC. The CME Fedwatch tool, was showing 67% probability of rate cut for June meeting in 3rd week of March, post FOMC the same has come down and presently showing at 56%. Moreover, FOMC members including Fed Chair Powell have been re-iterating their data dependent stance; and they will wait for clearer signs of slower inflation / growth before cutting rates.

We expect status quo decision from India MPC tomorrow

Since the last meeting, growth indications are holding up with slight moderation seen and GDP growth numbers have surprised to the upside to c.8% in recent quarters. Meanwhile, CPI inflation has become sticky at c.5.1% (our est for March is c.5.1%) as correction in food prices lagging seasonal trends. Hence the flexible inflation targeting MPC may choose to wait and watch if the softening in inflation towards the 4% target (as expected by Q2-FY25) is durable. Additionally, MPC will be mindful of the recent upward trend in crude oil prices towards the USD 90/bbl mark coupled with volatility in food prices which may sustain on heatwave concerns during April-June. Overall, we expect the MPC to stay data dependent and maintain the policy stance of "withdrawal of accommodation" in the 3-5 April meeting outcome due tomorrow.

In FY25, we expect the MPC to cut rates later than sooner

Consensus amongst economists show that the MPC is likely to cut rates from August following the start of rate cut cycle by major global central banks. However, we think that the start of rate cuts is likely to be deferred to Q3 FY25. In our view, while elevated real rate may open space for rate cuts, however the strong growth dynamics and RBI concerns about financial stability, policy easing may be implemented later rather than sooner.

With inflation expected at 4.5% in FY25, the real rate of 200bps is likely to open a small window for rate cut(s). Consequently, we expect the repo rate to be cut by 50 bps to 6% in FY25. Historically, repo rate has not slipped below the 6% mark sustainably except for crisis period(s). More importantly, the RBI is also paying due attention towards financial stability. This was reflected in the preemptive regulatory measures taken to limit credit excesses in some segments like unsecured retail credit, NBFCs etc. 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. *On balance, we expect a shallow 50bps rate cut cycle in H2-FY25 likely starting from October.*

Liquidity guidance key to watch in April

Banking system liquidity has shifted to surplus in Apr'24 of c.INR 1.5 lakh crores from an average deficit of c.INR 1.5-2.0 lakh crores on account of government spending and FX flows. Going forward, in April we see liquidity staying in surplus and broadly comfortable in FY25 as a whole on account of FX-flows, though the movement in government balances will be watched closely after the sharp moves last year. In this regard, the liquidity guidance provided by the RBI tomorrow will be key in terms of alignment of overnight call rate with repo rate. Going forward, we expect the RBI to manage liquidity by fine tuning operation i.e. VRRR with the magnitude of VRRRs on close watch. If the liquidity surplus rises sharply on a flush of FX flows, we will watch for use of any permanent liquidity absorption tools by the RBI like FX swaps among others.

