Monetary Policy Review: December 2023

8th December 2023

The Monetary Policy Committee (MPC) today unanimously decided to keep the policy repo rate unchanged at 6.50%. The policy stance was also kept unchanged, focussed on "withdrawal of accommodation to ensure that inflation progressively aligns with the target, while supporting growth". Consequently, SDF, MSF and CRR rates were also kept unchanged at 6.25%, 6.75% and 4.5% respectively. Additionally, with an objective of better liquidity management, RBI allowed reversal of liquidity during weekends and holidays as well from 30 December 2023.

On Growth: Global growth softened sequentially at an uneven pace in major economies driven by tight monetary policy and decelerating trade. India's growth, however, remained buoyant with Q2FY24 GDP growth surprising sharply on the upside. The growth was led by investments and government spending. The momentum is holding up well reflected in strong PMIs, above average capacity utilisation, healthy cement and steel consumption, robust GST collections and festive demand, etc. Domestic demand also remains supported by resilient urban demand and gradual recovery in rural consumption.

GDP Growth (%)	Oct-23E	Dec-23E
Q2FY24	6.5	7.6*
Q3FY24	6.0	6.5
Q4FY24	5.7	6.0
FY24 full year	**6.5**	**7.0**
Q1FY25	6.6	6.7
Q2FY25	NA	6.5
Q3FY25	NA	6.4

*actual Source: RBI, MOSPI

RBI revised its growth estimate upwards by 50 bps to 7.0% for FY24 and forecasts average growth of ~6.5% for 9MFY25. RBI expects the growth to be supported by robust manufacturing and construction activity, healthy services sector and improvement in rural sector.

On Inflation: CPI has moderated materially since last MPC meeting on back of correction in vegetable prices, reduction in LPG prices and broad-based softness in core inflation. RBI also noted that disinflation process is underway led by correction in commodity prices, tighter monetary policy and proactive measures by government.

RBI maintained its inflation estimate for FY24 at 5.4% and expects average inflation of ~4.6% during 9MFY24. RBI acknowledged that spike in prices of select vegetables is likely to push inflation higher in the near term. However, it expects CPI to normalise thereafter on back of easing of input prices led by correction in commodity prices, government interventions to manage supply side challenges and soft core CPI momentum.

CPI (%)	Oct-23E	Dec-23E
Q2FY24	6.4	6.4*
Q3FY24	5.6	5.6
Q4FY24	5.2	5.2
FY24 Average	**5.4**	**5.4**
Q1FY25	5.2	5.2
Q2FY25	NA	4.0
Q3FY25	NA	4.7

*Actual; Source: RBI

Conclusion and Outlook

RBI policy was largely on expected line and there were no surprises. The omission of any mention of likelihood of OMO sales and allowing liquidity reversal over weekends and holidays was viewed as mildly positive by the market participants. However, RBI maintained its cautious tone of it being "highly alert" to inflation risks and pursuit of "actively disinflationary policy".

The outlook for fixed income remains favourable over the medium term, in our view, considering the following:

- Robust tax and small saving collections limit the risk of fiscal slippage and additional market borrowings. Moreover, the net supply of SLR securities in H2FY24 is significantly low.
- Inclusion of India's sovereign securities in JP Morgan bond indices bodes well for demand outlook for G-Sec and can effectively cap any significant rise in yields.
- Subdued core CPI momentum on the back of lower input price pressures and benign global commodity prices. Inflation expectations also remain well anchored.
- Decline in fiscal impulse, weakness in international trade and soft private consumption is likely to moderate growth over the coming months.
- RBI is expected to maintain an extended pause and the bar for restart of rate hikes remains high.
- Adequate foreign exchange reserves should keep pressure on INR at bay despite high rates in AEs.

However, there are counter balancing factors which can put upward pressure on yields.

- Given the high durable liquidity, the interbank liquidity is likely to improve if the Government steps up spending. Thus, risk of RBI conducting OMO sales lingers but the timing and quantum are uncertain.
- Regular food price shocks can keep CPI elevated and can adversely impact inflation expectations.
- SLR holdings of the banking system are high and credit growth robust. Further, the demand from the Insurance sector is likely to taper down vis-à-vis last year. Hence, incremental demand for G-Secs is likely to remain muted.
- Even though global interest rate cycle may have peaked, any significant rise in global bond yields can have a rub-off effect on Indian yields as well.

On an overall basis, in our view, yields are likely to trade with a downward bias, and the long end is likely to outperform over the medium term. While we continue to recommend investments into short to medium duration debt funds, given the elevated yields levels, investors could consider higher allocation to longer duration funds, in line with individual risk appetite.

Glossary

BPS	Basis points (1 bps = 0.01%)
CPI	Consumer Price Index
GDP	Gross Domestic Product
MSF	Marginal Standing Facility
OMO	Open Market Operations
RBI	Reserve Bank of India
SDF	Standing Deposit Facility
SLR	Statutory Liquidity Ratio
WPI	Wholesale Price Index

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