07th June 2024

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. However, this time it was a 4:2 decision vis-a-vis 5:1 in April with only Dr. Varma as dissenter while Dr. Goyal also joined him this time to vote for a 25bps rate cut and change in stance to neutral.

Growth projection revised higher; provides space to delay timing of rate cut(s)

While the MPC retained the FY25 inflation projection at 4.5%, the GDP projection was revised upward to 7.2% with risks evenly balanced *(Figure 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. The MPC is likely to guard caution regarding inflation risks especially in food. Going forward, monsoon in focus to address food inflation concerns as a prime driver of cooling in inflation this year along with commodity prices as they played an estimated 50-60% contribution in cooling of core inflation to record lows.

Financial stability & credit quality remains the key focus

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. The Governor stressed on addressing the credit excesses in the banking system in order to ensure a sustainable pickup in credit cycle. More importantly, the Boards and top management of Regulated entities (REs) have been directed to ensure that risk limits and exposures for each line of business are kept well within their respective risk appetite framework. The persisting gap between credit and deposit growth rates warrants a rethink by the Boards of banks to re-strategize their business plans.

Additionally, the RBI has revised the definition of bulk deposits as 'Single Rupee term deposit of Rs 3 crore and above' for SCBs (excluding RRBs) and SFBs.

RBI is likely to stay nimble with liquidity management

Another key announcement to watch for in this policy was the RBI's guidance on liquidity management as it has switched to surplus in Jun'24 from deficit seen in May. 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 spike in government spending and / or rise in FX flows (if any), we will watch out for use of any permanent liquidity absorption tools by the RBI like FX swaps among others.

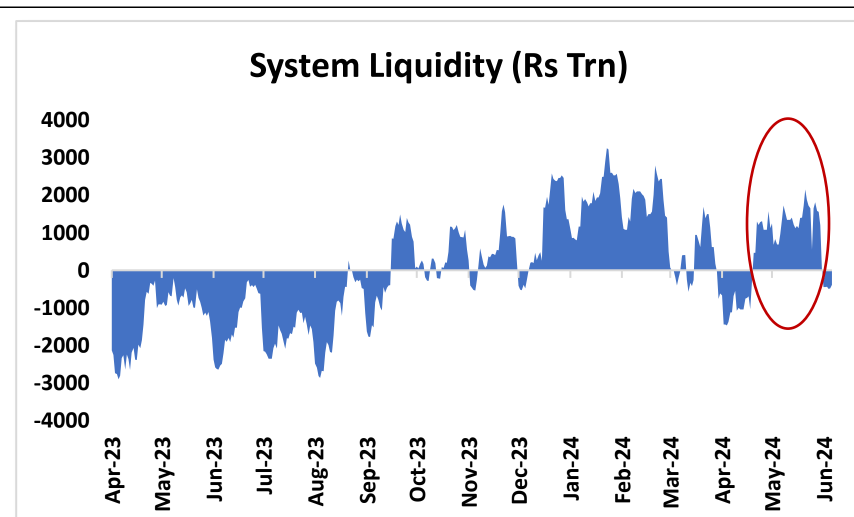
We expect rate cuts *"later rather than sooner"* in FY25

Going forward, we expect inflation dynamics to stay comfortable thereby making us project the start of a shallow 50bps rate cut cycle from October 2024. However, our bias remains for rate cuts *"later rather than sooner"* on account of: (i) High real rates of c.200bps 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	7.2	4.5	4.5
o/w: Q1	7.1	7.3	4.9	4.9
Q2	6.9	7.2	3.8	3.8
Q3	7.0	7.3	4.6	4.6
Q4	7.0	7.2	4.5	4.5

Fig 2: Liquidity has switched to surplus in June



Source: RBI, Bloomberg and UBI research

By:

Kanika Pasricha
kanika.pasricha@unionbankofindia.bank

Jovana Luke George
jovana.george@unionbankofindia.bank

Banking Research Team	
Kanika Pasricha Chief Economic Advisor	**kanika.pasricha@unionbankofindia.bank**
Suneesh K	suneeshk@unionbankofindia.bank
R Gunaseelan	gunaseelan@unionbankofindia.bank
Nidhi Arora	nidhiarora@unionbankofindia.bank
Rajesh Ranjan	rajeshranjan@unionbankofindia.bank
Amit Srivastava	asrivastava@unionbankofindia.bank
Jovana Luke George	jovana.george@unionbankofindia.bank
Dhiraj Kumar	dhirajkumar@unionbankofindia.bank
Akash Deb	akash510@unionbankofindia.bank
Rohit Yarmal	rohitdigambar@unionbankofindia.bank
S. Jaya Laxmi	s.jayalakshmi@unionbankofindia.bank