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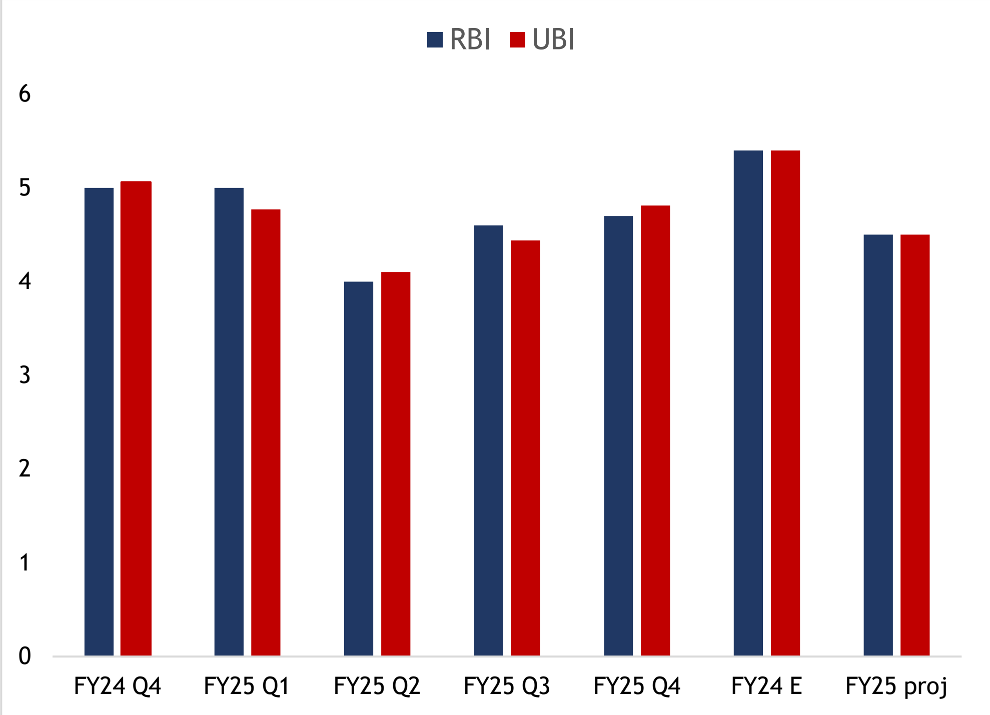
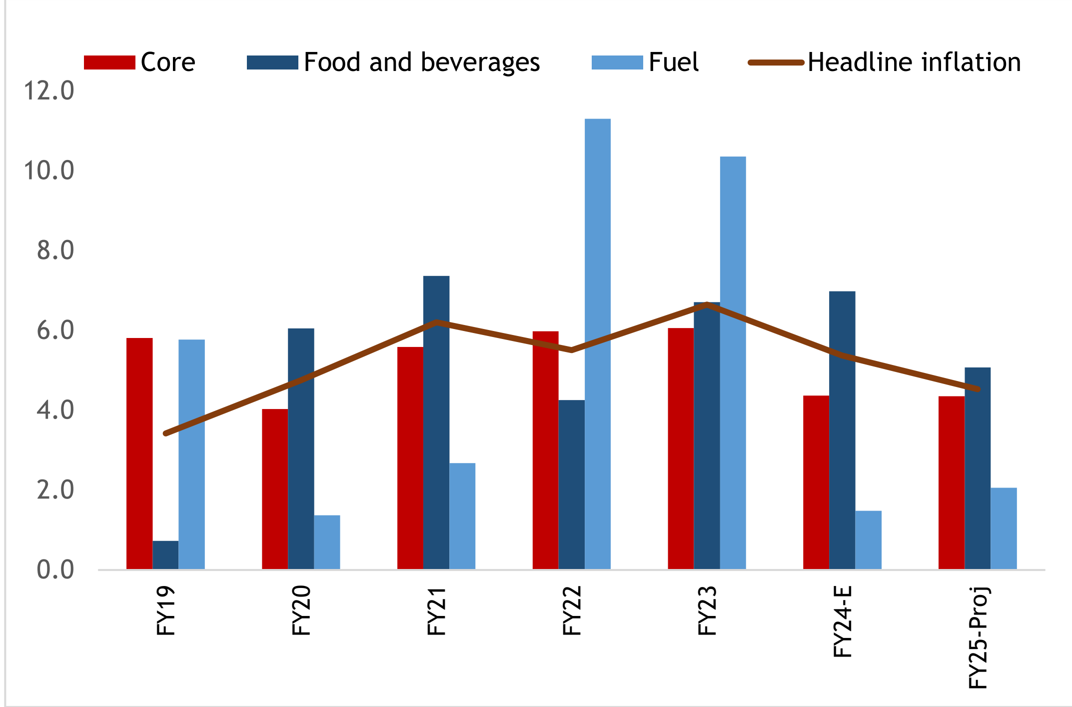
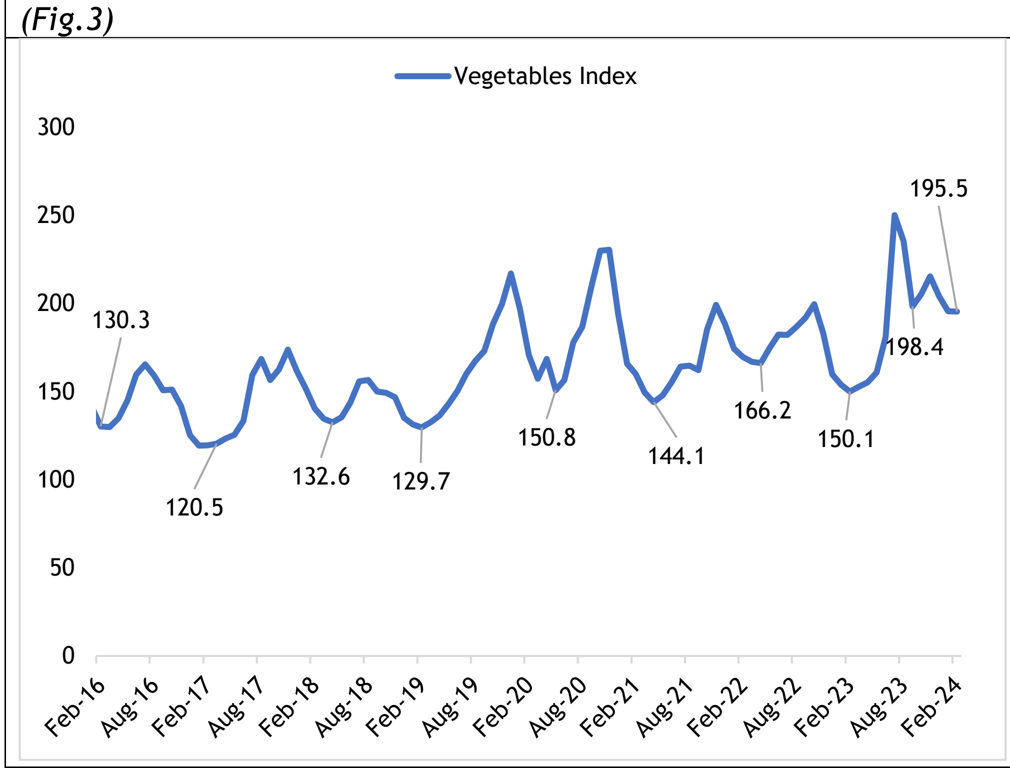
Our CPI projections aligned with MPC yet risks remain
(Fig.1)



