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The RBI keeps policy rate unchanged; stance changed to neutral

This paves the way for potential rate cuts

- **The Reserve Bank of India (RBI) announced its fourth bi-monthly monetary policy for FY25 on 9th Oct'24. The rate-setting panel decided to keep the benchmark repo rate unchanged at 6.5% for the tenth consecutive meeting, with five out of six members voting in favor. Dr. Nagesh Kumar voted to reduce the policy repo rate by 25bp.**
- **At the same time, the MPC unanimously decided to change the stance to 'neutral' from 'withdrawal of accommodation'. This would allow the central bank to act swiftly and smoothly if inflation/growth dynamics shift unfavorably. Governor Das emphasized that any rate cut will be contingent on achieving a durable alignment of inflation to the 4% target while supporting growth. The Governor mentioned that "today's monetary policy action gives greater flexibility and optionality to the MPC to act in sync with the evolving macroeconomic conditions and outlook".**
- **Headline inflation is on a downward trajectory, with CPI falling to 3.6%/3.7% in Jul'24/Aug'24 from 5.1% in Jun'24, mainly led by a dip in food inflation. However, it may see a significant pick-up in Sep'24 led by adverse base effects and a rise in food prices (due to lower production of onion, potato, and chana dal (gram) in FY24). CPI is projected to sequentially moderate in 4QFY25, backed by a good kharif harvest and rising prospects of a good rabi season. Unexpected weather events, worsening of geopolitical conflicts, and recent uptick in metal and crude prices pose upside risks to inflation. Inflation projection for FY25 was kept unchanged at 4.5% YoY, with 2Q/3Q/4Q at 4.1%/4.8%/4.2% vs. 4.4%/4.7%/4.3% in the Aug'24 policy.**
- **The RBI remains optimistic about India's growth. Domestic growth has sustained its momentum, with private consumption and investment growing in tandem. Real GDP growth forecast was kept unchanged at 7.2% for FY25 by raising 2HFY25 growth to 7.4% (despite lower 1Q and downward revision in 2Q to 7.0% from 7.2%). The growth forecast for 1QFY26 was also raised to 7.3% from 7.2%. These optimistic expectations for real GDP growth provide room to focus on inflation in order to ensure its durable descent to the 4% target.**
- **Overall, the change in stance is seen as positive, making it smoother for the RBI to cut rates in the future. However, if domestic growth remains as strong as forecasted, a rate cut appears difficult in Dec'24, especially with the risks of rising crude oil prices (due to the Middle East tensions). We, however, believe that the Dec'24 rate cut is a serious possibility now since we expect real GDP growth at ~6.2% YoY in 2Q (to be published on 29th Nov'24), much lower than the RBI and market forecasts.**

I. MPC keeps interest rates unchanged but changed policy stance to neutral

- The Reserve Bank of India (RBI) announced its fourth bi-monthly monetary policy for FY25 on 9th Oct'24. The rate-setting panel decided to keep the benchmark repo rate unchanged at 6.5% for the tenth consecutive meeting, with five out of six members voting in favor. Dr. Nagesh Kumar voted to reduce the policy repo rate by 25bp.
- At the same time, the MPC unanimously decided to change the stance to 'neutral' from 'withdrawal of accommodation'. This would allow the central bank to act swiftly and smoothly if inflation/growth dynamics shift unfavorably. Governor Das emphasized that any rate cut will be contingent on achieving a durable alignment of inflation to the 4% target while supporting growth.
- The Governor mentioned that "today's monetary policy action gives greater flexibility and optionality to the MPC to act in sync with the evolving macroeconomic conditions and outlook".

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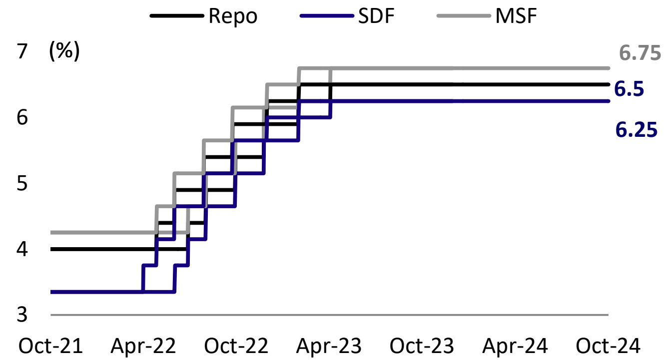
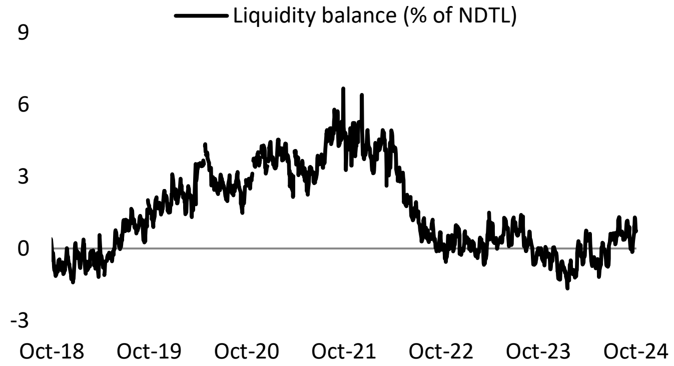
Exhibit 1: Repo rate unchanged at 6.5% in the Oct'24 policy



*Fixed Rate Reverse Repo (FRRR) was replaced by Standing Deposit Facility (SDF) on 8th Apr'22

Exhibit 2: Systemic liquidity remained in surplus in Aug-Sep'24,



Updated as of 7th Aug'24 Source: RBI,MOFSL

II. Inflation projection for FY25 maintained at 4.5%

- Headline inflation is on a downward trajectory, with CPI falling to 3.6%/3.7% in Jul'24/Aug'24 from 5.1% in Jun'24, mainly led by a dip in food inflation. However, it may see a significant pick-up in Sep'24 led by adverse base effects and a rise in food prices (due to lower production of onion, potato, and chana dal (gram) in FY24).
- The headline inflation trajectory is projected to sequentially moderate in 4QFY25, backed by a good kharif harvest and rising prospects of a good rabi season. Unexpected weather events, worsening of geopolitical conflicts, and recent uptick in metal and crude prices pose upside risks to inflation.
- Inflation projection for FY25 was kept unchanged at 4.5% YoY, with 2Q/3Q/4Q at 4.1%/4.8%/4.2% vs. 4.4%/4.7%/4.3% in the Aug'24 policy.

III. India's growth story remains intact

- The RBI remains optimistic about India's growth. The Governor's statement mentioned that "*high frequency indicators available so far suggest that domestic economic activity continues to be steady. The main components from the supply side – agriculture, manufacturing and services – remain resilient. On the demand side, rural demand is trending upwards while urban demand continues to hold firm. Government consumption is improving. Investment activity remains buoyant, with government capex rebounding from a contraction observed in the first quarter. Private investment continues to gain steam on the back of expansion in non-food bank credit, higher capacity utilization and rising investment intentions*".
- Against this backdrop, real GDP growth forecast was kept unchanged at 7.2% for FY25 by raising 2HFY25 growth to 7.4% (despite lower 1Q and downward revision in 2Q to 7.0% from 7.2%). The growth forecast for 1QFY26 was also raised to 7.3% from 7.2%.

IV. Our view

Overall, the change in stance is seen as positive, making it smoother for the RBI to cut rates in the future. However, if domestic growth remains as strong as forecasted, a rate cut appears difficult in Dec'24, especially with the risks of rising crude oil prices (due to the Middle East tensions). We, however, believe that the Dec'24 rate cut is a serious possibility now since we expect real GDP growth at ~6.2% YoY in 2Q (to be published on 29th Nov'24), much lower than the RBI and market forecasts.

Exhibit 3: FY25 real GDP growth projected at 7.2%

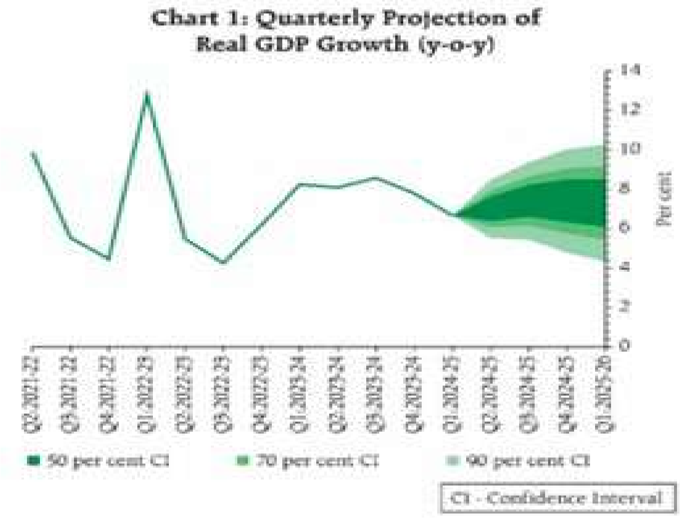
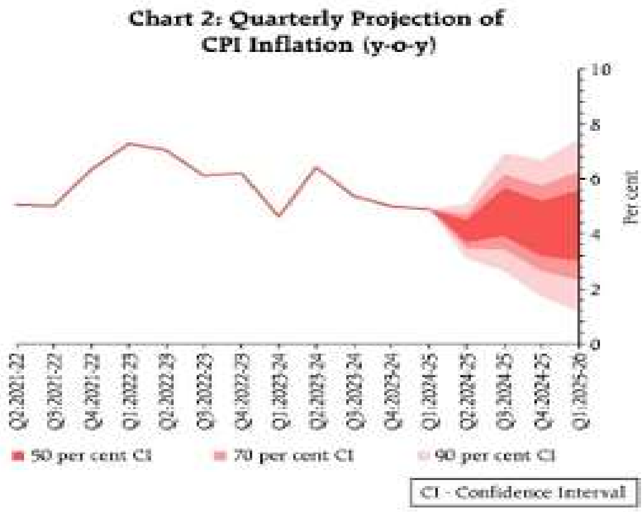


Exhibit 4: FY25 inflation projected at 4.5%



Source: RBI, MOFSL

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