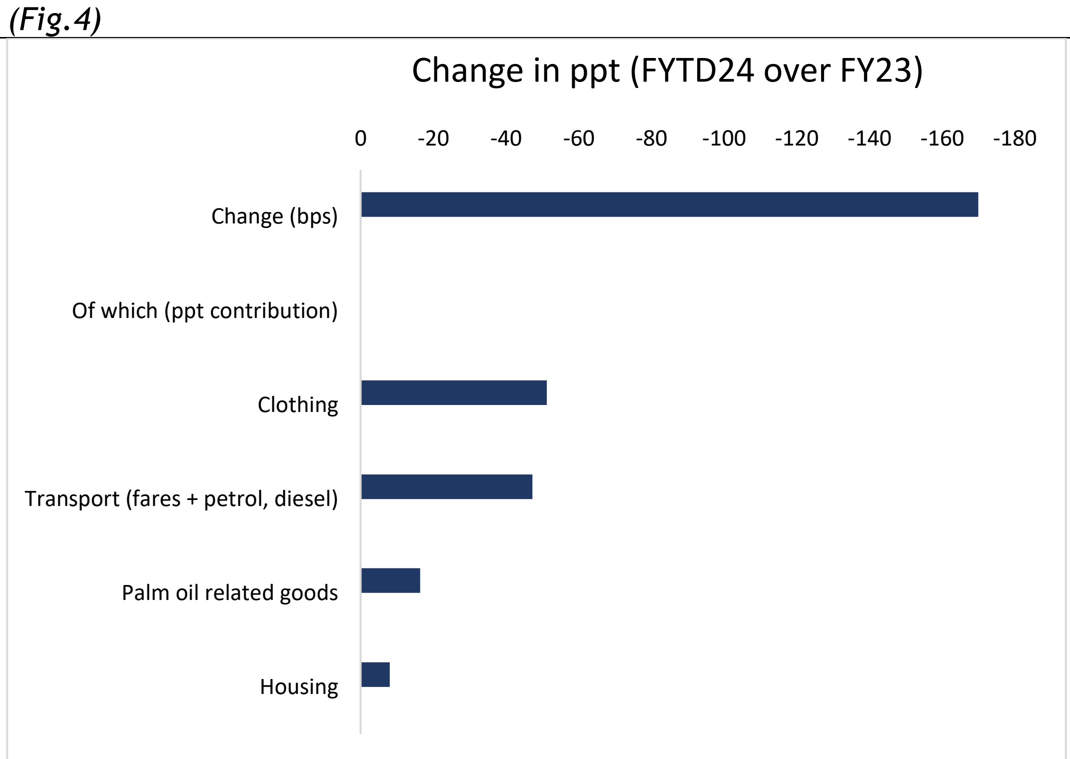
Volatile food prices likely to be key driver of cooling CPI in FY25
(Fig.2)



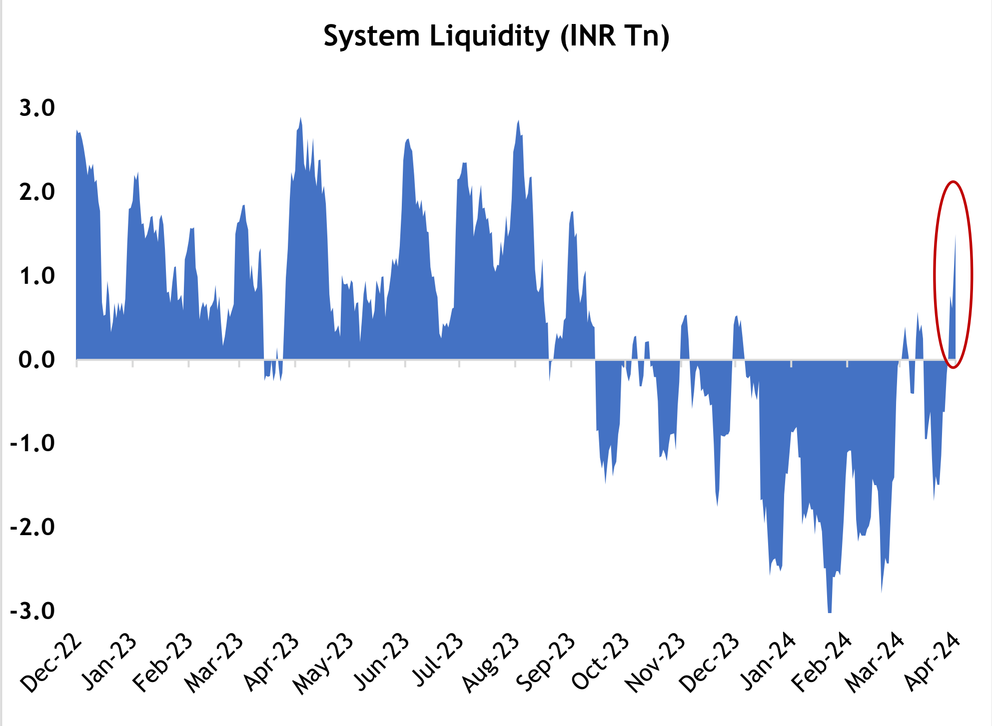
Vegetables lagging seasonal trends
(Fig.3)



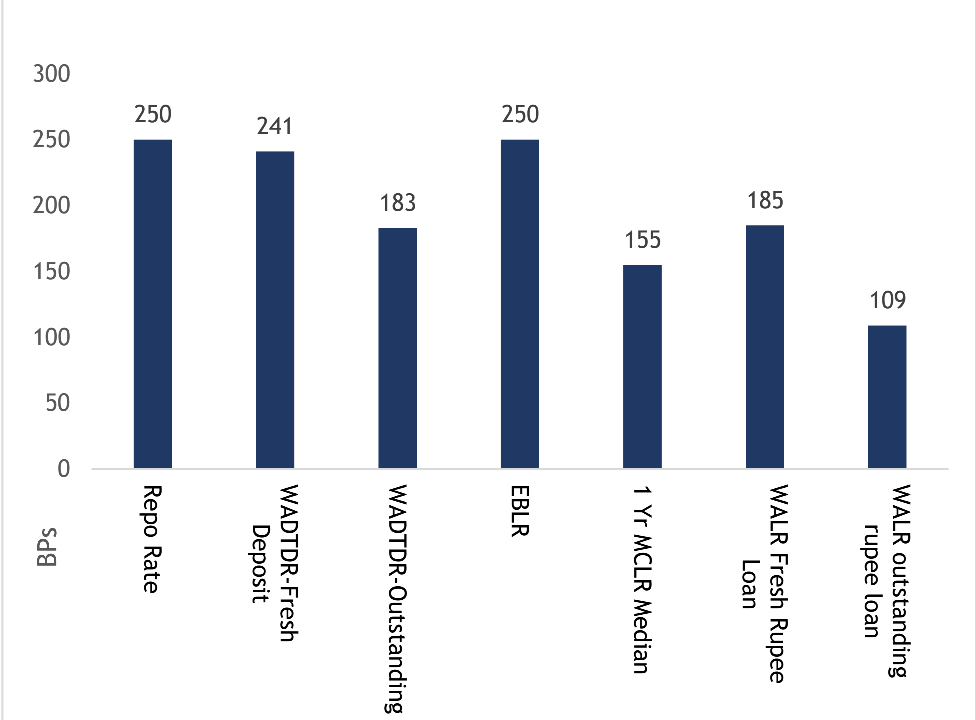
Commodity prices explain c.70% of drop in core CPI
(Fig.4)



Liquidity has switched to surplus in April
(Fig.5)



Transmission underway in lending rates while almost complete in deposit rates
(Fig.6)



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